

Edgar Filing: TECHNITROL INC - Form 10-Q

TECHNITROL INC  
Form 10-Q  
November 04, 2004

UNITED STATES  
SECURITIES & EXCHANGE COMMISSION

Washington, D.C. 20549

-----  
FORM 10-Q

Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 For the quarterly period ended October 1, 2004, 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 No. 1-5375

TECHNITROL, INC.

(Exact name of registrant as specified in its Charter)

PENNSYLVANIA  
(State or other jurisdiction of  
incorporation or organization)

23-1292472  
(IRS Employer  
Identification Number)

1210 Northbrook Drive, Suite 385  
Trevose, Pennsylvania  
(Address of principal executive offices)

19053  
(Zip code)

Registrant's telephone number, including area code: 215-355-2900

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 the filing requirements for at least the past 90 days.

YES  NO

Indicate by check mark whether the registrant is an accelerated filter (as defined in Rule 12b-2 of the Exchange Act.)

YES  NO

Common Stock - Shares Outstanding as of October 26, 2004: 40,438,028

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

Page 1 of 34

PART I. FINANCIAL INFORMATION

Item 1: Financial Statements

Technitrol, Inc. and Subsidiaries

Edgar Filing: TECHNITROL INC - Form 10-Q

Consolidated Balance Sheets

In thousands

Assets -----	October 1, 2004 ----- (unaudited)	December 26, 2003 -----
Current assets:		
Cash and cash equivalents	\$ 153,716	\$ 143,448
Trade receivables, net	106,935	96,353
Inventories	76,853	63,086
Prepaid expenses and other current assets	19,361	17,435
	-----	-----
Total current assets	356,865	320,322
Property, plant and equipment	228,742	205,885
Less accumulated depreciation	129,842	117,836
	-----	-----
Net property, plant and equipment	98,900	88,049
Deferred income taxes	10,555	12,457
Goodwill and other intangibles, net	162,826	153,083
Other assets	2,552	14,983
	-----	-----
	\$ 631,698	\$ 588,894
	=====	=====
Liabilities and Shareholders' Equity		
Current liabilities:		
Current installments of long-term debt	\$ 221	\$ 127
Short-term debt	8,020	--
Accounts payable	44,101	46,677
Accrued expenses	72,755	73,748
	-----	-----
Total current liabilities	125,097	120,552
Long-term liabilities:		
Long-term debt, excluding current installments	7,628	6,710
Other long-term liabilities	13,960	12,882
Minority interest	14,107	--
Shareholders' equity:		
Common stock and additional paid-in capital	213,574	209,768
Retained earnings	252,301	232,824
Deferred compensation	(2,283)	(1,342)
Other comprehensive income	7,314	7,500
	-----	-----
Total shareholders' equity	470,906	448,750
	-----	-----
	\$ 631,698	\$ 588,894
	=====	=====

See accompanying Notes to Unaudited Consolidated Financial Statements.

Edgar Filing: TECHNITROL INC - Form 10-Q

Technitrol, Inc. and Subsidiaries  
 Consolidated Statements of Operations  
 (Unaudited)  
 In thousands, except per share data

	Three Months Ended		
	October 1, 2004 ----	Sept. 26, 2003 ----	October 2004 -----
Net sales	\$ 146,452	\$ 126,260	\$ 433,000
Costs and expenses:			
Cost of sales	111,514	92,319	320,000
Selling, general and administrative expenses	27,158	24,943	83,000
Severance and asset impairment expense	2,399	998	6,000
	-----	-----	-----
Total costs and expenses applicable to sales	141,071	118,260	410,000
	-----	-----	-----
Operating profit	5,381	8,000	22,000
Other income (expense):			
Interest expense, net	(100)	(157)	(1,000)
Equity method investment earnings	395	125	1,000
Other	200	(87)	(1,000)
	-----	-----	-----
Total other income (expense)	495	(119)	1,000
Earnings before taxes and minority interest	5,876	7,881	23,000
Income taxes	1,297	1,469	4,000
Minority interest	(141)	--	(1,000)
	-----	-----	-----
Net earnings	\$ 4,438	\$ 6,412	\$ 19,000
	=====	=====	=====
Basic earnings per share	\$ 0.11	\$ 0.16	\$ 0.16
	=====	=====	=====
Diluted earnings per share	\$ 0.11	\$ 0.16	\$ 0.16
	=====	=====	=====

See accompanying Notes to Unaudited Consolidated Financial Statements.

# Edgar Filing: TECHNITROL INC - Form 10-Q

(Unaudited)

In thousands

	Nine Months Ended October 1, 2004 ----	September -----
Cash flows from operating activities:		
Net earnings	\$ 19,477	\$ 15,000
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation and amortization	17,862	18,000
Tax effect of employee stock compensation	--	--
Amortization of stock incentive plan expense	2,577	1,000
Minority interest in net earnings of consolidated subsidiary	141	--
Severance and asset impairment expense, net of cash payments	1,573	--
Changes in assets and liabilities, net of effect of acquisitions:		
Trade receivables	164	(1,000)
Inventories	(8,458)	10,000
Prepaid expenses and other current assets	601	(5,000)
Accounts payable and accrued expenses	(15,004)	(1,000)
Other, net	701	(5,000)
Net cash provided by operating activities	19,634	31,000
Cash flows from investing activities:		
Acquisitions, net of cash acquired	(4,844)	(83,000)
Capital expenditures	(5,434)	(4,000)
Proceeds from sale of property, plant and equipment	167	--
Foreign currency impact on intercompany lending	321	(5,000)
Net cash used in investing activities	(9,790)	(93,000)
Cash flows from financing activities:		
Principal payments of long-term debt, net	(238)	(11,000)
Sale of stock through employee stock purchase plan	691	--
Proceeds from exercise of stock options	11	--
Net cash provided by (used in) financing activities	464	(10,000)
Net effect of exchange rate changes on cash	(40)	(1,000)
Net increase (decrease) in cash and cash equivalents	10,268	(74,000)
Cash and cash equivalents at beginning of period	143,448	205,000
Cash and cash equivalents at end of period	\$ 153,716	\$ 130,000

See accompanying Notes to Unaudited Consolidated Financial Statements.

## Edgar Filing: TECHNITROL INC - Form 10-Q

### Consolidated Statement of Changes in Shareholders' Equity

Nine months Ended October 1, 2004

(Unaudited)  
In thousands

	Common stock and paid-in capital		Retained earnings	Deferred compen- sation
	Shares	Amount		
	-----	-----	-----	-----
Balance at December 26, 2003	40,279	\$ 209,768	\$ 232,824	\$ (1,342)
Stock options, awards and related compensation	114	3,115		(941)
Stock issued under employee stock purchase plan	45	691		
Currency translation adjustments				
Net earnings			19,477	
Comprehensive income				
	-----	-----	-----	-----
Balance at October 1, 2004	40,438	\$ 213,574	\$ 252,301	\$ (2,283)

See accompanying Notes to Unaudited Consolidated Financial Statements.

Page 5 of 34

### Technitrol, Inc. and Subsidiaries

#### Notes to Unaudited Consolidated Financial Statements

##### (1) Accounting Policies

For a complete description of the accounting policies of Technitrol, Inc. and its consolidated subsidiaries, refer to Note 1 of Notes to Consolidated Financial Statements included in Technitrol's Form 10-K filed for the year ended December 26, 2003. We sometimes refer to Technitrol as "we" or "our".

The results for the nine months ended October 1, 2004 and September 26, 2003 have been prepared by our management without audit by our independent auditors. In the opinion of management, the financial statements fairly present in all material respects, the financial position and results of operations for the periods presented. To the best of our knowledge and belief, all adjustments have been made to properly reflect income and expenses attributable to the periods presented. All such adjustments are of a normal recurring nature. Note that the three months ended October 1, 2004 consisted of fourteen weeks, whereas the three months ended September 26, 2003 consisted of thirteen weeks. Operating results for the nine months ended October 1, 2004 are not necessarily indicative of annual results.

##### New Accounting Pronouncements

## Edgar Filing: TECHNITROL INC - Form 10-Q

In December 2003, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards No. 132 (revised 2003), Employers' Disclosures about Pensions and Other Postretirement Benefits, an amendment of FASB Statements No. 87, 88, and 106, and a revision of FASB Statement No. 132 ("SFAS 132R"). SFAS 132R revises employers' disclosures about pension plans and other postretirement benefit plans. It does not change the measurement or recognition of those plans required by SFAS No. 87, Employers' Accounting for Pensions, SFAS No. 88, Employers' Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits, and SFAS No. 106, Employers' Accounting for Postretirement Benefits Other Than Pensions. The new rules require additional disclosures about the assets, obligations, cash flows, and net periodic benefit cost of defined benefit pension plans and other postretirement benefit plans. The required information will be provided separately for pension plans and for other postretirement benefit plans. The new disclosures became effective for fiscal 2003 year-end financial statements and certain interim disclosures in 2004. Adoption of this standard did not have any effect on our revenue, operating results, financial position or liquidity.

In December 2003, FASB issued Interpretation No. 46 (revised December 2003) Consolidation of Variable Interest Entities ("FIN 46R"). FIN 46R clarifies the application of Accounting Research Bulletin No. 51, Consolidated Financial Statements, to certain entities in which equity investors do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. FIN 46R replaces FASB Interpretation No. 46, Consolidation of Variable Interest Entities which was issued in January 2003. FIN 46R is required to be applied to variable interests in variable interest entities created after December 31, 2003. For variable interests in variable interest entities created before January 1, 2004, the final interpretation was required to be applied no later than the end of the first reporting period that ends after March 15, 2004. We do not have any variable interests or variable interest entities and the adoption of this interpretation did not have a material effect on our revenue, operating results, financial position, or liquidity.

### Reclassifications

Certain amounts in the prior year financial statements have been reclassified to conform with the current year presentation.

### (2) Acquisitions

Eldor High Tech Wire Wound Components S.r.L.: In January 2003, we acquired all of the capital stock of Eldor High Tech Wire Wound Components S.r.L. (Eldor), headquartered in Senna Comasco, Italy with production operations in Izmir and Istanbul, Turkey. Eldor produces flyback transformers and switch mode transformers for the European television market. The acquisition was accounted for by the purchase method of accounting. The purchase

Page 6 of 34

Technitrol, Inc. and Subsidiaries

Notes to Unaudited Consolidated Financial Statements, continued

### (2) Acquisitions, continued

price was approximately \$83.9 million net of cash acquired, plus related acquisition costs and expenses. The fair value of net tangible assets acquired approximated \$8.3 million. Based on the fair value of assets acquired, the

## Edgar Filing: TECHNITROL INC - Form 10-Q

purchase price allocation included \$18.6 million for manufacturing know-how, \$6.1 million for customer relationships, \$1.5 million for tradename and \$21.8 million allocated to goodwill. All of the separately identifiable intangible assets are being amortized, with estimated useful lives of 20 years for manufacturing know-how, 8 years for customer relationships and 2 years for tradename. The purchase price was funded with cash on hand. At closing, Eldor had no funded debt. Eldor has formed the nucleus of a new consumer division at Pulse and is treated as a separate reporting unit for purposes of SFAS 142.

Full Rise Electronics Co. Ltd. (FRE): FRE is based in the Republic of China (Taiwan) and manufactures connector products, including single and multiple-port jacks, and supplies such products to us under a cooperation agreement. In April 2001, we made a minority investment in the common stock of FRE, which was accounted for by the cost-basis method of accounting. On July 27, 2002, we made an additional investment in FRE of \$6.7 million which increased the total investment to \$20.9 million. As a result of the increased ownership percentage to approximately 29%, we began to account for the investment under the equity method of accounting beginning in the three months ended September 27, 2002. Shares of FRE began trading on the Taiwan Stock Exchange in January 2003, and they experienced considerable price volatility. In the three months ended December 26, 2003, we recorded an \$8.7 million net loss to adjust our original cost basis of the investment to market value. In July 2004, we purchased an additional 9.0 million shares of common stock in FRE for \$10.5 million. On September 12, 2004 we acquired an additional 2.4 million shares of common stock in FRE for \$2.5 million, bringing our total investment percentage up to 51%. Accordingly, FRE's operating results are consolidated with ours beginning September 12, 2004. Our net earnings will therefore reflect our proportionate share of FRE's net earnings, after deducting the minority interest due to the minority shareholders. The fair value of the proportionate net tangible assets acquired through September 12, 2004 approximated \$29.4 million, less a minority interest of \$14.0 million. Based on the fair value of net tangible assets acquired, the preliminary allocation of the investment included \$4.9 million of identifiable intangibles and \$5.3 million of goodwill. These fair value allocations are preliminary, and are subject to adjustment.

### (3) Severance and asset impairment expense

In the nine months ended October 1, 2004, we accrued \$6.7 million for severance and related payments comprised of \$3.0 million related to AMI Doduco's termination of manufacturing and personnel at a facility in Germany, \$2.5 million related to the termination of manufacturing and support personnel at a facility in France, \$0.8 million related to Pulse's shutdown of a facility in Carlsbad, California and \$0.4 million for other severances in various locations. The vast majority of these accruals will be paid by December 31, 2004.

In the nine months ended September 26, 2003, we accrued \$5.4 million for severance and related payments comprising \$2.2 million for the elimination of manufacturing and support positions at AMI Doduco's facility in North America and Germany, \$1.6 million to finalize the shutdown of a redundant facility in Spain acquired from Engelhard-CLAL by a subsidiary of AMI Doduco in 2001, \$1.4 million for the elimination of manufacturing and support positions at Pulse, primarily in the United Kingdom, France and Mexico and \$0.2 million for other facility exit costs. The majority of these accruals were utilized by December 26, 2003.

## Edgar Filing: TECHNITROL INC - Form 10-Q

(3) Severance and asset impairment expense, continued

Our severance and asset impairment charges are summarized on a year-to-date basis for 2004 as follows (in millions):

	AMI Doduco -----	Pulse -----	Total -----
Balance accrued at December 26, 2003	\$2.1	\$1.7	\$3.8
Accrued during the nine months ended October 1, 2004	5.6	1.1	6.7
Severance and other cash payments	(3.9)	(1.3)	(5.2)
Non-cash asset disposals/impairments	(1.4)	0.2	(1.2)
	-----	-----	-----
Balance accrued at October 1, 2004	\$2.4	\$1.7	\$4.1
	=====	=====	=====

(4) Inventories

Inventories consisted of the following (in thousands):

	October 1, 2004 ----	December 26, 2003 ----
Finished goods	\$28,125	\$25,326
Work in process	18,835	13,867
Raw materials and supplies	29,893	23,893
	-----	-----
	\$76,853	\$63,086
	=====	=====

(5) Derivatives

We utilize derivative financial instruments, primarily forward exchange contracts, to manage foreign currency risks. While these hedging instruments are subject to fluctuations in value, such fluctuations are generally offset by the value of the underlying exposures being hedged.

At October 1, 2004, we had one foreign exchange forward contract outstanding to sell forward approximately 60.9 million euros in the aggregate, in order to hedge intercompany loans. The term of this contract was approximately 30 days, although we routinely settle such obligations and enter into new 30-day contracts each month. We had no other derivative instruments at October 1, 2004. In addition, management believes that there is no material risk of loss from changes in inherent market rates or prices in our other financial instruments.

(6) Earnings Per Share

Basic earnings per share are calculated by dividing net earnings by the weighted average number of common shares outstanding (excluding restricted shares) during the period. We had restricted shares outstanding of approximately 211,000 and 119,000 as of October 1, 2004 and September 26, 2003, respectively. For calculating diluted earnings per share, common share equivalents and



## Edgar Filing: TECHNITROL INC - Form 10-Q

restricted stock outstanding are added to the weighted average number of common shares outstanding. Common share equivalents result from outstanding options to purchase common stock as calculated using the treasury stock method. Such common share equivalent amounts were approximately 10,000 for the nine months ended October 1, 2004. There were approximately 435,000 stock options outstanding for the nine months ended October 1, 2004 and approximately 330,000 as of September 26, 2003.

Page 8 of 34

### Technitrol, Inc. and Subsidiaries

#### Notes to Unaudited Consolidated Financial Statements, continued

(6) Earnings Per Share, continued

Earnings per share calculations are as follows (in thousands, except per share amounts):

	Three Months Ended		Nine Months Ended	
	October 1, 2004 ----	September 26, 2003 ----	October 1, 2004 ----	September 26, 2003 ----
Net earnings	\$ 4,438	\$ 6,412	\$19,477	\$19,477
Basic earnings per share:				
Shares	40,204	40,072	40,163	40,072
Per share amount	\$ 0.11	\$ 0.16	\$ 0.48	\$ 0.48
	=====	=====	=====	=====
Diluted earnings per share:				
Shares	40,439	40,170	40,387	40,170
Per share amount	\$ 0.11	\$ 0.16	\$ 0.48	\$ 0.48
	=====	=====	=====	=====

(7) Business Segment Information

For the three months ended October 1, 2004 and September 26, 2003 there were immaterial amounts of intersegment revenues eliminated in consolidation. There has been no material change in segment assets from December 26, 2003 to October 1, 2004, other than the inclusion of FRE's financial results with ours which occurred in connection with our obtaining a 51% ownership interest on September 12, 2004. In addition, the basis for determining segment financial information has not changed from 2003. Specific segment data is as follows:

	Three Months Ended		Nine Months Ended	
	October 1, 2004 ----	September 26, 2003 ----	October 1, 2004 ----	September 26, 2003 ----
Net sales:				
Pulse	\$ 77,374	\$ 74,877	\$ 236,367	\$ 236,367
AMI Doduco	69,078	51,383	196,662	196,662
	-----	-----	-----	-----
Total	\$ 146,452	\$ 126,260	\$ 433,029	\$ 433,029
	=====	=====	=====	=====

Edgar Filing: TECHNITROL INC - Form 10-Q

Earnings before income taxes:			
Pulse	\$ 5,935	\$ 7,643	\$ 24,376
AMI Doduco	(554)	357	(1,734)
	-----	-----	-----
Operating profit	5,381	8,000	22,642
Other income (expense), net	495	(119)	1,158
	-----	-----	-----
Earnings before income taxes and minority interest	\$ 5,876	\$ 7,881	\$ 23,800
	=====	=====	=====

(8) Accounting for Stock Based Compensation

We adopted SFAS 123, as amended by SFAS 148, at the beginning of the 2003 fiscal year. We implemented SFAS 123 under the prospective method approach per SFAS 148, whereby compensation expense is recorded for all awards granted subsequent to adoption.

As permitted by the provisions of SFAS 123, we applied Accounting Principles Board Opinion 25, "Accounting for Stock Issued to Employees" and related interpretations in accounting for our stock option and purchase plans prior to adoption of SFAS 123 in fiscal 2003. Accordingly, no compensation cost was recognized for our stock option awards and employee stock purchase plan awards prior to fiscal 2003.

Page 9 of 34

Technitrol, Inc. and Subsidiaries

Notes to Unaudited Consolidated Financial Statements, continued

(8) Accounting for Stock Based Compensation, continued

If compensation cost for our stock option plan and stock purchase plan had been determined based on the fair value as required by SFAS 123 for all awards (including those made prior to 2003), our pro forma net earnings and earnings per basic and diluted share would have been as follows, (in thousands, except per share amounts):

	Three Months Ended	
	October 1, 2004 ----	September 26, 2003 ----
Net earnings as reported	\$4,438	\$6,412
Add: Stock-based compensation expense included in reported net earnings net of taxes	548	372
Deduct: Total stock-based compensation expense determined under fair value based method for all awards, net of taxes	(664)	(565)
	-----	-----
Net earnings adjusted	\$4,322	\$6,219
Basic net earnings per share - as reported	\$ 0.11	\$ 0.16
Basic net earnings per share - adjusted	\$ 0.11	\$ 0.16
Diluted net earnings per share - as reported	\$ 0.11	\$ 0.16
Diluted net earnings per share - adjusted	\$ 0.11	\$ 0.15

## Edgar Filing: TECHNITROL INC - Form 10-Q

At October 1, 2004, we had approximately 435,000 options outstanding, representing approximately 1% of our outstanding shares of common stock. The value of restricted stock has always been and continues to be recorded as compensation expense over the restricted period, and such expense is included in the results of operations for the periods ended October 1, 2004 and September 26, 2003, respectively.

### (9) Pension

In the nine months ended October 1, 2004 we were not required to, nor did we, make any contributions to our qualified pension plan. Our net periodic expense was approximately \$1.1 million in the nine months ended October 1, 2004, and is expected to be approximately \$1.4 million for the full fiscal year in 2004.

Page 10 of 34

## Item 2: Management's Discussion and Analysis of Financial Condition and Results of Operations

### Introduction

This discussion and analysis of our financial condition and results of operations as well as other sections of this report, contain certain "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995 and involve a number of risks and uncertainties. Actual results may differ materially from those anticipated in these forward-looking statements for many reasons, including the risks faced by us described in "Risk Factors" section of this report on page 21 through 27.

### Critical Accounting Policies

The preparation of financial statements and related disclosures in conformity with accounting principles generally accepted in the United States requires us to make judgments, assumptions and estimates that affect the amounts reported in the Consolidated Financial Statements and accompanying notes. Note 1 to the Consolidated Financial Statements in our Annual Report on Form 10-K for the period ended December 26, 2003 describes the significant accounting policies and methods used in the preparation of the Consolidated Financial Statements. Estimates are used for, but not limited to, the accounting for inventory valuation, impairment of goodwill and other intangibles, severance and asset impairment expense, income taxes, and contingency accruals. Actual results could differ from these estimates. The following critical accounting policies are impacted significantly by judgments, assumptions and estimates used in the preparation of the Consolidated Financial Statements.

**Inventory Valuation.** Inventory purchases and commitments are based upon future demand forecasts estimated by taking into account actual purchases of our products over the recent past and customer forecasts. If there is a sudden and significant decrease in demand for our products or there is a higher risk of inventory obsolescence because of rapidly changing technology or customer requirements, we may be required to write down our inventory and our gross margin could be negatively affected. If we were to sell or use a significant portion of inventory already written down, our gross margin could be positively affected.

**Impairment of Goodwill and Other Intangibles.** We assess the carrying cost of goodwill and intangible assets with indefinite lives on an annual basis and between annual tests in certain circumstances. Impairment of goodwill or other intangible assets and a resulting charge to earnings may occur as a result of

## Edgar Filing: TECHNITROL INC - Form 10-Q

changes in demand or other factors we may not control or by a change in the underlying assumptions used in valuing such assets, such as cost of capital. In addition, in response to changes in industry and market conditions, we may strategically realign our resources and consider restructuring, disposing of, or otherwise exiting businesses, which could result in an impairment of goodwill or other intangibles.

**Severance and Asset Impairment Expense.** Our restructuring activities are designed to reduce both our fixed and variable costs, particularly in response to the on-going price competition in both segments. These costs include the consolidation of facilities, contract termination and the termination of employees. Acquisition-related costs are included in the allocation of the cost of the acquired business. Other restructuring costs are expensed during the period in which we determine that we will incur those costs, and all of the requirements for accrual are met in accordance with the applicable accounting guidance. Restructuring costs are recorded based upon our best estimates at the time. Our actual expenditures for the restructuring activities may differ from the initially recorded costs. If this occurs, we adjust our initial estimates in future periods. In the case of acquisition-related restructuring costs, depending on whether the assets impacted came from the acquired entity and the timing of the restructuring charge, such adjustment would generally require a change in value of the goodwill appearing on our balance sheet, which may not affect our current earnings. In the case of other restructuring costs, we could be required either to record additional expenses in future periods if our initial estimates were too low, or reverse part of the charges that we recorded initially if our initial estimates were too high.

**Income Taxes.** Except in limited circumstances, we have not provided for U.S. federal income and foreign withholding taxes on non-U.S. subsidiaries' undistributed earnings as calculated for income tax purposes. In accordance with the provisions of Accounting Principles Board Opinion No. 23, Accounting for Income Taxes - Special Areas ("APB 23") we intend to reinvest these earnings outside the U.S. indefinitely. If we encounter a significant domestic need for liquidity that we cannot fulfill through borrowings, equity offerings, or other internal or

Page 11 of 34

external sources, we may experience unfavorable tax consequences as cash invested outside the U.S. is transferred to the U.S. This adverse consequence would occur if the transfer of cash into the U.S. were subject to income tax without sufficient foreign tax credits available to offset the U.S. tax liability.

**Contingency Accruals.** During the normal course of business, a variety of issues may arise, which may result in litigation, environmental compliance issues and other contingent obligations. In developing our contingency accruals we consider both the likelihood of a loss or incurrence of a liability as well as our ability to reasonably estimate the amount of exposure. We record contingency accruals when a liability is probable and the amount can be reasonably estimated. We periodically evaluate available information to assess whether contingency accruals should be adjusted. We could be required to record additional expenses in future periods if our initial estimates were too low, or reverse part of the charges that we recorded initially if our estimates were too high.

### Overview

We are a global producer of precision-engineered passive magnetics-based electronic components and electrical contact products and materials. We believe

## Edgar Filing: TECHNITROL INC - Form 10-Q

we are a leading global producer of these products and materials in the primary markets we serve based on our estimates of the size of our primary markets in annual revenues and our share of those markets relative to our competitors.

We operate our business in two distinct segments:

- o the electronic components segment, which operates under the name Pulse, and
- o the electrical contact products segment, which operates under the name AMI Doduco.

General. We define net sales as gross sales less returns and allowances. We sometimes refer to net sales as revenue.

From 1997 through 2000, the growth in our consolidated net sales was due in large part to the growth of Pulse. However, beginning in late 2000, the electronics markets served by Pulse experienced a severe global contraction. In late 2002, many of these markets began to stabilize or increase in terms of unit sales. However, because of excess capacity, relocation by customers from North America and Europe to the Far East, and emergence of strong competitors in the Far East, the pricing environment for Pulse's products has been and remains challenging, preventing total revenue from growing proportionately with unit growth. Pulse has undertaken a series of cost-reduction actions from 2001 through 2004 to optimize its capacity with market conditions.

Since late 2000 and continuing through late 2003, the market in both North America and Europe for AMI Doduco's products has been weak. The markets in both North America and Europe began to recover in 2004. Demand at AMI Doduco typically mirrors the prevailing economic conditions in North America and Europe. This is true for electrical contacts, and for component subassemblies for automotive applications such as multi-function switches, motor control sensors and ignition security systems, and for non-automotive uses such as appliance and industrial controls. AMI Doduco continues its cost reduction actions including work force adjustments and plant consolidations in line with demand around the world in order to optimize efficiency.

Historically, the gross margin at Pulse has been significantly higher than at AMI Doduco. As a result, the mix of net sales generated by Pulse and AMI Doduco during a period affects our consolidated gross margin. Over the past two years, our gross margin has been positively impacted by the savings from our various restructuring activities and ongoing cost and expense controls. Our gross margin is also significantly affected by capacity utilization, particularly at AMI Doduco. Pulse's markets are characterized by a relatively short-term product life cycle compared to AMI Doduco. As a result, significant product turnover occurs each year. Therefore, Pulse's changes in average selling prices do not necessarily provide a meaningful and quantifiable measure of Pulse's operations. AMI Doduco has a relatively long-term and mature product line, without significant turnover, and with less frequent variation in the prices of product sold. Most of AMI Doduco's products are sold under annual (or longer) purchase contracts. Therefore, AMI Doduco's revenues historically have not been subject to significant price fluctuations. In addition, sales growth and contraction at AMI Doduco and Pulse's Consumer Division are generally attributable to changes in unit volume and changes in unit pricing, as well as foreign exchange rates, especially the U.S. dollar to the euro.

Page 12 of 34

Acquisitions. Historically, acquisitions have been an important part of our growth strategy. In many cases, our move into new product lines and

## Edgar Filing: TECHNITROL INC - Form 10-Q

extensions of our existing product lines or markets has been facilitated by an acquisition. Our acquisitions continually change the mix of our net sales. Pulse made numerous acquisitions in recent years which have increased our penetration into our primary markets and expanded our presence in new markets. Recent examples of these acquisitions include the consumer electronics business of Eldor Corporation and Excelsus. In addition, we acquired a controlling interest in Full Rise Electronics, Ltd. in 2004. Pulse acquired Eldor's consumer electronics business in January 2003 for approximately \$83.9 million and this became the Pulse Consumer Division, and is headquartered in Senna Comasco, Italy with production operations in Istanbul and Izmir, Turkey. The Consumer Division business is a leading supplier of flyback transformers to the European television industry. Excelsus was acquired in August 2001 for approximately \$85.9 million, net of cash acquired. Excelsus was based in Carlsbad, California, and was a leading producer of customer-premises digital subscriber line filters and other broadband accessories. It is now a core part of Pulse's telecommunications product division.

Similarly, AMI Doduco has made a number of acquisitions over the years. For example, in January 2001, AMI Doduco acquired the electrical contact and materials business of Engelhard-CLAL, a manufacturer of electrical contacts, wire and strip contact materials and related products. Generally, AMI Doduco's acquisitions have been driven by our strategy of expanding our product and geographical market presence for electrical contact products. Due to our integration of acquisitions and the interchangeable sources of net sales between existing and acquired operations, historically we have not separately tracked the net sales of an acquisition after the date of the transaction.

Technology. Our business is continually affected by changes in technology, design, and preferences of consumers and other end users of our products, as well as changes in regulatory requirements. We address these changes by continuing to invest in new product development and by maintaining a diverse product portfolio which contains both mature and emerging technologies in order to meet customer demands.

Management Focus. Our executives focus on a number of important factors in evaluating our financial condition and operation performance. We use economic profit which we define as operating profit after tax, less our cost of capital. Revenue growth, gross margin as a percentage of revenue, and operating profit as a percent of revenue are also among these factors. Operating leverage or incremental operating profit as a percentage of incremental sales is a factor that is discussed frequently with analysts and investors, as this is believed to represent the benefit of absorbing fixed overhead and operating expenses, and increased profitability on higher sales. In evaluating working capital management, liquidity and cash flow, our executives also use performance measures such as days sales outstanding, days payable outstanding and inventory turnover.

The continued success of our business is largely dependent on meeting and exceeding our customers' expectations. Non-financial performance measures such as safety statistics, on-time delivery and quality statistics assist our management in monitoring this activity on an on-going basis.

Cost Reduction Programs. During 1999 and 2000, the electronic components industries served by Pulse were characterized by unprecedented growth. Beginning in late 2000 and continuing all during 2001 and a significant part of 2002, however, these markets experienced a severe worldwide contraction and many of our customers canceled orders and decreased their level of business activity as a result of lower demand for their end products. Our manufacturing business model for Pulse's non-consumer markets has a very high variable cost component due to the labor-intensity of many processes, which allows us to quickly change our capacity based on market demand. Just as we expanded capacity during 1999 and 2000, we reduced capacity during 2001 and 2002. The Pulse Consumer Division,

## Edgar Filing: TECHNITROL INC - Form 10-Q

acquired from Eldor in 2003, however, is capital intensive and therefore more sensitive to volume changes. Generally speaking, since 2003, Pulse's end markets experienced increased unit demand, but the increasing presence of Far Eastern competition also increased pricing pressure, which in turn put pressure on Pulse to reduce selling prices. Unit sales and pricing pressures were, however, not uniform across all product lines, making product mix an important factor in revenue generation. While the electrical contact industry served by AMI Doduco is generally less dependent on volatile technology markets, it too was negatively impacted by general economic trends as reflected in slower non-residential construction spending and reduced capital spending in 2001 and 2002. AMI Doduco has a higher fixed cost component of manufacturing activity than Pulse, as it is more capital intensive. Therefore, AMI Doduco is unable to expand or contract its capacity as quickly as Pulse in response to market demand, although significant actions have been taken to align AMI Doduco's capacity with current market demand.

As a result of our continuing focus on both economic and operating profit, we will continue to aggressively size both Pulse and AMI Doduco so that costs are optimally matched to current and anticipated future revenue and

Page 13 of 34

unit demand. We will also continue to pursue additional growth opportunities. The amounts of additional charges will depend on specific actions taken. The actions taken over the past three years such as plant closures, plant relocations, asset impairments and reduction in personnel worldwide have resulted in the elimination of a variety of costs. The majority of these costs represent the annual salaries and benefits of terminated employees, both those directly related to manufacturing and those providing selling, general and administrative services, as well as lower overhead costs related to factory relocations to lower-cost locations. The eliminated costs also include depreciation savings from disposed equipment. We have implemented a succession of cost reduction initiatives and programs, summarized as follows:

During 2001, we announced the closure of our production facilities in Thailand and Malaysia. The production at these two facilities was transferred to other Pulse facilities in Asia. We recorded charges of \$3.6 million for these plant closings, comprised of \$2.5 million for severance and related payments and \$1.1 million for other exit costs. The majority of this accrual was utilized by the end of 2002. We also adopted other restructuring plans during 2001. In this regard, provisions of \$6.4 million were recorded during 2001. Termination costs for employees at our Thailand and Malaysian facilities were included in the separate provisions for exiting those facilities. In addition to these terminations, headcount was reduced by approximately 12,300, net of new hires, during fiscal 2001 through voluntary employee attrition and involuntary workforce reductions primarily at manufacturing facilities in the People's Republic of China ("PRC") where severance payments are not necessary. In addition, a charge of \$3.5 million was recorded during 2001 to writedown the value of certain Pulse fixed assets to their disposal value.

During 2002, we announced the closure of our production facility in the Philippines. The production at this facility was transferred to other Pulse facilities in Asia. We recorded charges of \$3.8 million for this plant closing, comprising \$1.4 million for severance and related payments and \$2.4 million for asset writedowns. The majority of this accrual was utilized by the end of 2002. We also adopted other restructuring plans during 2002. In this regard, we recorded provisions of \$6.0 million for personnel reductions, and substantially all of the employee severance and related payments in connection with these actions were completed as of December 26, 2003. An additional provision of \$7.0 million was recorded in 2002 related to asset writedowns. These assets were

## Edgar Filing: TECHNITROL INC - Form 10-Q

primarily Asian-based production equipment that became idle in 2002.

During 2003, we accrued \$9.0 million in the aggregate for severance and related payments and asset impairments. At Pulse, we accrued \$1.5 million for the elimination of certain manufacturing and support positions located in France, the United Kingdom, Mexico and the PRC and \$0.7 million for other facility exit costs. We additionally accrued \$1.9 million for shutdown of Pulse's manufacturing facility in Mexico and \$0.5 million to write down the carrying cost of Pulse's facility in the Philippines which is held for sale. At AMI Doduco, we accrued \$2.9 million for the elimination of certain manufacturing positions principally located in North America and Germany and \$1.5 million to complete the shutdown of a redundant facility in Spain that we acquired from Engelhard-CLAL in 2001. The majority of these accruals were utilized by the end of 2003.

In 2004, we accrued \$6.7 million for severance and related payments comprised of \$3.0 million related to the termination of personnel primarily at AMI Doduco's facility in Germany, and \$0.8 million related to Pulse's shutdown of a facility in Carlsbad, California, \$2.5 million related to AMI Doduco's shutdown of a facility in France, and \$0.4 million for other severance in various locations. The vast majority of these accruals will be utilized by December 31, 2004.

International Operations. As of October 1, 2004, we had manufacturing operations in 9 countries and had no significant net sales in currencies other than the U.S. dollar and the euro. An increasing percentage of our sales in recent years have been outside of the United States. In the year ended December 26, 2003, 76% of our net sales were outside of the U.S. Changing exchange rates often impact our financial results and our period-over-period comparisons. This is particularly true of movements in the exchange rate between the U.S. dollar and the euro. AMI Doduco's European sales are denominated primarily in euro. AMI Doduco's and the Pulse Consumer Division's euro-denominated sales and earnings may result in higher or lower dollar sales and net earnings upon translation for our U.S. consolidated financial statements. We may also experience a positive or negative translation adjustment to equity because our investment in Pulse's Consumer Division and AMI Doduco's European operations may be worth more or less in U.S. dollars after translation for our U. S. consolidated financial statements. The Pulse non-consumer operations may incur foreign currency gains or losses as euro-denominated transactions are remeasured to U.S. dollars for financial reporting purposes. If an increasing percentage of our sales is denominated in non-U.S. currencies, increased exposure to currency fluctuations may result.

Page 14 of 34

In order to reduce our exposure resulting from currency fluctuations, we may purchase currency exchange forward contracts and/or currency options. These contracts guarantee a predetermined range of exchange rates at the time the contract is purchased. This allows us to shift the majority of the risk of currency fluctuations from the date of the contract to a third party for a fee. As of October 1, 2004, we had one foreign currency forward contract outstanding to sell forward approximately 60.9 million euros in order to hedge intercompany loans. In determining the use of forward exchange contracts and currency options, we consider the amount of sales, purchases and net assets or liabilities denominated in local currencies, the type of currency, and the costs associated with the contracts.

Precious Metals. AMI Doduco uses silver, as well as other precious metals, in manufacturing some of its electrical contacts, contact materials and contact subassemblies. Historically, we have leased or held these materials through



## Edgar Filing: TECHNITROL INC - Form 10-Q

consignment arrangements with our suppliers except in the case of AMI Doduco's entity in the PRC which owns its precious metals. Leasing and consignment costs have typically been below the costs to borrow funds to purchase the metals, and more importantly, these arrangements eliminate the effects of fluctuations in the market price of owned precious metal and enable us to minimize our inventories. AMI Doduco's terms of sale generally allow us to charge customers for precious metal content based on market value of precious metal on the day after shipment to the customer. Thus far we have been successful in managing the costs associated with our precious metals. While limited amounts are purchased for use in production, the majority of our precious metal inventory continues to be leased or held on consignment. If our leasing/consignment fees increase significantly in a short period of time, and we are unable to recover these increased costs through higher sale prices, a negative impact on our results of operations and liquidity may result. Leasing/consignment fee increases are caused by increases in interest rates or volatility in the price of the consigned material.

**Income Taxes.** Our effective income tax rate is affected by the proportion of our income earned in high-tax jurisdictions such as Germany and the income earned in low-tax jurisdictions, particularly Izmir, Turkey and the People's Republic of China. This mix of income can vary significantly from one period to another. We have benefited over recent years from favorable tax treatments outside of the U.S. However, there is no guarantee as to how long these benefits will continue to exist.

Except in limited circumstances, we have not provided for U.S. federal income and foreign withholding taxes on our non-U.S. subsidiaries' undistributed earnings as per Accounting Principles Board Opinion No. 23, Accounting for Income Taxes - Special Areas. Such earnings include pre-acquisition earnings of foreign entities acquired through stock purchases, and are intended to be reinvested outside of the U.S. indefinitely. We have not provided for U.S. federal income and foreign withholding taxes on approximately \$299.4 million of our non-U.S. subsidiaries' undistributed earnings (as calculated for income tax purposes) as of December 26, 2003, as per APB 23. Unrecognized deferred taxes on these undistributed earnings are estimated to be approximately \$94.2 million. Where excess cash has accumulated in our non-U.S. subsidiaries and it is advantageous for tax reasons, subsidiary earnings may be repatriated.

Page 15 of 34

### Results of Operations

Three months ended October 1, 2004 compared to the three months ended September 26, 2003

**Net Sales.** Net sales for the three months ended October 1, 2004 increased \$20.2 million, or 16.0%, to \$146.5 million from \$126.3 million in the three months ended September 26, 2003. Our sales increase was primarily attributable to favorable foreign currency translation, higher silver prices, and the inclusion of FRE sales in our consolidated financial statements from the time we acquired a controlling interest on September 12, 2004. Sales also benefited from improved market conditions for AMI Doduco, and its continued success in increasing market share, particularly in North America.

Pulse's net sales increased \$2.5 million, or 3.3%, to \$77.4 million for the three months ended October 1, 2004 from \$74.9 million in the three months ended September 26, 2003. The increase in sales was primarily attributable to the inclusion of \$2.2 million of FRE net sales in our consolidation from the time we acquired a controlling interest on September 12, 2004. Pulse had sales gains in the networking, power conversion, and military/aerospace markets,

## Edgar Filing: TECHNITROL INC - Form 10-Q

whereas the telecommunications market was down significantly. In addition, sales from the consumer division, (which are denominated in euros) were down in local currencies, although this was partially offset by the favorable translation effect of a stronger euro in the 2004 period.

AMI Doduco's net sales increased \$17.7 million, or 34.4%, to \$69.1 million for the three months ended October 1, 2004 from \$51.4 million in the three months ended September 26, 2003. The sales benefited from an increase in the average euro-to-U.S. dollar exchange rate and higher prices for precious metals which were passed on to customers. The higher average euro-to-dollar exchange rate increased sales by approximately \$3.7 million in the three months ended October 1, 2004 versus the comparable 2003 quarter. Sales in the 2004 period also reflect improving demand and increases in market share in North America, particularly in the commercial and industrial markets, whereas European markets were marginally higher in local currencies.

Cost of Sales. As a result of higher sales, our cost of sales increased \$19.2 million, or 20.8%, to \$111.5 million for the three months ended October 1, 2004 from \$92.3 million for the three months ended September 26, 2003. Our consolidated gross margin for the three months ended October 1, 2004 was 23.9% compared to 26.9% for the three months ended September 26, 2003. Our consolidated gross margin was negatively affected by a higher proportion of sales arising from AMI Doduco, in that AMI Doduco typically earns lower gross margins than Pulse. In addition, gross margins were negatively affected by lower capacity utilization at Pulse in the three months ended October 1, 2004 compared to the three months ended September 26, 2003. Cost of sales was also negatively affected by margin pressure resulting from lower average weekly revenues at Pulse that was compounded by the unusual fourteen-week duration of the third quarter, with its extra week of fixed costs in the 2004 quarter. Also, the 2004 quarter included a four-week-long diversion of resources in Pulse's consumer division due to a customer's rejection of a large shipment of television transformers (which were re-tested and found to be satisfactory) and that customer's temporary refusal to accept new shipments of these products. At AMI Doduco, cost of sales was negatively affected by a one time inventory write-off of \$0.5 million in connection with the shutdown of a facility in France, and the disruptive effects of hurricanes and tropical storms on AMI Doduco's facility in Luquillo, Puerto Rico and its overall North American supply chain. While the impact of these disruptions is difficult to quantify, we believe that the negative effect on operations during the quarter was significant.

Selling, General and Administrative Expenses. Total selling, general and administrative expenses for the three months ended October 1, 2004 increased \$2.2 million, or 8.9%, to \$27.2 million, or 18.5% of net sales, from \$24.9 million, or 19.8% net of sales for the three months ended September 26, 2003. Increased spending was a result of the inclusion of approximately three weeks of FRE expenses in our consolidated financial statements, increased fixed costs such as salaries, attributable to the extra week in the 2004 period, and higher variable costs such as selling commissions and stock compensation expense. Partially offsetting the higher spending were lower incentive compensation expense and the favorable effects of restructuring actions that we took over the last year to reduce costs and tighten spending controls. European expenses that are denominated in euros were also translated to a higher level of U.S. dollars at the higher average dollar-to-euro exchange rate in 2004.

Research, development and engineering expenses are included in selling, general and administrative expenses. We refer to research, development and engineering expenses as RD&E. For the three months ended October 1, 2004 and September 26, 2003 respectively, RD&E by segment was as follows (dollars in

## Edgar Filing: TECHNITROL INC - Form 10-Q

thousands):

	2004	2003
	----	----
Pulse	\$4,846	\$3,693
Percentage of segment sales	6.2%	4.9%
AMI Doduco	\$1,066	\$ 956
Percentage of segment sales	1.5%	1.9%

Higher RD&E spending in 2004 at Pulse includes additional investments in our China Development Center, the effect of the extra week of fixed expenses in the 2004 period and higher U.S. dollar reported spending of RD&E expenses incurred in euros. We believe that future sales in the electronic components markets will be driven by next-generation products. Design and development activities with our OEM customers continued at an aggressive pace during 2003 and into 2004.

Interest. Net interest expense was \$0.1 million for the three months ended October 1, 2004 compared to net interest expense of \$ 0.2 million for the three months ended September 26, 2003. The higher average balance of invested cash in 2004 versus the comparable period in 2003, at a higher interest income yield, resulted in slightly lower net interest expense. Recurring aggregate components of interest expense such as silver leasing fees, interest on bank debt and bank commitment fees, approximated those of 2003.

Other Income. Other income was \$0.2 million for the three months ended October 1, 2004 versus \$0.1 million of expense for the three months ended September 26, 2003.

Equity Earnings in Minority-Owned Investments. Equity earnings in minority-owned investments were \$0.4 million of income for the three months ended October 1, 2004 versus \$0.1 million of income for the three months ended September 26, 2003. Given that we acquired control of FRE on September 12, 2004 and will be consolidating FRE's results prospectively from the date we acquired control, we will no longer reflect equity earnings from FRE. Rather, the full consolidation of FRE and related elimination of the minority interest will be reflected in our financial statements.

Income Taxes. The effective income tax rate for the three months ended October 1, 2004 was 22.1% compared to 18.6% for the three months ended September 26, 2003. The higher tax rate in 2004 resulted from a higher proportion of income being attributable to high-tax jurisdictions, as well as the impact of non-deductible restructuring costs in 2004 in high-tax jurisdictions.

Minority Interest. Minority interest was \$0.1 million of expense for the three months ended October 1, 2004. Since we acquired control of FRE on September 12, 2004 and will be consolidating FRE's results prospectively from the date we acquired control, the net earnings attributable to the minority interest were reflected in minority interest expense in the three months ended October 1, 2004.

Nine months ended October 1, 2004 compared to the nine months ended September 26, 2003

Net Sales. Net sales for the nine months ended October 1, 2004 increased \$58.5 million, or 15.6%, to \$433.0 million from \$374.5 million in the nine months ended September 26, 2003. Our sales increase from the comparable period last year was attributable to improvement in the markets for both Pulse and AMI Doduco. Pulse's increase in net sales was due to stronger demand in networking, power conversion, military/aerospace and consumer markets. AMI Doduco's increase in net sales was due to higher prices for precious metals and favorable

## Edgar Filing: TECHNITROL INC - Form 10-Q

translation effect of a stronger euro, as well as early successes in AMI Doduco's efforts to increase its market share, particularly in North America.

Pulse's net sales increased \$21.8 million, or 10.2%, to \$236.4 million for the nine months ended October 1, 2004 from \$214.5 million in the nine months ended September 26, 2003. This increase was experienced in Pulse's networking, telecommunications, power conversion, military/aerospace and consumer division markets on a worldwide basis. Sales derived from the consumer division (which are denominated in euros) decreased in local

Page 17 of 34

currency, although this was offset by the favorable translation effect of a stronger euro in 2004, after translating the consumer division's sales in to U.S. Dollars. To a lesser extent, Pulse sales also benefited from the inclusion of FRE sales in our consolidation from the time we acquired a controlling interest on September 12, 2004.

AMI Doduco's net sales increased \$36.7 million, or 22.9%, to \$196.7 million for the nine months ended October 1, 2004 from \$160.0 million in the nine months ended September 26, 2003. The sales benefited from an increase in the average euro-to-U.S. dollar exchange rate and higher prices for precious metals which were passed on to customers. The higher average euro-to-dollar exchange rate during 2004 versus the comparable nine-month period in 2003 had the effect of increasing reported sales by approximately \$12.2 million. Sales in the 2004 period reflect improving demand in North America, particularly in the commercial and industrial markets, whereas European markets were flat. The sales improvements were partially offset by continuing weakness in European automotive market and price adjustments related to new long-term contracts with major customers.

Cost of Sales. As a result of higher net sales, our cost of sales increased \$43.1 million, or 15.5%, to \$320.4 million for the nine months ended October 1, 2004 from \$277.3 million for the nine months ended September 26, 2003. Our consolidated gross margin for the nine months ended October 1, 2004 was 26.0%, the same as the nine months ended September 26, 2003. Our consolidated gross margin was positively affected by higher capacity utilization at Pulse and AMI Doduco in the first six months of 2004 compared to 2003. However, gross margins were negatively affected by lower capacity utilization at Pulse in the third quarter of 2004 compared to 2003.

Selling, General and Administrative Expenses. Total selling, general and administrative expenses for the nine months ended October 1, 2004 increased \$10.0 million, or 13.7%, to \$83.2 million, or 19.2% of net sales, from \$73.2 million, or 19.6% net of sales for the nine months ended September 26, 2003. Increased spending was a result of increased variable costs such as selling commissions and stock compensation expense, partially offset by restructuring actions that we took over the last year to reduce costs and tighten spending controls. Stock compensation expense, in particular, was \$1.0 million higher in 2004 versus the comparable period in 2003. European expenses that are denominated in euros were also translated to a higher level of U. S. dollars at the higher euro-to-dollar exchange rate in 2004. Increased spending was also a result of the inclusion of FRE expenses in our consolidation and increased fixed costs such as salaries due to the extra week in the 2004 period.

Research, development and engineering expenses are included in selling, general and administrative expenses. We refer to research, development and engineering expenses as RD&E. For the nine months ended October 1, 2004 and September 26, 2003 respectively, RD&E by segment was as follows (dollars in thousands):

## Edgar Filing: TECHNITROL INC - Form 10-Q

	2004	2003
	----	----
Pulse	\$14,135	\$10,624
Percentage of segment sales	6.0%	5.0%
AMI Doduco	\$ 3,111	\$ 2,974
Percentage of segment sales	1.6%	1.9%

Higher RD&E spending in 2004 at Pulse includes additional investments in our China Development Center, the effect of the extra week of fixed expenses in the 2004 period and higher U.S. dollar reported spending of RD&E expenses incurred in euros. We believe that future sales in the electronic components markets will be driven by next-generation products. Design and development activities with our OEM customers continued at an aggressive pace during 2003 and into 2004.

Interest. Net interest expense was \$0.4 million for the nine months ended October 1, 2004 compared to net interest expense of \$0.7 million for the nine months ended September 26, 2003. The average higher balance of invested cash in 2004 over the comparable period in 2003, at a similar interest income yield, resulting in slightly lower net interest expense. Recurring aggregate components of interest expense, such as silver leasing fees, interest on bank debt and bank commitment fees, approximated those of 2003.

Other Income. Other income (expense) was \$0.8 million of income for the nine months ended October 1, 2004 versus \$0.6 million of expense for the nine months ended September 26, 2003. The increase in 2004 is primarily attributable to \$1.1 million gain related to the sale of equity rights arising for the 2001 acquisition of the Engelhard-CLAL electrical contacts business.

Page 18 of 34

Equity Earnings in Minority-Owned Investments. Equity earnings in minority-owned investments were \$0.8 million of income for the nine months ended October 1, 2004 versus \$0.6 million of income for the three months ended September 26, 2003. Since we acquired control of FRE on September 12, 2004 and will be consolidating FRE's results prospectively from the date we acquired control, we will no longer reflect equity earnings from FRE. Rather, the full consolidation of FRE and related elimination of the minority interest will be reflected in our financial statements.

Income Taxes. The effective income tax rate for the nine months ended October 1, 2004 was 17.6% compared to 15.9% for the nine months ended September 26, 2003. The higher tax rate in 2004 resulted from a higher proportion of income being attributable to high-tax jurisdictions and the impact of non-deductible restructuring expenses in high-tax jurisdictions.

Minority Interest. Minority interest was \$0.1 million of expense for the nine months ended October 1, 2004. Since we acquired control of FRE on September 12, 2004 and will be consolidating FRE's results prospectively from the date we acquired control, the net earnings attributable to the minority interest were reflected in minority interest expense in the nine months ended October 1, 2004.

### Liquidity and Capital Resources

Working capital as of October 1, 2004 was \$231.8 million compared to \$199.8 million as of December 26, 2003. This increase was primarily due to the increase in cash and cash equivalents, trade receivables, and inventories, and decrease in accounts payable and accrued expenses. Cash and cash equivalents,

## Edgar Filing: TECHNITROL INC - Form 10-Q

which is included in working capital, increased from \$143.4 million as of December 26, 2003 to \$153.7 million as of October 1, 2004.

Net cash provided by operating activities was \$19.6 million for the nine months ended October 1, 2004 and \$32.0 million in the comparable period of 2003, a decrease of \$12.4 million. This decrease is primarily attributable to increases in net working capital which more than offset higher net earnings. The increase in working capital was primarily caused by an increase in inventory and a decrease in accounts payable and accrued expenses during the nine months ended October 1, 2004. This increase in inventory and decrease in accounts payable was attributable to the sales decrease the three months ended October 1, 2004 versus the immediately preceding three months ended June 25, 2004.

We present our statement of cash flows using the indirect method as permitted under Financial Accounting Standards Board Statement No. 95, Statement of Cash Flows. Our management has found that investors and analysts typically refer to changes in accounts receivable, inventory, and other components of working capital when analyzing operating cash flows. Also, changes in working capital are more directly related to the way we manage our business for cash flow than are items such as cash receipts from the sale of goods, as would appear using the direct method.

Capital expenditures were \$5.4 million during the nine months ended October 1, 2004 and \$4.9 million in the comparable period of 2003. We make capital expenditures to expand production capacity, improve our operating efficiency, and enhance workplace safety. We plan to continue making such expenditures in the future as and when necessary.

We used \$16.6 million for acquisitions during the nine months ended October 1, 2004. The current year expenditures related to the acquisition by Pulse of a plastics fabrication operation in the People's Republic of China for \$3.6 million and an additional equity investment in FRE for \$13.0 million. Offsetting the cash paid for FRE in the current year was \$11.7 million of cash held by FRE that is now included in our consolidated financial statements. We used \$83.9 million cash for acquisitions in the comparable period of 2003, primarily for the purchase of Eldor's consumer electronics division in January 2003. We may acquire other businesses or product lines to expand our breadth and scope of operations.

We do not pay cash dividends on our common stock. We currently intend to retain future earnings to finance the growth of our business.

We entered into a new credit agreement on June 17, 2004 providing for \$125.0 million of credit capacity. The facility consists of an aggregate U.S. dollar-equivalent revolving line of credit in the principal amount of up to

Page 19 of 34

\$125.0 million, which provides for borrowings in multiple currencies including but not limited to U.S. dollars and euros, including individual sub-limits of:

- a U.S. dollar based swing-line loan not to exceed \$10.0 million; and
- a multicurrency facility providing for the issuance of letters of credit in an aggregate amount not to exceed the U.S. dollar equivalent of \$15.0 million.

The credit agreement permits us to request one or more increases in the total commitment not to exceed \$75.0 million, provided the minimum increase is \$25.0 million, subject to bank approval.

## Edgar Filing: TECHNITROL INC - Form 10-Q

The total amount outstanding under the credit facility may not exceed \$125.0 million, provided we do not request an increase in total commitment as noted above. In any event, outstanding borrowings are limited to a maximum of three times our earnings before interest, taxes depreciation and amortization (EBITDA) on a rolling twelve-month basis as of the most recent quarter-end.

The credit facility contains covenants specifying a maximum debt to EBITDA ratio, as defined above, minimum interest expense coverage, capital expenditure limitations, and other customary and normal provisions. We are in compliance with all such covenants. As of October 1, 2004, we have no outstanding borrowings under our existing three-year revolving credit agreement.

We pay a commitment fee on the unborrowed portion of the commitment, which ranges from 0.175% to 0.300% of the total commitment, depending on our debt to EBITDA ratio, as defined above. The interest rate for each currency borrowing will be a combination of the base rate for that currency plus a credit margin spread. The base rate is different for each currency. The credit margin spread is the same for each currency and is 0.750% to 1.500% depending on our debt to EBITDA ratio, as defined above. Each of our domestic subsidiaries with net worth equal to or greater than \$5 million guarantees all obligations incurred under the credit facility.

We also have an obligation outstanding due in August 2009 under an unsecured term loan agreement with Sparkasse Pforzheim in Germany, for the borrowing of approximately 5.1 million euros.

At October 1, 2004, we included \$9.2 million of outstanding debt of FRE in connection with our consolidation of FRE's financial statements. FRE has a total credit limit of approximately \$12.2 million in U.S. dollar equivalents as of October 1, 2004.

We had three standby letters of credit outstanding at October 1, 2004 in the aggregate amount of \$1.3 million securing transactions entered into in the ordinary course of business.

We had commercial commitments outstanding at October 1, 2004 of approximately \$81.3 million due under precious metal consignment-type leases. This represents an increase of \$20.7 million from the \$60.6 million outstanding as of December 26, 2003 and is attributable to volume increases and higher average silver prices during 2004.

We believe that the combination of cash on hand, cash generated by operations and borrowings under our credit agreement will be sufficient to satisfy our operating cash requirements in the foreseeable future. In addition, we may use internally generated funds or borrowings, or additional equity offerings for acquisitions of suitable businesses or assets.

All retained earnings are free of legal or contractual restrictions as of December 26, 2003, with the exception of approximately \$13.0 million of retained earnings primarily in the PRC, that are restricted in accordance with Section 58 of the PRC Foreign Investment Enterprises Law. The amount restricted in accordance with the PRC Foreign Investment Enterprise Law is for employee welfare programs and is applicable to all foreign investment enterprises doing business in the PRC. The restriction applies to 10% of our net earnings in the PRC, limited to 50% of the total capital invested in the PRC. We have not experienced any significant liquidity restrictions in any country in which we operate and none are foreseen. However, foreign exchange ceilings imposed by local governments and the sometimes-lengthy approval processes which some foreign governments require for international cash transfers may delay our internal cash movements from time to time. The retained earnings in other countries represent a material portion of our assets. We expect to reinvest

## Edgar Filing: TECHNITROL INC - Form 10-Q

these earnings outside of the United States because we anticipate that a significant portion of our opportunities for growth in the coming years will be abroad. If these earnings were

Page 20 of 34

brought back to the United States, significant tax liabilities could be incurred in the United States as several countries in which we operate have rates significantly lower than the U.S. statutory rate. Additionally, we have not accrued U.S. income taxes on foreign earnings indefinitely invested abroad.

### New Accounting Pronouncements

In December 2003, the Financial Accounting Standards Board "FASB" issued Statement of Financial Accounting Standards No. 132 (revised 2003), Employers' Disclosures about Pensions and Other Postretirement Benefits, an amendment of FASB Statements No. 87, 88, and 106, and a revision of FASB Statement No. 132 ("SFAS 132R"). SFAS 132R revises employers' disclosures about pension plans and other postretirement benefit plans. It does not change the measurement or recognition of those plans required by SFAS No. 87, Employers' Accounting for Pensions, SFAS No. 88, Employers' Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits, and SFAS No. 106, Employers' Accounting for Postretirement Benefits Other Than Pensions. The new rules require additional disclosures about the assets, obligations, cash flows, and net periodic benefit cost of defined benefit pension plans and other postretirement benefit plans. The required information will be provided separately for pension plans and for other postretirement benefit plans. The new disclosures are effective for fiscal 2003 year-end financial statements and certain interim disclosures in 2004. Adoption of this standard did not have any effect on our revenue, operating results, financial position or liquidity.

In December 2003, FASB issued Interpretation No. 46 (revised December 2003) Consolidation of Variable Interest Entities ("FIN 46R"). FIN 46R clarifies the application of Accounting Research Bulletin No. 51, Consolidated Financial Statements, to certain entities in which equity investors do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. FIN 46R replaces FASB Interpretation No. 46, Consolidation of Variable Interest Entities which was issued in January 2003. FIN 46R is required to be applied to variable interest in variable interest entities created after December 31, 2003. For variable interests in variable interest entities created before January 1, 2004, the final interpretation was required to be applied no later than the end of the first reporting period that ends after March 15, 2004. We do not have any variable interests or variable interest entities and the adoption of this interpretation did not have a material effect on our revenue, operating results, financial position, or liquidity.

Factors That May Affect Our Future Results (Cautionary Statements for Purposes of the "Safe Harbor" Provisions of the Private Securities Litigation Reform Act of 1995)

Our disclosures and analysis in this report contain forward-looking statements. Forward-looking statements reflect our current expectations of future events or future financial performance. You can identify these statements by the fact that they do not relate strictly to historical or current facts. They often use words such as "anticipate", "estimate", "expect", "project", "intend", "plan", "believe", and similar terms. These forward-looking statements are based on our current plans and expectations.



## Edgar Filing: TECHNITROL INC - Form 10-Q

Any or all of our forward-looking statements in this report may prove to be incorrect. They may be affected by inaccurate assumptions we might make or by risks and uncertainties which are either unknown or not fully known or understood. Accordingly, actual outcomes and results may differ materially from what is expressed or forecasted in this report.

We sometimes provide forecasts of future financial performance. The risks and uncertainties described under "Risk Factors" as well as other risks identified from time to time in other Securities and Exchange Commission reports, registration statements and public announcements, among others, should be considered in evaluating our prospects for the future. We undertake no obligation to release updates or revisions to any forward-looking statement, whether as a result of new information, future events or otherwise.

### Risk Factors

Cyclical changes in the markets we serve could result in a significant decrease in demand for our products and reduce our profitability.

Our components are used in various products for the electronic and electrical equipment markets. These markets are highly cyclical. The demand for our components reflects the demand for products in the electronic

Page 21 of 34

and electrical equipment markets generally. Beginning in late 2000 and continuing into 2003, these markets, particularly the electronics market, experienced a severe worldwide contraction. This contraction resulted in a decrease in demand for our products, as our customers:

- o canceled many existing orders;
- o introduced fewer new products; and
- o worked to decrease their inventory levels.

The decrease in demand for our products had a significant adverse effect on our operating results and profitability. While these markets have recovered to varying degrees, we cannot predict the duration or strength of any recovery. Accordingly, we may continue to experience volatility in both our revenues and profits.

Reduced prices for our products may adversely affect our profit margins if we are unable to reduce our costs of production.

The average selling prices for our products tend to decrease over their life cycle. In addition, the recent economic contraction has significantly increased the pressure on our customers to seek lower prices from their suppliers. As a result, our customers are likely to continue to demand lower prices from us. To maintain our margins and remain profitable, we must continue to meet our customers' design needs while reducing costs through efficient raw material procurement and process and product improvements. Our profit margins will suffer if we are unable to reduce our costs of production as sales prices decline.

An inability to adequately respond to changes in technology may decrease our sales.

Pulse operates in an industry characterized by rapid change caused by the frequent emergence of new technologies. Generally, we expect life cycles for our

## Edgar Filing: TECHNITROL INC - Form 10-Q

products in the electronic components industry to be relatively short. This requires us to anticipate and respond rapidly to changes in industry standards and customer needs and to develop and introduce new and enhanced products on a timely and cost effective basis. Our engineering and development teams place a priority on working closely with our customers to design innovative products and improve our manufacturing processes. Our inability to react to changes in technology quickly and efficiently may decrease our sales and profitability.

If our inventories become obsolete, our future performance and operating results will be adversely affected.

The life cycles of our products depend heavily upon the life cycles of the end products into which our products are designed. Many of Pulse's products have very short life cycles which are measured in quarters. Products with short life cycles require us to closely manage our production and inventory levels. Inventory may become obsolete because of adverse changes in end market demand. During market slowdowns, this may result in significant charges for inventory write-offs, as was the case during 2001. Our future operating results may be adversely affected by material levels of obsolete or excess inventories.

An inability to capitalize on our recent or future acquisitions may adversely affect our business.

In recent years we have completed several acquisitions. We continually seek acquisitions to grow our business. We may fail to derive significant benefits from our acquisitions. In addition, if we fail to achieve sufficient financial performance from an acquisition, goodwill and other intangibles could become impaired, resulting in our recognition of a loss. In 2002, we recorded a goodwill impairment charge of \$15.7 million related to AMI Doduco and a trade name impairment charge of \$32.1 million related to Pulse. In 2003, we recorded an equity method investment loss of \$8.7 million related to our investment in FRE. The degree of success of any of our acquisitions depends on our ability to:

- o successfully integrate or consolidate acquired operations into our existing businesses;
- o identify and take advantage of cost reduction opportunities; and
- o further penetrate the markets for the product capabilities acquired.

Page 22 of 34

Integration of acquisitions may take longer than we expect and may never be achieved to the extent originally anticipated. This could result in slower than anticipated business growth or higher than anticipated costs. In addition, acquisitions may:

- o cause a disruption in our ongoing business;
- o distract our managers;
- o unduly burden our other resources; and
- o result in an inability to maintain our historical standards, procedures and controls.

Integration of acquisitions into the acquiring segment may limit the ability of investors to track the performance of individual acquisitions and to analyze trends in our operating results.

## Edgar Filing: TECHNITROL INC - Form 10-Q

Our historical practice has been to quickly integrate acquisitions into the existing business of the acquiring segment and to report financial performance on the segment level. As a result of this practice, we do not separately track the stand-alone performance of acquisitions after the date of the transaction. Consequently, investors cannot quantify the financial performance and success of any individual acquisition or the financial performance and success of a particular segment excluding the impact of acquisitions. In addition, our practice of quickly integrating acquisitions into the financial performance of each segment may limit the ability of investors to analyze any trends in our operating results over time.

An inability to identify additional acquisition opportunities may slow our future growth.

We intend to continue to identify and consummate additional acquisitions to further diversify our business and to penetrate important markets. We may not be able to identify suitable acquisition candidates at reasonable prices. Even if we identify promising acquisition candidates, the timing, price, structure and success of future acquisitions are uncertain. An inability to consummate attractive acquisitions may reduce our growth rate and our ability to penetrate new markets.

If our customers terminate their existing agreements, or do not enter into new agreements or submit additional purchase orders for our products, our business will suffer.

Most of our sales are made on a purchase order basis as needed by our customers. In addition, to the extent we have agreements in place with our customers, most of these agreements are either short term in nature or provide our customers with the ability to terminate the arrangement with little or no prior notice. Our contracts typically do not provide us with any material recourse in the event of non-renewal or early termination. We will lose business and our revenues will decrease if a significant number of customers:

- o do not submit additional purchase orders;
- o do not enter into new agreements with us; or
- o elect to terminate their relationship with us.

If we do not effectively manage our business in the face of fluctuations in the size of our organization, our business may be disrupted.

We have grown rapidly over the last ten years, both organically and as a result of acquisitions. However, in 2001 and 2002 we significantly reduced our workforce and facilities in response to a dramatic decrease in demand for our products due to prevailing global market conditions. These rapid fluctuations place strains on our resources and systems. If we do not effectively manage our resources and systems, our business may suffer.

Uncertainty in demand for our products may result in increased costs of production and an inability to service our customers.

We have very little visibility into our customers' purchasing patterns and are highly dependent on our customers' forecasts. These forecasts are non-binding and often highly unreliable. Given the fluctuation in growth rates and cyclical demand for our products, as well as our reliance on often imprecise customer forecasts, it is difficult to accurately manage our production schedule, equipment and personnel needs and our raw material and working capital requirements. Our failure to effectively manage these issues may result in:

- o production delays;
- o increased costs of production;
- o an inability to make timely deliveries; and
- o a decrease in profits.

A decrease in availability or increase in cost of our key raw materials could adversely affect our profit margins.

We use several types of raw materials in the manufacturing of our products, including:

- o precious metals such as silver;
- o base metals such as copper and brass; and
- o ferrite cores.

Some of these materials are produced by a limited number of suppliers. From time to time, we may be unable to obtain these raw materials in sufficient quantities or in a timely manner to meet the demand for our products. The lack of availability or a delay in obtaining any of the raw materials used in our products could adversely affect our manufacturing costs and profit margins. In addition, if the price of our raw materials increases significantly over a short period of time, customers may be unwilling to bear the increased price for our products and we may be forced to sell our products containing these materials at prices that reduce our profit margins.

Some of our raw materials, such as precious metals, are considered commodities and are subject to price volatility. We attempt to limit our exposure to fluctuations in the cost of precious materials, including silver, by holding the majority of our precious metal inventory through leasing or consignment arrangements with our suppliers. We then typically purchase the precious metal from our supplier at the current market price on the day after delivery to our customer and pass this cost on to our customer. In addition, leasing and consignment costs have historically been substantially below the costs to borrow funds to purchase the precious metals. We currently have four consignment or leasing agreements related to precious metals, all of which generally have one year terms with varying maturity dates, but can be terminated by either party with 30 days' prior notice. Our results of operations and liquidity will be negatively impacted if:

- o we are unable to enter into new leasing or consignment arrangements with similarly favorable terms after our existing agreements terminate, or
- o our leasing or consignment fees increase significantly in a short period of time and we are unable to recover these increased costs through higher sale prices.

Fees charged by the consignor are driven by interest rates and the market price of the consigned material. The market price of the consigned material is determined by the supply of and the demand for the material. Consignment fees will increase if interest rates or the price of the consigned material increase.

Competition may result in lower prices for our products and reduced sales.

## Edgar Filing: TECHNITROL INC - Form 10-Q

Both Pulse and AMI Doduco frequently encounter strong competition within individual product lines from various competitors throughout the world. We compete principally on the basis of:

- o product quality and reliability;
- o global design and manufacturing capabilities;
- o breadth of product line;
- o customer service;
- o price; and
- o on-time delivery.

Our inability to successfully compete on any or all of the above factors may result in reduced sales.

Page 24 of 34

Our backlog is not an accurate measure of future revenues and is subject to customer cancellation.

While our backlog consists of firm accepted orders with an express release date generally scheduled within nine months of the order, many of the orders that comprise our backlog may be canceled by customers without penalty. It is widely known that customers in the electronics industry have on occasion double and triple-ordered components from multiple sources to ensure timely delivery when quoted lead-time is particularly long. In addition, customers often cancel orders when business is weak and inventories are excessive, a process that we experienced in the recent contraction. Although backlog should not be relied on as an indicator of our future revenues, our results of operations could be adversely impacted if customers cancel a material portion of orders in our backlog.

Fluctuations in foreign currency exchange rates may adversely affect our operating results.

We manufacture and sell our products in various regions of the world and export and import these products to and from a large number of countries. Fluctuations in exchange rates could negatively impact our cost of production and sales that, in turn, could decrease our operating results and cash flow. Although we engage in limited hedging transactions, including foreign currency contracts, to reduce our transaction and economic exposure to foreign currency fluctuations, these measures may not eliminate or substantially reduce our risk in the future.

Our international operations subject us to the risks of unfavorable political, regulatory, labor and tax conditions in other countries.

We manufacture and assemble some of our products in foreign locations, including the PRC, and Turkey. In addition, approximately 76% of our revenues for the year ended December 26, 2003 were derived from sales to customers outside the United States. Our future operations and earnings may be adversely affected by the risks related to, or any other problems arising from, operating in international markets.

Risks inherent in doing business internationally may include:

## Edgar Filing: TECHNITROL INC - Form 10-Q

- o economic and political instability;
- o expropriation and nationalization;
- o trade restrictions and disruptions;
- o capital and exchange control programs;
- o transportation delays;
- o foreign currency fluctuations; and
- o unexpected changes in the laws and policies of the United States or of the countries in which we operate.

In particular, Pulse has substantially all of its non-consumer manufacturing operations in the PRC. Our presence in the PRC has enabled Pulse to maintain lower manufacturing costs and to flexibly adjust our work force to demand levels for our products. Although the PRC has a large and growing economy, the potential economic, political, legal and labor developments entail uncertainties and risks. While the PRC has been receptive to foreign investment, we cannot be certain that its current policies will continue indefinitely into the future. In the event of any changes that adversely affect our ability to conduct our operations within the PRC, our business will suffer. The Pulse Consumer Division is headquartered in Italy, with substantially all of its manufacturing operations in Turkey. These operations in Turkey are subject to unique risks, including those associated with continuing Middle East geo-political events.

We have benefited over recent years from favorable tax treatment as a result of our international operations. We operate in foreign countries where we realize favorable income tax treatment relative to the U.S. statutory rate. We have also been granted or benefited from special tax incentives in other countries including the PRC and Turkey. This favorable situation could change if these countries were to increase rates or revoke the special tax incentives, or if we discontinue our manufacturing operations in any of these countries and do not substitute the operations with operations in other locations with favorable tax incentives. Accordingly, in the event of changes in laws and regulations affecting our international operations, we may not be able to continue to take advantage of similar benefits in the future.

Page 25 of 34

Shifting our operations between regions may entail considerable expense.

In the past we have shifted our operations from one region to another in order to maximize manufacturing and operational efficiency. We may close one or more additional factories in the future. This could entail significant one-time earnings charges to account for severance, equipment write-offs or write-downs and moving expenses. In addition, as we implement transfers of our operations we may experience disruptions, including strikes or other types of labor unrest resulting from layoffs or termination of employees.

Liquidity requirements could necessitate movements of existing cash balances which may be subject to restrictions or cause unfavorable tax and earnings consequences.

A significant portion of our cash is held offshore by our international subsidiaries and is predominantly denominated in U.S. dollars. While we intend

## Edgar Filing: TECHNITROL INC - Form 10-Q

to use cash held overseas to fund our international operation and growth, if we encounter a significant domestic need for liquidity that we cannot fulfill through borrowings, equity offerings, or other internal or external sources, we may experience unfavorable tax and earnings consequences if this cash is transferred to the United States. These adverse consequences would occur if the transfer of cash into the United States is taxed without sufficient foreign tax credit to offset the U.S. tax liability, resulting in lower earnings and cash flow. In addition, we may be prohibited from transferring cash from the PRC. With the exception of approximately \$13.0 million of non-cash retained earnings as of October 1, 2004 in primarily the PRC that are restricted in accordance with the PRC Foreign Investment Enterprises Law, substantially all retained earnings are free from legal or contractual restrictions. The PRC Foreign Investment Enterprise Law restricts 10% of our net earnings in the PRC, up to a maximum amount equal to 50% of the total capital we have invested in the PRC. We have not experienced any significant liquidity restrictions in any country in which we operate and none are presently foreseen. However, foreign exchange ceilings imposed by local governments and the sometimes-lengthy approval processes which some foreign governments require for international cash transfers may delay our internal cash movements from time to time.

Losing the services of our executive officers or our other highly qualified and experienced employees could adversely affect our business.

Our success depends upon the continued contributions of our executive officers and management, many of whom have many years of experience and would be extremely difficult to replace. We must also attract and maintain experienced and highly skilled engineering, sales and marketing and managerial personnel. Competition for qualified personnel is intense in our industries, and we may not be successful in hiring and retaining these people. If we lose the services of our executive officers or cannot attract and retain other qualified personnel, our business could be adversely affected.

Public health epidemics (such as Severe Acute Respiratory Syndrome) or other natural disasters (such as earthquakes or fires) may disrupt operations in affected regions and affect operating results.

We maintain extensive manufacturing operations in the PRC and Turkey, as do many of our customers and suppliers. A sustained interruption of our manufacturing operations, or those of our customers or suppliers, as a result of complications from severe acute respiratory syndrome or another public health epidemic or other natural disasters, could have a material adverse effect on our business and results of operations.

The unavailability of insurance against certain business risks may adversely affect our future operating results.

As part of our comprehensive risk management program, we purchase insurance coverage against certain business risks. If any of our insurance carriers discontinues an insurance policy or significantly reduces available coverage and we cannot find another insurance carrier to write comparable coverage, we may be subject to uninsured losses which may adversely affect our operating results.

Environmental liability and compliance obligations may affect our operations and results.

Our manufacturing operations are subject to a variety of environmental laws and regulations governing:

- o air emissions;

## Edgar Filing: TECHNITROL INC - Form 10-Q

- o waste water discharges;
- o the storage, use, handling, disposal and remediation of hazardous substances, wastes and chemicals; and
- o employee health and safety.

If violations of environmental laws should occur, we could be held liable for damages, penalties, fines and remedial actions. Our operations and results could be adversely affected by any material obligations arising from existing laws, as well as any required material modifications arising from new regulations that may be enacted in the future. We may also be held liable for past disposal of hazardous substances generated by our business or businesses we acquire. In addition, it is possible that we may be held liable for contamination discovered at our present or former facilities.

We are aware of contamination at two locations. In Sinsheim, Germany, there is a shallow groundwater and soil contamination that is naturally decreasing over time. The German environmental authorities have not required corrective action to date. In addition, property in Leesburg, Indiana, which was acquired with our acquisition of GTI in 1998, is the subject of a 1994 Corrective Action Order to GTI by the Indiana Department of Environmental Management (IDEM). The order requires us to investigate and take corrective actions. Substantially all of the corrective actions relating to impacted soil have been taken and IDEM has issued us no further action letters for the remediated areas. Studies and analysis are ongoing with respect to a ground water issue. We anticipate making additional environmental expenditures in the future to continue our environmental studies, analysis and remediation activities with respect to the ground water. Based on current knowledge, we do not believe that any future expenses or liabilities associated with environmental remediation will have a material impact on our operations or our consolidated financial position, liquidity or operating results; however, we may be subject to additional costs and liabilities if the scope of the contamination or the cost of remediation exceeds our current expectations.

Page 27 of 34

### Item 3: Quantitative and Qualitative Disclosures about Market Risk

There were no material changes in market risk exposures that affect the quantitative and qualitative disclosures presented in our Form 10-K for the year ended December 26, 2003.

### Item 4: Controls and Procedures

As of the end of the period covered by this report ("Evaluation Date"), we evaluated the effectiveness of the design and operation of our "disclosure controls and procedures" for purposes of filing reports under the Securities Exchange Act of 1934 ("Exchange Act"). This evaluation was done under the supervision and with the participation of our management, including our Principal Executive Officer ("PEO") and Principal Financial Officer ("PFO"). Disclosure controls and procedures are designed with the objective of ensuring that information required to be disclosed in our reports filed under the Exchange Act, such as this periodic report on Form 10-Q, is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms. Disclosure controls and procedures are also designed with the objective of ensuring that such information is accumulated and communicated to our management, including the PEO and the PFO, as appropriate to allow timely



## Edgar Filing: TECHNITROL INC - Form 10-Q

decisions regarding required disclosure.

Our management, including the PEO and PFO, does not expect that our disclosure controls and procedures will prevent all error and all fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of a simple human or systems error. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the controls. The design of any system of controls also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Over time, controls may become inadequate because of changes in conditions, or the degree of compliance with the policies or procedures may deteriorate. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected timely, in the ordinary course of business.

We plan to evaluate our disclosure controls and procedures on a quarterly basis in accordance with the Exchange Act so that the conclusions concerning the effectiveness of controls can be reported in our quarterly reports on Form 10-Q and our annual reports on Form 10-K. Our disclosure controls and procedures are also evaluated on an ongoing basis by personnel in our finance organization and our internal audit group in connection with their audit and review activities. The overall goals of these various evaluation activities are to monitor our disclosure controls and procedures over financial reporting and to make modifications as necessary. Our intent in this regard is that these controls and procedures will be maintained as dynamic systems that change to include improvements and corrections as conditions warrant.

Among other matters, we sought in our evaluation to determine whether there were any "significant deficiencies" or "material weaknesses" in our internal controls and procedures, and whether we had identified any acts of fraud involving personnel who have a significant role in our internal controls and procedures. This information was important both for the controls evaluation generally and because the PEO and PFO certification requirement under items 5 and 6 of Section 302 of the Sarbanes-Oxley Act of 2002 mandates that they disclose that information to our audit committee and to our independent auditors and to report on related matters in this section of the quarterly report on Form 10-Q. In the professional auditing literature, "significant deficiencies" are referred to as those control issues that could have a significant adverse effect on our ability to record, process, summarize and report financial data in the financial statements. A "material weakness" is defined in the auditing literature as a particularly serious reportable condition where the internal control does not reduce to a relatively low level the risk that misstatements caused by error or fraud may occur in amounts that would be material in relation to the financial statements and not be detected within a timely period by employees in the normal course of performing their assigned functions. We also sought to deal with other internal control matters

in the controls evaluation, and where appropriate, to consider what revision, improvement and/or correction to make. In addition, our evaluation of the impact

## Edgar Filing: TECHNITROL INC - Form 10-Q

on our controls and procedures of our recent acquisition of a controlling interest in Full Rise Electronics Co., Ltd. is still in process.

Subject to the matters discussed in the preceding paragraph, and based upon an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures pursuant to Exchange Act Rule 13a-15, our PEO and PFO have concluded that, subject to the inherent limitations noted above, as of the Evaluation Date our disclosure controls and procedures are effective to ensure that material information relating to the company and our consolidated subsidiaries is made known to management, including the PEO and PFO, particularly during the period when our periodic reports are being prepared. There has been no change in our internal controls over financial reporting during the quarter ended October 1, 2004, that has materially affected, or is reasonably likely to materially affect our internal controls over financial reporting.

Page 29 of 34

### PART II. OTHER INFORMATION

Item 1	Legal Proceedings	None
Item 2	Changes in Securities and Use of Proceeds	None
Item 3	Defaults Upon Senior Securities	None
Item 4	Submission of Matters to a Vote of Security Holders	None
Item 5	Other Information	None
Item 6	Exhibits and Reports on Form 8-K	
	(a) Exhibits	
	The Exhibit Index is on page 31.	
	(b) Reports On Form 8-K	
	We filed a current report on Form 8-K dated July 19, 2004. This report pertains to our press release issued to announce our second quarter 2004 results.	

Page 30 of 34

### Exhibit Index

2.1	Share Purchase Agreement, dated as of January 9, 2003, by Pulse Electronics (Singapore) Pte. Ltd. and Forfin Holdings B.V. that are signatories thereto (incorporated by reference to Exhibit 2 to our Form 8-K dated January 10, 2003).
3.1	Amended and Restated Articles of Incorporation (incorporated by reference to Exhibit 3.1 to our Form 10-K for the year ended December 26, 2003)
3.3	By-laws (incorporated by reference to Exhibit 3.3 to our Form 10-K for the year ended December 27, 2002).

## Edgar Filing: TECHNITROL INC - Form 10-Q

- 4.1 Rights Agreement, dated as of August 30, 1996, between Technitrol, Inc. and Registrar and Transfer Company, as Rights Agent (incorporated by reference to Exhibit 3 to our Registration Statement on Form 8-A dated October 24, 1996).
- 4.2 Amendment No. 1 to the Rights Agreement, dated March 25, 1998, between Technitrol, Inc. and Registrar and Transfer Company, as Rights Agent (incorporated by reference to Exhibit 4 to our Registration Statement on Form 8-A/A dated April 10, 1998).
- 4.3 Amendment No. 2 to the Rights Agreement, dated June 15, 2000, between Technitrol, Inc. and Registrar and Transfer Company, as Rights Agent (incorporated by reference to Exhibit 5 to our Registration Statement on Form 8-A/A dated July 5, 2000).
- 10.1 Technitrol, Inc. 2001 Employee Stock Purchase Plan (incorporated by reference to Exhibit 4.1 to our Registration Statement on Form S-8 dated June 28, 2001, File Number 333-64060).
  - 10.1(1) Form of Stock Option Agreement
- 10.2 Technitrol, Inc. Restricted Stock Plan II, as amended and restated as of January 1, 2001 (incorporated by reference to Exhibit C, to our Definitive Proxy on Schedule 14A dated March 28, 2001).
- 10.3 Technitrol, Inc. 2001 Stock Option Plan (incorporated by reference to Exhibit 4.1 to our Registration Statement on Form S-8 dated June 28, 2001, File Number 333-64068).
- 10.4 Technitrol, Inc. Board of Directors Stock Plan (incorporated by reference to Exhibit 4.1 to our Registration Statement on Form S-8 dated June 1, 1998, File Number 333-55751).
- 10.5 Revolving Credit Agreement, by and among Technitrol, Inc. and certain of its subsidiaries, JPMorgan Chase Bank. as Agent and Lender, and certain other Lenders that are signatories thereto, dated as of June 17, 2004. (incorporated by reference to Exhibit 10.5 to our Form 10-Q for the three months ended June 25, 2004)
- 10.6 Lease Agreement, dated October 15, 1991, between Ridilla-Delmont and AMI Doduco, Inc. (formerly known as Advanced Metallurgy Incorporated), as amended September 21, 2001 (incorporated by reference to Exhibit 10.6 to the Company's Amendment No. 1 to Registration Statement on Form S-3 dated February 28, 2002, File Number 333-81286).
- 10.7 Incentive Compensation Plan of Technitrol, Inc. (incorporated by reference to Exhibit 10.7 to Amendment No. 1 to our Registration Statement on Form S-3 filed on February 28, 2002, File Number 333-81286).
- 10.8 Technitrol, Inc. Supplemental Retirement Plan, amended and restated January 1, 2002 (incorporated by reference to Exhibit 10.8 to Amendment No. 1 to our Registration Statement on Form S-3 filed on February 28, 2002, File Number 333-81286).
- 10.9 Agreement between Technitrol, Inc. and James M. Papada, III, dated July 1, 1999, as amended April 23, 2001, relating to the Technitrol, Inc. Supplemental Retirement Plan (incorporated by reference to Exhibit 10.9 to Amendment No. 1 to our Registration Statement on Form S-3 filed on February 28, 2002, File Number 333-81286).

## Edgar Filing: TECHNITROL INC - Form 10-Q

Page 31 of 34

### Exhibit Index, continued

- 10.10 Letter Agreement between Technitrol, Inc. and James M. Papada, III, dated April 16, 1999, as amended October 18, 2000 (incorporated by reference to Exhibit 10.10 to Amendment No. 1 to our Registration Statement on Form S-3 filed on February 28, 2002, File Number 333-81286).
- 10.10(1) Letter Agreement between Technitrol, Inc. and James M. Papada, III dated July 1, 2004
- 10.11 Form of Indemnity Agreement (incorporated by reference to Exhibit 10.11 to our Form 10-K for the year ended December 27, 2002).
- 10.12 Technitrol Inc. Supplemental Savings Plan (incorporated by reference to Exhibit 10.15 to our Form 10-Q for the three months ended September 26, 2003)
- 10.13 Technitrol, Inc. 401(K) Retirement Savings Plan, as amended (incorporated by reference to post-effective Amendment No. 1, to our Registration Statement on Form S-8 filed on October 31, 2003, File Number 033-35334) (incorporated by reference to Exhibit 10.16 to our Form 10-Q for the three months ended March 26, 2003).
- 10.14 Pulse Engineering, Inc. 401(K) Plan as amended (incorporated by reference to post-effective Amendment No. 1, to our Registration Statement on Form S-8 filed on October 31, 2003, File Number 033-94073) (incorporated by reference to Exhibit 10.16 to our Form 10-Q for the three months ended March 26, 2003).
- 10.15 Amended and Restated short-term Incentive Plan (incorporated by reference to Exhibit 10.15 to Form 10-Q for the three months ended June 25, 2004)
- 10.16 Amended and Restated Consignment Agreement, dated May 27, 1997, by and among Rhode Island Hospital Trust National Bank, Doduco GmbH, Doduco Espana, S.A. and Technitrol, Inc.
- 10.16(1) First Amendment to Amended and Restated Consignment Agreement, dated August, 1997, by and among Rhode Island Hospital Trust National Bank, Doduco GmbH, Doduco Espana, S.A. and Technitrol, Inc.
- 10.16(2) Second Amendment to Amended and Restated Consignment Agreement, dated September 10, 1997, by and among Rhode Island Hospital Trust National Bank, Doduco GmbH, Doduco Espana, S.A. and Technitrol, Inc.
- 10.16(3) Third Amendment to Amended and Restated Consignment Agreement, dated October 1, 1997, by and among Rhode Island Hospital Trust National Bank, Doduco GmbH, Doduco Espana, S.A. and Technitrol, Inc.
- 10.16(4) Fourth Amendment to Amended and Restated Consignment Agreement, dated April 14, 1998, by and among Rhode Island Hospital Trust National Bank, Doduco GmbH, Doduco Espana, S.A. and Technitrol, Inc.
- 10.16(5) Fifth Amendment to Amended and Restated Consignment Agreement, dated May 2000 by and among AMI Doduco, GmbH formerly known as Albert Thorp Holding GmbH, also known as Doduco GmbH, AMI Doduco Espana, S.A. also known as Doduco Espana, S.A., AMI Doduco Italia, S.R.L.,

## Edgar Filing: TECHNITROL INC - Form 10-Q

Technitrol, Inc. and Sovereign Bank, as successor in interest to Fleet National Bank, formerly known as Bank Boston N.A., successor by merger with Rhode Island Hospital Trust National Bank.

- 10.17 Consignment Agreement dated December 18, 1997, among Fleet Precious Metals Inc., Technitrol, Inc. and Advanced Metallurgy, Incorporated.

Page 32 of 34

### Exhibit Index, continued

- 10.17(1) First Amendment to Consignment Agreement dated June 23, 1998, among Fleet Precious Metals, Inc., Technitrol, Inc. and Advanced Metallurgy, Incorporated.
- 10.17(2) Second Amendment to Consignment Agreement dated September 25, 2000 among Fleet Precious Metals Inc., Technitrol, Inc. and AMI Doduco, Inc.
- 10.17(3) Letter Amendment to Consignment Agreement dated December 15, 2003, among Fleet Precious Metals, Inc., Technitrol, Inc., and AMI Doduco, Inc.
- 10.17(4) Letter Amendment to Consignment Agreement dated January 29, 2004, among Fleet Precious Metals, Inc., Technitrol, Inc. and AMI Doduco, Inc.
- 10.18 Silver Lease Agreement dated April 9, 1996 between Standard Chartered Bank Mocatta Bullion - New York and Advanced Metallurgy, Inc. and Guarantee dated April 29, 1996 by Technitrol, Inc.
- 10.18(1) Letter Agreement dated April 9, 1996 between Standard Chartered Bank Mocatta Bullion - New York and Advanced Metallurgy, Inc.
- 10.18(2) Amendment to Silver Lease Agreement dated February 14, 1997 between Standard Chartered Bank Mocatta Bullion - New York and Advanced Metallurgy Inc.
- 10.18(3) Amendment to Silver Lease Agreement dated November 3, 1997 between Standard Chartered Bank Mocatta Bullion - New York and Advanced Metallurgy Inc.
- 10.18(4) Amendment to Silver Lease Agreement dated May 21, 2003 between Standard Chartered Bank Mocatta Bullion - New York and AMI Doduco, Inc.
- 10.19 Consignment Agreement dated September 24, 2004 between Mitsui & Co. Precious Metals Inc., and AMI Doduco, Inc.
- 10.20 Unlimited Guaranty dated December 16, 1996 by Technitrol, Inc. in favor of Rhode Island Hospital Trust National Bank.
- 10.21 Corporate Guaranty dated November 1, 2004 by Technitrol, Inc. in favor of Mitsui & Co. Precious Metals, Inc.
- 31.1 Certification of Principal Executive Officer pursuant to Section 302(a) of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification of Principal Financial Officer pursuant to Section 302(a) of the Sarbanes-Oxley Act of 2002.

Edgar Filing: TECHNITROL INC - Form 10-Q

- 32.1 Certification of Principal Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2 Certification of Principal Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

Page 33 of 34

Signatures

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Technitrol, Inc.

-----  
(Registrant)

November 3, 2004

-----  
(Date)

/s/Drew A. Moyer

-----  
Drew A. Moyer  
Senior Vice President and Chief  
Financial Officer (duly authorized  
officer, principal financial and  
accounting officer)

Page 34 of 34