

SENSIENT TECHNOLOGIES CORP

Form 10-Q

November 08, 2006

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**UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549
FORM 10-Q**

(Mark One)

☒ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934**

For the quarterly period ended: September 30, 2006

OR

☐ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934**

For the transition period from to

Commission file number: 1-7626

SENSIENT TECHNOLOGIES CORPORATION

(Exact name of registrant as specified in its charter)

Wisconsin

39-0561070

(State or other jurisdiction of
incorporation or organization)

(I.R.S. Employer Identification
Number)

777 East Wisconsin Avenue, Milwaukee, Wisconsin 53202-5304

(Address of principal executive offices)

Registrant's telephone number, including area code: (414) 271-6755

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for at least the past 90 days. Yes ☒ No ☐

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer" and "large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):
Large accelerated filer ☐ Accelerated filer ☐ Non-accelerated filer ☒

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes ☐ No ☒

Indicate the number of shares outstanding of each of the issuer's classes of Common Stock, as of the latest practicable date.

Class

Outstanding at October 31, 2006

Common Stock, par value \$0.10 per share

46,466,551 shares

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Waiver Regarding Restricted Stock Grant Agreements
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SENSIENT TECHNOLOGIES CORPORATION
CONSOLIDATED CONDENSED STATEMENTS OF EARNINGS
(In thousands except per share amounts)
(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	2005	2006	2005
Revenue	\$ 280,878	\$ 256,416	\$ 826,014	\$ 771,043
Cost of products sold	197,274	183,267	577,470	543,674
Selling and administrative expenses	50,063	45,663	149,100	144,399
Operating income	33,541	27,486	99,444	82,970
Interest expense	9,091	8,820	26,779	26,446
Earnings before income taxes	24,450	18,666	72,665	56,524
Income taxes	7,473	4,538	21,607	13,702
Net earnings	\$ 16,977	\$ 14,128	\$ 51,058	\$ 42,822
Average number of common shares outstanding:				
Basic	45,909	46,910	45,856	46,834
Diluted	46,217	47,170	46,102	47,173
Earnings per common share:				
Basic	\$.37	\$.30	\$ 1.11	\$.91
Diluted	\$.37	\$.30	\$ 1.11	\$.91
Dividends per common share	\$.15	\$.15	\$.45	\$.45

See accompanying notes to consolidated condensed financial statements.

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SENSIENT TECHNOLOGIES CORPORATION
CONSOLIDATED CONDENSED BALANCE SHEETS
(In thousands)

	September 30, 2006 (Unaudited)	December 31, 2005 *
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	\$ 4,400	\$ 7,068
Trade accounts receivable, net	183,373	163,724
Inventories	317,219	313,513
Prepaid expenses and other current assets	37,221	36,039
TOTAL CURRENT ASSETS	542,213	520,344
OTHER ASSETS	54,721	63,384
INTANGIBLE ASSETS, NET	14,635	14,964
GOODWILL	441,291	420,201
PROPERTY, PLANT AND EQUIPMENT:		
Land	36,041	33,351
Buildings	240,871	232,301
Machinery and equipment	539,258	532,852
Construction in progress	29,157	13,779
	845,327	812,283
Less accumulated depreciation	(464,619)	(437,060)
	380,708	375,223
TOTAL ASSETS	\$ 1,433,568	\$ 1,394,116
LIABILITIES AND SHAREHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Trade accounts payable	\$ 78,056	\$ 77,080
Accrued salaries, wages and withholdings from employees	19,660	15,249
Other accrued expenses	54,700	53,432
Income taxes	15,335	21,610
Short-term borrowings	25,915	63,218
Current maturities of long-term debt	65,405	207,341
TOTAL CURRENT LIABILITIES	259,071	437,930
DEFERRED INCOME TAXES	2,887	4,881
OTHER LIABILITIES	4,440	3,974
ACCRUED EMPLOYEE AND RETIREE BENEFITS	46,433	41,980
LONG-TERM DEBT	436,385	283,123

SHAREHOLDERS' EQUITY:

Common stock	5,396	5,396
Additional paid-in capital	68,171	71,582
Earnings reinvested in the business	766,745	736,544
Treasury stock, at cost	(151,863)	(152,727)
Nonvested stock		(5,965)
Accumulated other comprehensive loss	(4,097)	(32,602)
TOTAL SHAREHOLDERS' EQUITY	684,352	622,228
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	\$ 1,433,568	\$ 1,394,116

See accompanying notes to consolidated condensed financial statements.

* Condensed from
audited financial
statements.

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SENSIENT TECHNOLOGIES CORPORATION
CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS
(In thousands)
(Unaudited)

	Nine Months Ended September 30,	
	2006	2005
Net cash provided by operating activities	\$ 80,857	\$ 91,900
Cash flows from investing activities:		
Acquisition of property, plant and equipment	(24,526)	(22,342)
Proceeds from sale of fixed assets and investments	3,164	982
Decrease in other assets	1,408	616
Net cash used in investing activities	(19,954)	(20,744)
Cash flows from financing activities:		
Proceeds from additional borrowings	24,881	40,540
Debt and capital lease payments	(66,367)	(91,713)
Purchase of treasury stock	(4,563)	
Dividends paid	(20,857)	(21,240)
Proceeds from options exercised	2,961	3,855
Net cash used in financing activities	(63,945)	(68,558)
Effect of exchange rate changes on cash and cash equivalents	374	(261)
Net (decrease) increase in cash and cash equivalents	(2,668)	2,337
Cash and cash equivalents at beginning of period	7,068	2,243
Cash and cash equivalents at end of period	\$ 4,400	\$ 4,580

See accompanying notes to consolidated condensed financial statements.

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SENSIENT TECHNOLOGIES CORPORATION
NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
(Unaudited)

1. Accounting Policies

In the opinion of Sensient Technologies Corporation (the Company), the accompanying unaudited consolidated condensed financial statements contain all adjustments (consisting of only normal recurring adjustments) which are necessary to present fairly the financial position of the Company as of September 30, 2006 and December 31, 2005, the results of operations for the three and nine months ended September 30, 2006 and 2005, and cash flows for the nine months ended September 30, 2006 and 2005. The results of operations for any interim period are not necessarily indicative of the results to be expected for the full year.

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

Expenses are charged to operations in the year incurred. However, for interim reporting purposes, certain expenses are charged to operations based on a proportionate share of estimated annual amounts rather than as they are actually incurred.

Certain amounts as previously presented have been reclassified to conform to the current period presentation. The effect of these reclassifications is not material to the consolidated condensed financial statements.

Refer to the notes in the Company's annual consolidated financial statements for the year ended December 31, 2005, for additional details of the Company's financial condition and a description of the Company's accounting policies, which have been continued without change except for the item discussed in Note 2.

In June 2006, the Financial Accounting Standards Board (FASB) issued FASB Interpretation No. 48 (FIN 48), Accounting for Uncertainty in Income Taxes. This interpretation prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. The new standard will be effective for the Company in the first quarter of 2007. The impact of FIN 48 on the Company's financial results is currently being evaluated.

In September 2006, the FASB issued Statement No. 158 (SFAS No. 158), Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans. This statement requires the Company to recognize the overfunded or underfunded status of a defined benefit postretirement plan as an asset or liability in the balance sheet and to recognize changes in that funded status in the year in which the changes occur through comprehensive income. Additionally, SFAS No. 158 requires the Company to measure the funded status of a plan as of the date of its fiscal year end. The requirement to recognize the funded status of a defined benefit postretirement plan and the related disclosure requirements are effective for the Company as of December 31, 2006, while the requirement to measure the funded status as of fiscal year-end is not effective for the Company until December 31, 2008. The impact of SFAS No. 158 on the Company's financial results is currently being evaluated.

2. Stock-Based Compensation

The Company adopted Statement of Financial Accounting Standards (SFAS) No. 123(R), Share-Based Payment, on January 1, 2006. SFAS No. 123(R) requires stock-based compensation to be expensed over the vesting period of the awards based on the grant-date fair value. The Company elected to adopt using the modified prospective transition method which does not result in the restatement of previously issued financial statements. Under the

provisions of SFAS No. 123(R), expense is recognized on all awards granted or modified after the date of adoption and unvested awards at the date of adoption.

Prior to January 1, 2006, the Company accounted for stock-based compensation in accordance with Accounting Principles Board Opinion (APB) No. 25, Accounting for Stock Issued to Employees. Accordingly, no compensation expense had been recognized for stock options because all options granted had an exercise price equal to the market value of the underlying stock on the grant date.

The Company has various stock plans under which employees and directors may be granted options to purchase common stock at 100% of the market price on the day the options are granted. As of September 30, 2006, there are 1.6 million shares available to be granted as future stock options under existing stock plans. Stock options become exercisable over a three-year vesting period, or earlier upon retirement, and expire 10

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years from the date of grant. Expense for stock options is recognized over three years from the date of grant or over the period from the date of grant until the participant is retirement-eligible, whichever is less.

The Company estimated the fair value of stock options using the Black-Scholes option pricing model. Grants during the first nine months of 2006 and 2005 had weighted-average fair values of \$4.50 and \$5.59, respectively. Significant assumptions used in estimating the fair value of awards granted during the nine months ended September 30, 2006 and 2005 are as follows:

	2006	2005
Dividend yield	3.3%	2.8%
Volatility	27.3%	29.1%
Risk-free interest rate	4.9%	4.1%
Expected term (years)	5.3	5.1

The Company's stock plans also provide for the awarding of nonvested stock. Expense for shares of nonvested stock is recognized over five years from the date of grant or during the period from the date of grant until the participant attains age 65, whichever is less. During the period of restriction, the holder of nonvested stock has voting rights and is entitled to receive all dividends and other distributions paid with respect to the stock.

Total pre-tax stock-based compensation recognized in the Consolidated Condensed Statements of Earnings was \$0.9 million and \$0.5 million for the quarters ended September 30, 2006 and 2005, respectively. Tax related benefits of \$0.3 million and \$0.2 million were also recognized for the quarters ended September 30, 2006 and 2005, respectively. Total pre-tax stock-based compensation recognized in the Consolidated Condensed Statements of Earnings was \$3.3 million and \$1.4 million for the nine months ended September 30, 2006 and 2005, respectively. Tax related benefits of \$1.1 million and \$0.5 million were also recognized for the nine months ended September 30, 2006 and 2005, respectively. Amounts recorded in 2005 primarily represent expenses related to nonvested stock awards because no expense was recognized for stock options. Cash received from the exercise of stock options was \$3.0 million and \$3.9 million for the nine months ended September 30, 2006 and 2005, respectively, and is reflected in cash flows from financing activities in the Consolidated Condensed Statements of Cash Flows.

As a result of adopting SFAS No. 123(R) on January 1, 2006, the Company's earnings before income taxes and net earnings for the quarter ended September 30, 2006, are \$0.2 million and \$0.1 million lower, respectively, than if the Company had continued to account for stock-based compensation under APB No. 25. For the quarter ended September 30, 2006, there is no impact on basic or diluted earnings per share as a result of adopting SFAS No. 123(R). For the nine months ended September 30, 2006, earnings before income taxes and net earnings were \$0.9 million and \$0.7 million lower, respectively, as a result of adopting SFAS No. 123(R). Basic and diluted earnings per share for the nine months ended September 30, 2006, are \$.02 and \$.01 lower, respectively, than if the Company had continued to account for stock-based compensation under APB No. 25.

The following table illustrates the pro forma effect on net earnings and earnings per share if the Company had applied the fair value recognition provisions of SFAS No. 123 to stock-based employee compensation for the quarter and nine months ended September 30, 2005:

	Three Months Ended September 30, 2005	Nine Months Ended September 30, 2005
(in thousands except per share information)		
Net earnings, as reported	\$ 14,128	\$ 42,822
Add: reported stock compensation expense net of tax	307	875

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Less: fair value of stock compensation expense net of tax	(467)	(2,875)
Pro forma net earnings	\$ 13,968	\$ 40,822
Earnings per share:		
Basic as reported	\$ 0.30	\$ 0.91
Basic pro forma	\$ 0.30	\$ 0.87
Diluted as reported	\$ 0.30	\$ 0.91
Diluted pro forma	\$ 0.30	\$ 0.87

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The pro forma expense for the nine months ended September 30, 2005, included \$1.0 million after-tax compensation expense for stock options related to accelerated amortization for retirement eligible participants, as the Company's stock compensation plans provide for full vesting of option awards at retirement. Beginning in the first quarter of 2005, stock compensation expense for retirement eligible participants was reported in pro forma net earnings over the lesser of three years or until the participant achieves early retirement age. Previously, this expense was recognized over the vesting period, which was three years.

The following table summarizes the transactions involving the stock option plans for the nine months ended September 30, 2006:

(In thousands except exercise price and life)	Options	Weighted-Average Exercise Price	Weighted-Average Remaining Life (Years)	Aggregate Intrinsic Value
Outstanding at January 1, 2006	3,231	\$ 20.62	5.8	\$ 376
Granted	103	19.20		
Exercised	(178)	15.99		
Cancelled	(129)	20.62		
Outstanding at September 30, 2006	3,027	\$ 20.85	5.6	\$ 923
Exercisable at September 30, 2006	2,351	\$ 20.95	4.8	\$ 660

The aggregate intrinsic values of stock options exercised during the nine months ended September 30, 2006 and 2005, were \$773,000 and \$647,000, respectively.

As of September 30, 2006, total remaining unearned compensation, net of expected forfeitures, related to unvested stock options was \$1.0 million, which will be amortized over the weighted-average remaining service period of 1.7 years.

The following table summarizes the nonvested stock activity for the nine months ended September 30, 2006:

(In thousands except fair value)	Shares	Weighted-Average Fair Value	Aggregate Intrinsic Value
Outstanding at January 1, 2006	456	\$ 20.26	\$ 8,164
Granted	6	20.25	
Vested	(6)	20.64	
Outstanding at September 30, 2006	456	\$ 20.25	\$ 8,920

The fair value of the nonvested shares at the date of grant is amortized over the vesting period but not exceeding age 65 of the participant. As of September 30, 2006, total remaining unearned compensation related to nonvested stock was \$3.7 million, which will be amortized over the weighted-average remaining service period of 2.9 years.

SFAS No. 123(R) requires the cash flows from the excess tax benefits the Company realizes on the exercise of stock options to be presented as cash flows from financing activities in the Consolidated Condensed Statements of Cash Flows. Previously, the entire tax benefit related to the exercise of stock options was reported as cash flows

from operating activities. The prior year statement of cash flows has not been restated. The tax benefits on the exercise of stock options for the quarter and nine months ended September 30, 2005, presented as cash flows from operating activities, were not material.

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3. Segment Information

Operating results by segment for the periods and at the dates presented are as follows:

(In thousands)	Flavors & Fragrances	Color	Corporate & Other	Consolidated
Three months ended September 30, 2006:				
Revenue from external customers	\$ 185,802	\$ 84,888	\$ 10,188	\$ 280,878
Intersegment revenue	3,760	2,232	215	6,207
Total revenue	\$ 189,562	\$ 87,120	\$ 10,403	\$ 287,085
Operating income (loss)	\$ 27,443	\$ 13,879	\$ (7,781)	\$ 33,541
Interest expense			9,091	9,091
Earnings (loss) before income taxes	\$ 27,443	\$ 13,879	\$ (16,872)	\$ 24,450
Three months ended September 30, 2005:				
Revenue from external customers	\$ 167,262	\$ 79,240	\$ 9,914	\$ 256,416
Intersegment revenue	3,356	2,876	489	6,721
Total revenue	\$ 170,618	\$ 82,116	\$ 10,403	\$ 263,137
Operating income (loss)	\$ 20,246	\$ 13,137	\$ (5,897)	\$ 27,486
Interest expense			8,820	8,820
Earnings (loss) before income taxes	\$ 20,246	\$ 13,137	\$ (14,717)	\$ 18,666