

Edgar Filing: TECHNITROL INC - Form 10-Q

TECHNITROL INC
Form 10-Q
July 30, 2003

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 June 27, 2003, 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 July 25, 2003: 40,182,632

Page 1 of 32

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 | June 27, 2003 ---- (unaudited) | December 27, 2002 ---- |
|--|---|------------------------------|
| Current assets: | | |
| Cash and cash equivalents | \$ 115,830 | \$ 205,075 |
| Trade receivables, net | 91,866 | 65,185 |
| Inventories | 66,010 | 60,588 |
| Prepaid expenses and other current assets | 18,182 | 13,878 |
| | ----- | ----- |
| Total current assets | 291,888 | 344,726 |
| Property, plant and equipment | 200,163 | 163,147 |
| Less accumulated depreciation | 109,442 | 98,286 |
| | ----- | ----- |
| Net property, plant and equipment | 90,721 | 64,861 |
| Deferred income taxes | 10,518 | 11,743 |
| Goodwill and other intangibles, net | 150,920 | 100,768 |
| Other assets | 25,035 | 25,608 |
| | ----- | ----- |
| | \$ 569,082 | \$ 547,706 |
| | ===== | ===== |
| Liabilities and Shareholders' Equity | | |
| Current liabilities: | | |
| Current installments of long-term debt | \$ 83 | \$ 10,667 |
| Accounts payable | 39,172 | 28,791 |
| Accrued expenses | 72,552 | 69,689 |
| | ----- | ----- |
| Total current liabilities | 111,807 | 109,147 |
| Long-term liabilities: | | |
| Long-term debt, excluding current installments | 6,203 | 5,681 |
| Other long-term liabilities | 12,744 | 10,501 |
| Shareholders' equity: | | |
| Common stock and additional paid-in capital | 207,730 | 207,033 |
| Retained earnings | 229,490 | 220,836 |
| Other | 1,108 | (5,492) |
| | ----- | ----- |
| Total shareholders' equity | 438,328 | 422,377 |
| | ----- | ----- |
| | \$ 569,082 | \$ 547,706 |
| | ===== | ===== |

See accompanying Notes to Unaudited Consolidated Financial Statements.

Edgar Filing: TECHNITROL INC - Form 10-Q

Consolidated Statements of Operations

(Unaudited)

In thousands, except per share data

| | Three Months Ended | | June 28, 2002 |
|---|--------------------|------------------|------------------|
| | June 27, 2003 | June 28, 2002 | |
| Net sales | \$ 125,706 | \$ 106,185 | \$ 248,000 |
| Costs and expenses: | | | |
| Cost of sales | 92,888 | 81,519 | 185,000 |
| Selling, general and administrative expenses | 24,558 | 22,372 | 48,000 |
| Restructuring and unusual and infrequent items | 505 | 43,098 | 4,000 |
| | ----- | ----- | ----- |
| Total costs and expenses applicable to sales | 117,951 | 146,989 | 237,000 |
| | ----- | ----- | ----- |
| Operating profit (loss) | 7,755 | (40,804) | 10,000 |
| Other (expense) income: | | | |
| Interest expense, net | (257) | (133) | (1,000) |
| Equity method investment earnings | 233 | -- | (1,000) |
| Other | (445) | (542) | (1,000) |
| | ----- | ----- | ----- |
| Total other expense | (469) | (675) | (1,000) |
| | ----- | ----- | ----- |
| Earnings (loss) before taxes and cumulative effect of accounting change | 7,286 | (41,479) | 10,000 |
| Income taxes (benefit) | 1,266 | (12,434) | 1,000 |
| | ----- | ----- | ----- |
| Net earnings (loss) before cumulative effect of accounting change | 6,020 | (29,045) | 8,000 |
| Cumulative effect of accounting change, net of income taxes | -- | -- | -- |
| | ----- | ----- | ----- |
| Net earnings (loss) | \$ 6,020 | \$ (29,045) | \$ 8,000 |
| | ===== | ===== | ===== |
| Basic earnings (loss) per share before cumulative effect of accounting change | \$ 0.15 | \$ (0.75) | \$ 0.00 |
| Cumulative effect of accounting change, net of income taxes | -- | -- | -- |
| | ----- | ----- | ----- |
| Basic earnings (loss) per share | \$ 0.15 | \$ (0.75) | \$ 0.00 |
| | ===== | ===== | ===== |
| Diluted earnings (loss) per share before cumulative effect of accounting change | \$ 0.15 | \$ (0.75) | \$ 0.00 |
| Cumulative effect of accounting change, net of income taxes | -- | -- | -- |
| | ----- | ----- | ----- |
| Diluted earnings (loss) per share | \$ 0.15 | \$ (0.75) | \$ 0.00 |
| | ===== | ===== | ===== |

Edgar Filing: TECHNITROL INC - Form 10-Q

See accompanying Notes to Unaudited Consolidated Financial Statements.

Page 3 of 32

Technitrol, Inc. and Subsidiaries
 Consolidated Statements of Cash Flows
 (Unaudited)
 In thousands

| | Six Months E | J |
|--|--------------|-------|
| | June 27, | |
| | 2003 | |
| | ---- | |
| Cash flows from operating activities: | | |
| Net earnings (loss) | \$ 8,654 | \$ |
| Adjustments to reconcile net earnings to net cash provided by operating activities: | | |
| Depreciation and amortization | 11,793 | |
| Tax benefit from employee stock compensation | 123 | |
| Amortization of stock incentive plan expense | 1,011 | |
| Restructuring and unusual and infrequent items, net of cash payments | 600 | |
| Cumulative effect of accounting change, net of income taxes | -- | |
| Loss on disposal of assets | 697 | |
| Trade name write off, net of tax effect | -- | |
| Changes in assets and liabilities, net of effect of acquisitions: | | |
| Trade receivables | 96 | |
| Inventories | 6,212 | |
| Prepaid expenses and other current assets | (3,732) | |
| Accounts payable and accrued expenses | (5,548) | |
| Other, net | (5,720) | |
| | ----- | ----- |
| Net cash provided by operating activities | 14,186 | |
| | ----- | ----- |
| Cash flows from investing activities: | | |
| Acquisitions, net of cash acquired | (81,926) | |
| Capital expenditures | (3,499) | |
| Proceeds from sale of property, plant and equipment | 347 | |
| | ----- | ----- |
| Net cash used in investing activities | (85,078) | |
| | ----- | ----- |
| Cash flows from financing activities: | | |
| Dividends paid | -- | |
| Principal payments of long-term debt | (11,794) | |
| Sale of stock through employee stock purchase plan | 481 | |
| Net proceeds from follow-on offering | -- | |
| | ----- | ----- |
| Net cash (used in) provided by financing activities | (11,313) | |
| | ----- | ----- |
| Net effect of exchange rate changes on cash | (7,040) | |
| | ----- | ----- |
| Net (decrease) increase in cash and cash equivalents | (89,245) | |

Edgar Filing: TECHNITROL INC - Form 10-Q

| | | |
|---|------------|-------------|
| Cash and cash equivalents at beginning of year | 205,075 | ----- |
| Cash and cash equivalents at June 27, 2003 and June 28, 2002 | \$ 115,830 | \$ ===== |

See accompanying Notes to Unaudited Consolidated Financial Statements.

Page 4 of 32

Technitrol, Inc. and Subsidiaries
Consolidated Statement of Changes in Shareholders' Equity
Six Months Ended June 27, 2003

(Unaudited)
In thousands

| | Common stock and paid-in capital | | Retained earnings | Deferred compensation |
|--|-------------------------------------|------------|----------------------|--------------------------|
| | Shares | Amount | ----- | ----- |
| Balance at December 27, 2002 | 40,130 | \$ 207,033 | \$ 220,836 | \$ (1,177) |
| Stock options, awards and related compensation | 16 | 330 | -- | 433 |
| Tax effect of stock compensation | -- | (123) | -- | -- |
| Stock issued under employee stock purchase plan | 36 | 490 | -- | -- |
| Currency translation adjustments | -- | -- | -- | -- |
| Net earnings | -- | -- | 8,654 | -- |
| Comprehensive income | | | | |
| Balance at June 27, 2003 | 40,182 | \$ 207,730 | \$ 229,490 | \$ (744) |
| | ===== | ===== | ===== | ===== |

See accompanying Notes to Unaudited Consolidated Financial Statements.

Page 5 of 32

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

Edgar Filing: TECHNITROL INC - Form 10-Q

Financial Statements included in Technitrol's Form 10-K filed for the year ended December 27, 2002. We sometimes refer to Technitrol as "we" or "our".

The results for the three months and six months ended June 27, 2003 and June 28, 2002 respectively, 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. Operating results for the six months ended June 27, 2003 are not necessarily indicative of annual results.

New Accounting Pronouncements In January 2003, the Financial Accounting Standards Board ("FASB") issued FASB Interpretation No. 46 Consolidation of Variable Interest Entities ("FIN 46"). FIN 46 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. We were required to adopt the provisions of FIN 46 for variable interest entities created after January 31, 2003, whereas it is otherwise effective June 15, 2003 for variable interest entities acquired before February 1, 2003. Adoption of this interpretation has not had a material effect on our revenue, operating results, financial position, or liquidity.

In December 2002, the FASB issued Statement No. 148, Accounting for Stock-Based Compensation, Transition and Disclosure, an amendment to Statement No. 123 ("SFAS 148"). SFAS 148 provides alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. In addition, SFAS 148 amends the disclosure requirements of Statement No. 123, Accounting for Stock-Based Compensation ("SFAS 123"), by requiring prominent disclosures in both annual and interim financial statements, about the method of accounting for stock-based employee compensation and the effect of the method used on reported results. We adopted the provisions of SFAS 123, as amended by SFAS 148, as of the beginning of our fiscal year in 2003. We used the prospective method of adoption, which recognizes expense for all employee awards granted, modified or settled after the beginning of the fiscal year in which the recognition provisions are first applied. Adoption of this standard did not have a material effect on our revenue, operating results, financial position or liquidity.

In November 2002, the FASB issued FASB Interpretation No. 45, Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees and Indebtedness of Others ("FIN 45"). FIN 45 elaborates on the disclosures to be made by a guarantor in its interim and annual financial statements about its obligations under certain guarantees that it has issued. FIN 45 also clarifies that a guarantor is required to recognize, at the inception of a guarantee, a liability for the fair value of the obligation undertaken in issuing the guarantee. We were required to adopt the provisions of FIN 45 on a prospective basis to guarantees issued or modified after December 31, 2002. We have not issued any guarantees for performance of third parties since December 31, 2002. Accordingly, adoption of this interpretation did not have a material effect on our revenue, operating results, financial position or liquidity.

In June 2002, the FASB issued Statement No. 146 Accounting for Costs Associated with Exit or Disposal Activities ("SFAS 146"). SFAS 146 superceded the Emerging Issues Task Force Issue No. 94-3, Liability Recognition for Certain Termination Benefits and Other Costs to Exit an Activity, ("EITF 94-3") The principal difference between SFAS 146 and EITF 94-3 is that SFAS 146 requires that a liability for a cost associated with an exit or disposal activity be

Edgar Filing: TECHNITROL INC - Form 10-Q

recognized when the liability is incurred. Under EITF 94-3, a liability for an exit cost was recognized at the date of an entity's commitment to an exit plan. As such, under SFAS 146, an entity's

Page 6 of 32

Technitrol, Inc. and Subsidiaries

Notes to Unaudited Consolidated Financial Statements, continued

(1) Accounting Policies, continued

commitment to a plan by itself, does not create a present obligation meeting the definition of a liability. SFAS 146 also established fair value as the objective for initial measurement of the liability. We were required to adopt the provisions of SFAS 146 for all exit or disposal activities initiated after December 15, 2002. These activities, which we refer to as restructuring and unusual and infrequent items, did have a material impact on our operating results in 2003. Although the underlying activities were material, the impact in changing from EITF 94-3 to SFAS 146 was not significant.

(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 Orsenigo, 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 adjusted preliminary purchase price was approximately \$83.8 million net of cash acquired, plus related acquisition costs and expenses. The fair value of net tangible assets acquired approximated \$12.3 million. Based on the fair value of assets acquired, the preliminary allocation of the unadjusted purchase price included \$18.6 million for manufacturing know-how, \$6.1 million for customer relationships, \$1.5 million for tradename and \$17.7 million allocated to goodwill. These fair value allocations are preliminary, and are subject to adjustment. All of the separately identifiable intangible assets will be 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. Eldor has formed the nucleus of a new consumer division in the Pulse segment and will be treated as a separate reporting unit for purposes of SFAS 142.

Excelsus Technologies, Inc.: In August 2001, we acquired all of the capital stock of Excelsus Technologies, Inc. ("Excelsus") based in Carlsbad, California. Excelsus produced customer-premises digital subscriber line filters and other broadband accessories. The acquisition was accounted for by the purchase method of accounting. The purchase price was approximately \$85.9 million, net of \$4.8 million of cash acquired. The fair value of net assets acquired approximated \$18.2 million. Based on the fair value of the assets acquired, the allocation of the purchase price included \$40.0 million for trade names, \$27.0 million for goodwill and \$8.0 million for technology. The technology intangible is subject to amortization and is estimated to have a 5-year life. In order to fund the purchase price, we used approximately \$19.0 million of cash on-hand and borrowed approximately \$74.0 million under our existing credit facility with a syndicate of commercial banks.

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 for us under a cooperation

Edgar Filing: TECHNITROL INC - Form 10-Q

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 which is accounted for under the equity accounting method. We also have an option to purchase additional shares of common stock in FRE in the future and we expect to make an additional investment during fiscal 2003. See discussion in "Liquidity and Capital Resources" section of this report. Also refer to Note 8 "Equity Method Investment".

Page 7 of 32

Technitrol, Inc. and Subsidiaries

Notes to Unaudited Consolidated Financial Statements, continued

(3) Restructuring

In the three months ended June 27, 2003, we accrued \$0.5 million for severance and related payments comprising \$0.2 million for the elimination of manufacturing and positions at AMI Doduco, and \$0.3 million for severance and related payments at Pulse facilities in France and the United Kingdom. The majority of these accruals is expected to be utilized by the end of the third quarter in 2003.

In the three months ended March 28, 2003, we accrued \$3.9 million for severance and related payments comprising \$1.7 million for the elimination of manufacturing and support positions at AMI Doduco's facility in Germany, \$1.6 million to finalize the shutdown of a redundant facility in Spain acquired from Engelhard-ECAL by a subsidiary of AMI Doduco and \$0.6 million for the elimination of manufacturing and support positions at Pulse, primarily in France and Mexico. The majority of these accruals were utilized by the end of the second quarter of 2003.

In the three months ended June 28, 2002, we accrued \$11.0 million in total for the shutdown of our Philippines manufacturing facility, severance and related payments, asset impairments and plant consolidations. The \$11.0 million charge included \$3.8 million for the Philippines shutdown of which \$1.4 million represented severance and related payments and \$2.4 million was recorded for asset writedowns. Pulse accrued an additional \$1.0 million for severance and related payments for approximately 67 personnel on a worldwide basis and \$4.1 million for asset impairments primarily involved in Asian manufacturing. AMI Doduco accrued \$2.1 million of restructuring and unusual and infrequent items in the second quarter of 2002. This comprised approximately \$1.0 million for severance and related payments for approximately 45 people in Europe and \$1.1 million for asset impairments, writedowns and relocations in Europe.

During the three months ended June 28, 2002, we recorded an impairment charge of \$32.1 million of the value assigned to the Excelsus trade names before any tax benefit. This charge was triggered by the combined effect of reorganizing Pulse into a product-line based organization, and updated financial forecasts for DSL microfilters.

In the three month ended March 29, 2002, we accrued \$1.8 million for severance and related payments, related to the termination of approximately 400 manufacturing personnel and approximately 75 support personnel. An additional accrual of \$0.8 million was provided for asset disposals. These accruals were primarily related to Pulse. The vast majority of these accruals were utilized by the end of the first quarter in 2002.

Our restructuring charges are summarized on a year-to-date basis for 2003

Edgar Filing: TECHNITROL INC - Form 10-Q

as follows:

| Restructuring provision (in millions): | AMI | Doduco | Pulse | Total |
|---|-------|--------|-------|-------|
| Balance accrued at December 27, 2002 | \$2.0 | | \$2.2 | \$4.2 |
| Accrued during the six months ended June 27, 2003 | 3.4 | | 1.0 | 4.4 |
| Severance and other cash payments | (2.8) | | (1.0) | (3.8) |
| Non-cash asset disposals | -- | | (0.5) | (0.5) |
| | ---- | | ---- | ---- |
| Balance accrued at June 27, 2003 | \$.6 | | \$1.7 | \$4.3 |
| | ==== | | ==== | ==== |

Page 8 of 32

Technitrol, Inc. and Subsidiaries

Notes to Unaudited Consolidated Financial Statements, continued

(4) Inventories

Inventories consisted of the following (in thousands):

| | June 27, 2003 | December 27, 2002 |
|----------------------------|------------------|----------------------|
| | ---- | ---- |
| Finished goods | \$23,430 | \$21,446 |
| Work in process | 13,839 | 12,390 |
| Raw materials and supplies | 28,741 | 26,752 |
| | ----- | ----- |
| | \$66,010 | \$60,588 |
| | ===== | ===== |

(5) Derivatives and Other Financial Instruments

We utilize derivative financial instruments, primarily forward exchange contracts and currency options, 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 June 27, 2003, we had 2 foreign exchange forward contracts outstanding to sell forward approximately 79.9 million euros in the aggregate, in order to hedge intercompany loans. The terms of these contracts were approximately 30 days. We had no other financial derivative instruments at June 27, 2003. In addition, management believes that there is no material risk of loss from changes in market rates or prices which are inherent in 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 141,000 and 311,000 as of June 27, 2003 and June 28, 2002, respectively. For calculating diluted earnings per share, common share equivalents and restricted stock outstanding are added to the weighted average number of common shares

Edgar Filing: TECHNITROL INC - Form 10-Q

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 96,000 for the six months ended June 27, 2003. There were 24,000 common share equivalents outstanding for the six months ended June 28, 2002. Earnings per share calculations are as follows (in thousands, except per share amounts):

| | Three Months Ended | | |
|---|--------------------------|--------------------------|----|
| | June 27, 2003 ---- | June 28, 2002 ---- | |
| Net earnings (loss) | \$ 6,020 | \$ (29,045) | \$ |
| Basic earnings (loss) per share: | | | |
| Shares | 40,062 | 38,718 | |
| Per share amount, before change in accounting principle | \$.15 | \$ (.75) | \$ |
| Change in accounting principle | -- | -- | |
| | ----- | ----- | - |
| Per share amount | \$.15 | \$ (.75) | \$ |
| | ===== | ===== | = |
| Diluted earnings (loss) per share: | | | |
| Shares | 40,160 | 38,984 | |
| Per share amount, before change in accounting principle | \$.15 | \$ (.75) | \$ |
| Change in accounting principle | -- | -- | |
| | ----- | ----- | - |
| Per share amount | \$.15 | \$ (.75) | \$ |
| | ===== | ===== | = |

Page 9 of 32

Technitrol, Inc. and Subsidiaries

Notes to Unaudited Consolidated Financial Statements, continued

(7) Business Segment Information

For the three months ended June 27, 2003 and June 28, 2002, there were immaterial amounts of intersegment revenues eliminated in consolidation. There has been no material change in segment assets from December 27, 2002 to June 27, 2003, except for those related to the acquisition of Eldor by Pulse. In addition, the basis for determining segment financial information has not changed from 2002. Specific segment data are as follows:

| | Three Months Ended | | Six Months Ended | |
|----------------------------------|--------------------------|--------------------------|--------------------------|--------------------------|
| | June 27, 2003 ---- | June 28, 2002 ---- | June 27, 2003 ---- | June 28, 2002 ---- |
| Net sales: | | | | |
| Pulse | \$ 71,766 | \$ 53,888 | \$ 139,646 | \$ 98,984 |
| AMI Doduco | 53,940 | 52,297 | 108,604 | 100,604 |
| | ----- | ----- | ----- | ----- |
| Total | \$ 125,706 | \$ 106,185 | \$ 248,250 | \$ 199,588 |
| | ===== | ===== | ===== | ===== |
| Earnings (loss) before taxes and | | | | |

Edgar Filing: TECHNITROL INC - Form 10-Q

cumulative effect of accounting change:

| | | | | |
|--|----------|-------------|-----------|----------|
| Pulse | \$ 6,997 | \$ (39,427) | \$ 12,553 | \$ (45,7 |
| AMI Doduco | 758 | (1,377) | (2,004) | (1,8 |
| Other income, net | (469) | (675) | (524) | (1,3 |
| | ----- | ----- | ----- | ----- |
| Earnings (loss) before income taxes and cumulative effect of accounting change | \$ 7,286 | \$ (41,479) | \$ 10,025 | \$ (49,0 |
| | ===== | ===== | ===== | ===== |

(8) Equity Method Investment

During the three months ended September 27, 2002, our minority ownership in FRE increased from approximately 19% to 29%. In accordance with generally accepted accounting principles, we have adjusted presentations in all relevant prior periods to reflect the impact of a change in accounting for our ownership in this investment from the cost basis method to the equity method of accounting as if the original 19% investment was accounted for as an equity method investment since the initial investment. All prior period amounts have been adjusted to reflect this recognition of equity earnings as if it occurred at the time of the original investment in April 2001. Equity earnings were not, however, significant in the first six months of 2002. Therefore no restatement was made for this period. This investment is reflected in the Other assets caption on the Consolidated Balance Sheets.

(9) 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 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 in fiscal 2003. Accordingly, no compensation cost was recognized for our stock option and employee purchase plans prior to fiscal 2003.

Page 10 of 32

Technitrol, Inc. and Subsidiaries

Notes to Unaudited Consolidated Financial Statements, continued

(9) 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, our pro forma net income (loss) and earnings (loss) per basic and diluted share would have been as follows, (amounts are in thousands, except per share amounts):

| | | |
|--|--------------------|----------|
| | Three Months Ended | |
| | June 27, | June 28, |
| | 2003 | 2002 |
| | | Jun |

Edgar Filing: TECHNITROL INC - Form 10-Q

| | | | |
|---|----------|-------------|-------|
| Net earnings (loss), as reported | \$ 6,020 | \$ (29,045) | \$ |
| Add: Stock-based compensation expense included in reported net earnings (loss), net of taxes | 327 | 325 | |
| Deduct: Total stock-based compensation expense determined under fair value based method for all awards, net of taxes | (753) | (819) | |
| | ----- | ----- | ----- |
| Net earnings (loss) adjusted | \$ 5,594 | \$ (29,539) | \$ |
| Basic net earnings (loss) per share - as reported | \$ 0.15 | \$ (0.75) | \$ |
| Basic net earnings (loss) per share - adjusted | \$ 0.14 | \$ (0.76) | \$ |
| Diluted net earnings (loss) per share - as reported | \$ 0.15 | \$ (0.75) | \$ |
| Diluted net earnings (loss) per share - adjusted | \$ 0.14 | \$ (0.76) | \$ |

At June 27, 2003, we had approximately 337,000 options outstanding, representing less than 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 June 27, 2003 and June 28, 2002, respectively.

Page 11 of 32

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 22 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 27, 2002 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 provisions, impairment of goodwill and other intangibles, restructuring expense and acquisition-related restructuring costs, 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 Provisions. Inventory purchases and commitments are based upon

Edgar Filing: TECHNITROL INC - Form 10-Q

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 goodwill impairment on an annual basis and between annual tests in certain circumstances. 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.

Restructuring Expense and Acquisition Related Restructuring Costs. Our restructuring activities through 2002, which related to our existing and recently acquired businesses, were designed to reduce both our fixed and variable costs, particularly in response to the dramatically reduced demand for our products in the electronics components industry. These costs included the closing of facilities 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 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 of accrual, such as estimated residual asset values. Our actual expenditures for the restructuring activities may differ from the initially recorded costs. If this occurs, we would 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 planned restructuring, such adjustment would generally require a change in value of the goodwill appearing on our balance sheet, which may not affect our 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. 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, because, 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 external sources, we may experience unfavorable tax consequences as cash invested outside the U.S. is transferred to the U.S. This adverse

Page 12 of 32

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 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

Edgar Filing: TECHNITROL INC - Form 10-Q

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 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 1996 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 have experienced a severe global contraction. We believe that in late 2002, many of the markets Pulse serves began to stabilize 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 has been and remains deflationary for Pulse's products. We believe that a broad-based market rebound in terms of pricing power will be erratic and gradual, probably requiring several years. In markets where unit demand has begun to recover, downward pressure on selling prices has kept total revenue from growing proportionately with unit growth.

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 and medical equipment. AMI Doduco continues its cost reduction actions including work force adjustments and plant consolidations in line with demand around the world.

In 2002, we recorded a goodwill impairment charge of \$15.7 million, net of income tax benefit, related to AMI Doduco as a cumulative effect of accounting change. We also recorded a trade name impairment charge of \$32.1 million, less a \$12.8 million income tax benefit, related to Pulse.

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 several 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, unlike Pulse where fixed term price contracts are rare. Most of AMI Doduco's products are sold under annual (or longer) purchase

Edgar Filing: TECHNITROL INC - Form 10-Q

contracts. Therefore, changes in prices have not historically had a material impact on AMI Doduco revenue. Accordingly, a significant portion of the sales growth and contraction at AMI Doduco is attributable to changes in unit volume, as well as foreign exchange rates, especially the U.S. dollar to the euro.

Page 13 of 32

Acquisitions. Historically, acquisitions have been an important part of our growth strategy. In many cases, our move into new and high-growth 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 Excelsus, and the consumer electronics business of Eldor Corporation. 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. Pulse acquired Eldor's consumer electronics business in January 2003 for approximately \$83.8 million. Eldor is headquartered in Orsenigo, Italy with production operations in Istanbul and Izmir, Turkey. Eldor's consumer business is a leading supplier of flyback transformers to the European television industry.

Similarly, AMI Doduco has made a number of acquisitions over the years. 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.

Recent 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, the opposite trend was experienced as these industries 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 at Pulse has a very high variable cost component due to the labor-intensity of many processes. This 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. 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. 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 reduce its capacity as quickly as Pulse in response to declining market demand, although continuing actions are being taken to align AMI Doduco's capacity with current market demand. In response to the decline in demand and deflationary environment for our products, we implemented a series of cost reduction initiatives and programs, summarized as follows:

In the three months ended June 27, 2003, we accrued \$0.5 million for severance and related payments comprising \$0.2 million for the elimination of manufacturing and support positions at AMI Doduco, and \$0.3 million for severance and related payments at Pulse facilities in France and the United

Edgar Filing: TECHNITROL INC - Form 10-Q

Kingdom. The majority of these accruals is expected to be utilized by the end of the third quarter in 2003.

In the three months ended March 28 2003, we accrued \$3.9 million for severance and related payments comprised of \$1.7 million for the elimination of manufacturing and support positions at AMI Doduco's facility in Germany, \$1.6 million to finalize the shutdown of a redundant facility in Spain acquired by a subsidiary of AMI Doduco from Engelhard-ECLAL and \$0.6 million for the elimination of manufacturing and support positions at Pulse, primarily in France and Mexico. The majority of these accruals were utilized by the end of the second quarter of 2003.

In 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, comprised of \$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. Approximately 800 personnel were terminated in 2002 and substantially all of the employee severance and related payments in connection with these actions were completed as of December 27, 2002. An additional provision of \$7.0 million was recorded in 2002

Page 14 of 32

related to asset writedowns. These assets were primarily Asian-based production equipment that became idle in 2002.

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 present and anticipated future revenue and unit demand, and as we pursue additional growth opportunities. The amounts of additional charges will depend on specific actions taken. The actions taken over the past two 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. The eliminated costs also include depreciation savings from disposed equipment.

International Operations. An increasing percentage of our sales in recent years has been outside of the United States. Changing exchange rates often impact our financial results and the analysis of our period-over-period results. 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 euros. A portion of Pulse's European sales are also denominated in euros. However, the proportion at Pulse is less than it is at AMI Doduco, although Pulse's portion has increased as Eldor sells to its customers primarily in euros. As a result of this and other factors, prior to the acquisition of Eldor, Pulse used the U.S. dollar as its functional currency in Europe while AMI Doduco uses the euro. For the acquired Eldor operations, Pulse uses the euro as its functional currency. The use of different functional currencies creates different financial effects. AMI Doduco's and Eldor's euro-denominated sales and earnings may result in higher or lower dollar sales 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 Eldor 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. At Pulse, we may

Edgar Filing: TECHNITROL INC - Form 10-Q

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 are denominated in non-U.S. currencies, it could increase our exposure to currency fluctuations.

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 June 27, 2003, we had 2 foreign currency forward contracts outstanding to sell forward approximately 79.9 million of 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 consignment arrangements with our suppliers. Leasing and consignment costs have been typically below the costs to borrow funds to purchase the metals and, more importantly, these arrangements eliminate the fluctuations in the market price of owned precious metal and enables us to minimize our inventories. AMI Doduco's terms of sale generally allow us to charge customers for precious metal content based on the 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 increases 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 that earned in low-tax jurisdictions, particularly in Izmir, Turkey and the PRC. 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, we may not be able to realize similar benefits in the future. Developing countries, in particular, the PRC, may change their tax policies at any time.

We have not provided for U.S. federal income and foreign withholding taxes of our non-U.S. subsidiaries' undistributed earnings (as calculated for income tax purposes) as per Accounting Principles Board Opinion No. 23, Accounting for Income Taxes - Special Areas. Such earnings include pre-acquisition earnings of foreign entities

Page 15 of 32

acquired through stock purchases, and are intended to be reinvested outside of the U.S. indefinitely. Where excess cash has accumulated in our non-U.S. subsidiaries and it is advantageous for tax reasons, subsidiary earnings may be remitted.

Results of Operations

Three months ended June 27, 2003 compared to the three months ended June 28, 2002

Edgar Filing: TECHNITROL INC - Form 10-Q

Net Sales. Net sales for the three months ended June 27, 2003 increased \$19.5 million, or 18.4%, to \$125.7 million from \$106.2 million in the three months ended June 28, 2002. Our sales increase from the comparable period last year was attributable primarily to the increases from the Eldor acquisition and stronger sales of Pulse's pre-Eldor products ("Pulse legacy"), tempered somewhat by ongoing deflationary pressure on selling prices at Pulse, and to a lesser extent, weaker demand at AMI Doduco, which resulted in lower sales on a constant-euro basis.

Pulse's net sales increased \$17.9 million, or 33.2%, to \$71.8 million for the three months ended June 27, 2003 from \$53.9 million in the three months ended June 28, 2002. Most of the increase is attributable to sales derived from our acquisition of Eldor since the date of acquisition in January 2003. Volume gains in many Pulse legacy product lines were somewhat offset by declining average selling prices.

AMI Doduco's net sales increased \$1.6 million, or 3.1%, to \$53.9 million for the three months ended June 27, 2003 from \$52.3 million in the three months ended June 28, 2002. Sales in the 2003 period reflect weak North American and European markets, which were more than offset by the translation effect of an increase in the average euro-to-U.S. dollar exchange rate during the period. Weak net sales resulted primarily from weak demand in the commercial and industrial machinery, and non-residential construction end markets. Demand for automotive and residential circuit components, was stronger in the current year period.

Cost of Sales. Our cost of sales increased \$11.4 million, or 13.9%, to \$92.9 million for the three months ended June 27, 2003 from \$81.5 million for the three months ended June 28, 2002. Our consolidated gross margin for the three months ended June 27, 2003 was 26.1% compared to 23.2% for the three months ended June 28, 2002. Our consolidated gross margin in 2003 was positively affected by:

- o the gross margin on Eldor sales, which was higher than the average gross margin on AMI Doduco sales and sales of some of Pulse's legacy products,
- o a mix of net sales weighted more heavily by Pulse on a relative basis, as Pulse's gross profit as a percentage of sales is typically higher than that of AMI Doduco, and
- o better capacity utilization and lower overhead costs at Pulse in 2003 than in 2002.

Selling, General and Administrative Expenses. Total selling, general and administrative expenses for the three months ended June 27, 2003 increased \$2.2 million, or 9.8%, to \$24.6 million or 19.5% of net sales, from \$22.4 million or 21.1% of net sales, for the three months ended June 28, 2002. The increase in spending is primarily attributable to an increase of \$1.3 million in incentive and stock compensation expense, compared to 2002. The addition of Eldor expenses was partially offset by savings from restructuring actions that we took over the last year to reduce costs and tighten spending controls.

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 June 27, 2003 and June 28, 2002 respectively, RD&E by segment was as follows (dollars in thousands):

| | 2003 | 2002 |
|-------|---------|---------|
| | ---- | ---- |
| Pulse | \$3,575 | \$3,652 |

Edgar Filing: TECHNITROL INC - Form 10-Q

| | | |
|-----------------------------|--------|--------|
| Percentage of segment sales | 5.0% | 6.8% |
| AMI Doduco | \$ 972 | \$ 901 |
| Percentage of segment sales | 1.8% | 1.7% |

Page 16 of 32

Although some consolidation of RD&E, particularly design activity, has occurred through restructuring and relocation activities at Pulse, we have minimized spending cuts in the RD&E area as 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 2002 and into 2003. The change in RD&E as a percentage of sales at Pulse relates to the effect of the acquisition of Eldor as Eldor incurs a lower portion of RD&E compared to its sales as compared to Pulse legacy.

Interest. Net interest expense was \$0.3 million for the three months ended June 27, 2003 compared to net interest expense of \$0.1 million for the three months ended June 28, 2002. The increase in net interest expense in the current period is due to lower yields on a lower average cash invested balance, which more than offset higher average outstanding bank debt and related interest expense in the prior year.

Our credit facility, which we entered into on June 20, 2001, has variable interest rates. Accordingly, interest expense may increase if the rates associated with, or the amounts borrowed under, our credit facilities move higher during subsequent quarters. At June 27, 2003, we had no borrowings under this facility. We may use interest rate swaps or other financial derivatives in order to manage the risk associated with changes in market interest rates; however, we have not used any such instruments to date.

Income Taxes. The effective income tax rate for the three months ended June 27, 2003 was 17.4% compared to 30.0%, in the form of a benefit, for the three months ended June 28, 2002. The lower tax rate resulted from a higher proportion of income being attributable to low-tax jurisdictions, particularly China and Izmir, Turkey, combined with significant expenses of AMI Doduco which yielded tax benefits in high-tax jurisdictions.

Six months ended June 27, 2003 compared to the six months ended June 28, 2002

Net Sales. Net sales for the six months ended June 27, 2003 increased \$48.7 million, or 24.4%, to \$248.3 million from \$199.6 million for the six months ended June 28, 2002. Our sales increase from the comparable period last year was attributable primarily to the increases from the Eldor acquisition and stronger sales of Pulse's pre-Eldor products, tempered somewhat by ongoing deflationary pressure on selling prices at Pulse, and to a lesser extent, weaker demand at AMI Doduco customers, which resulted in lower sales on a constant-euro basis.

Pulse's net sales increased \$40.6 million, or 41.1%, to \$139.7 million for the six months ended June 27, 2003 from \$99.0 million for the six months ended June 28, 2002. This increase was primarily attributable to the Eldor acquisition. Volume gains in many legacy product lines were somewhat offset by declining average selling prices.

AMI Doduco's net sales increased \$8.0 million, or 7.9%, to \$108.6 million for the six months ended June 27, 2003 from \$100.6 million in the six months ended June 28, 2002. Sales in the 2003 period reflect weaker North American and European markets, which was more than offset by the translation effect of a stronger average euro-to-U.S. dollar exchange rate during the period. For the

Edgar Filing: TECHNITROL INC - Form 10-Q

six-month period, the average euro-to-dollar exchange rate was 22.9% stronger in 2003 than in 2002. Lower net sales resulted from lower manufacturing activity primarily related to customers in the commercial and industrial controls and non-residential construction industries.

Cost of Sales. Our cost of sales increased \$29.3 million, or 18.8%, to \$185.0 million for the six months ended June 27, 2003 from \$155.7 million for the six months ended June 28, 2002. This increase was due to an increase in net sales. Our consolidated gross margin for the six months ended June 27, 2003 was 25.5% compared to 22.0% for the six months ended June 28, 2002. Our consolidated gross margin in 2003 was positively affected by:

- o a mix of net sales weighted more toward Pulse which typically have a higher gross margin than those of AMI Doduco, and
- o a proportionate increase in sales at Pulse of consumer division products, which typically have a higher gross margin than AMI Doduco products and certain Pulse legacy products.

These positive impacts on gross margin in 2003 were partially offset by manufacturing inefficiencies at AMI Doduco due to under-utilization of capacity and continued consolidation activities in European, Asian and North American manufacturing facilities.

Page 17 of 32

Selling, General and Administrative Expenses. Total selling, general and administrative expenses for the six months ended June 27, 2003 increased \$2.4 million, or 5.3%, to \$48.3 million, or 19.5% of net sales, from \$45.9 million, or 23.0% of net sales for the six months ended June 28, 2002. The increase in spending is primarily attributable to an increase of \$2.2 million in incentive and stock compensation expense, compared to 2002. The addition of Eldor expenses in 2003 was partially offset by savings from restructuring actions that we took over the last year to reduce costs and tighten spending controls.

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 six months ended June 27, 2003 and June 28, 2002 respectively, RD&E by segment was as follows (dollars in thousands):

| | 2003 | 2002 |
|-----------------------------|---------|---------|
| | ---- | ---- |
| Pulse | \$6,931 | \$7,489 |
| Percentage of segment sales | 5.0% | 7.6% |
| AMI Doduco | \$2,019 | \$1,890 |
| Percentage of segment sales | 1.9% | 1.9% |

Although 2002 and the first six months of 2003 have been characterized by cost reduction activities, we minimized spending cuts in the RD&E area as we believe that the recovery in the electronic components markets will be driven by next-generation products. Design and development activity with our OEM customers continued at an aggressive pace during 2002 and into 2003. The change in RD&E as a percentage of sales at Pulse relates to the effect of the acquisition of Eldor, as Eldor incurs a lower portion of RD&E compared to its sales as compared to Pulse legacy.

Interest. Net interest expense was \$0.5 million for the six months ended June 27, 2003 compared to net interest expense of \$0.4 million for the six months ended June 28, 2002. The increase in net interest expense in the current

Edgar Filing: TECHNITROL INC - Form 10-Q

period is due to lower yields on a lower average cash invested balance, which more than offset higher average outstanding bank debt and related interest expense in prior year period.

Income Taxes. The effective income tax rate for the six months ended June 27, 2003 was 13.7% compared to 30.2%, in the form of a benefit, for the six months ended June 28, 2002. The lower tax rate in 2003 resulted from a higher portion of income being attributable to low-tax jurisdictions, particularly in the PRC and Izmir, Turkey, combined with significant expenses of AMI Doduco which yielded tax benefits in high-tax jurisdictions.

Liquidity and Capital Resources

Working capital as of June 27, 2003 was \$180.1 million compared to \$235.6 million as of December 27, 2002. This decrease was primarily due to the cash purchase of the Eldor business in January 2003, which reduced invested cash as of June 27, 2003. Cash and cash equivalents, which is included in working capital, decreased from \$205.1 million as of December 27, 2002 to \$115.8 million as of June 27, 2003.

Net cash provided by operating activities was \$14.2 million for the six months ended June 27, 2003 and \$2.2 million in the comparable period of 2002, an increase of \$12.0 million. This increase is primarily attributable to the higher net earnings during the six months ended June 27, 2003, partially offset by increased working capital requirements related to higher unit volumes.

Capital expenditures were \$3.5 million during the six months ended June 27, 2003 and \$2.6 million in the comparable period of 2002. We make capital expenditures to expand production capacity and to improve our operating efficiency. We plan to continue making such expenditures in the future as and when necessary.

We used \$81.9 million in cash for acquisitions in the six months ended June 27, 2003 and no cash in the comparable period in 2002. The 2003 spending was for the acquisition of Eldor. We may acquire other businesses or product lines to expand our breadth and scope of operations. We expect to exercise our option to expand our investment in FRE during 2003.

Page 18 of 32

We paid off two euro-denominated term loans during the six months ended June 27, 2003 with \$11.7 million of cash on hand. The one remaining euro-denominated term loan is not due until 2009.

We paid dividends of \$1.1 million in the six months ended June 28, 2002. After paying a dividend on January 25, 2002 to shareholders of record on January 4, 2002, we no longer intend to pay cash dividends on our common stock. We currently intend to retain future earnings to finance the growth of our business, although our policy regarding dividends may be re-evaluated at any time.

As of June 27, 2003, we have no outstanding borrowings under our existing three-year revolving credit agreement. We entered into this credit agreement on June 20, 2001 providing for \$225.0 million of credit capacity. Following the conclusion of our follow-on equity offering in April 2002, we voluntarily reduced the size of this credit facility to a maximum of \$175.0 million and then in March 2003 to a current maximum of \$125.0 million in order to reduce commitment fees and to size the facility to estimated future needs given cash on hand. We also amended the minimum net worth threshold from \$275.0 million to \$259.3 million as a result of a cumulative effect of an accounting change,

Edgar Filing: TECHNITROL INC - Form 10-Q

recorded in the three months ended June 28, 2002. As of June 27, 2003 the amended facility consists of:

- o an aggregate U.S. dollar-based revolving line of credit in the principal amount of up to \$125.0 million, including individual sub-limits of:
 - a British pounds sterling-based or euro-based revolving line of credit in the principal amount of up to the U.S. dollar equivalent of \$75.0 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 \$10.0 million.

The amounts outstanding under the credit facility in total may not exceed \$125.0 million. 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 also contains covenants requiring maintenance of minimum net worth, 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.

We pay a facility fee, irrespective of whether there are outstanding borrowings or not, which ranges from 0.275% to 0.450% of the total commitment, depending on our EBITDA. The interest rate for each currency's 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. It is LIBOR or prime rate for U.S. dollars, Euro-LIBOR for euros, and a rate approximating sterling LIBOR for British pounds. The credit margin spread is the same for each currency and is 0.850% to 1.425% depending on our debt to EBITDA ratio. Each of our domestic subsidiaries with net worth equal to or greater than \$5 million has agreed to guarantee all obligations incurred under the credit facility.

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

We had 3 standby letters of credit outstanding at June 27, 2003 in the aggregate amount of \$0.8 million securing transactions entered into in the ordinary course of business.

We had commercial commitments outstanding at June 27, 2003 of approximately \$46.9 million due under precious metal consignment-type leases.

We believe that the combination of cash on hand, cash generated by operations and, if necessary, additional 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.

With the exception of approximately \$11.6 million of retained earnings as of June 27, 2003, primarily in the PRC that are restricted in accordance with Section 58 of the PRC Foreign Investment Enterprises Law, substantially

all retained earnings are free from legal or contractual restrictions. The

Edgar Filing: TECHNITROL INC - Form 10-Q

amount restricted in accordance with the PRC Foreign Investment Enterprise Law 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 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 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. We have also been granted special tax incentives in other countries such as the PRC. This favorable situation could change if these countries were to increase rates or revoke the special tax incentives, or if we were to discontinue manufacturing operations in these countries. This could have a material unfavorable impact on our net income and cash position.

New Accounting Pronouncements

In January 2003, the Financial Accounting Standards Board ("FASB") issued FASB Interpretation No. 46 Consolidation of Variable Interest Entities ("FIN 46"). FIN 46 clarifies the application of Accounting Research Bulletin No. 51, Consolidated Financial Statements, to certain entities in which equity investors do not have 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. We were required to adopt the provisions of FIN 46 for variable interest entities created after January 31, 2003 whereas it is otherwise effective June 15, 2003 for variable interest entities acquired before February 1, 2003. Adoption of this interpretation did not have a material effect on our revenue, operating results, financial position, or liquidity.

In December 2002, the FASB issued Statement No. 148, Accounting for Stock-Based Compensation, Transition and Disclosure, an amendment to Statement No. 123 ("SFAS 148"). SFAS 148 provides alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. In addition, SFAS 148 amends the disclosure requirements of Statement No. 123, Accounting for Stock-Based Compensation ("SFAS 123"), by requiring prominent disclosures in both annual and interim financial statements, about the method of accounting for stock-based employee compensation and the effect of the method used on reported results. The provisions of SFAS 148 are effective for fiscal years ending after December 15, 2002. We adopted the provisions of SFAS 123, as amended by SFAS 148, as of the beginning of our fiscal year in 2003. We used the prospective method of adoption, which recognizes expense for all employee awards granted, modified or settled after the beginning of the fiscal year in which the recognition provisions are first applied. Adoption of this standard did not have a material effect on our revenue, operating results financial position or liquidity.

In November 2002, the FASB issued FASB Interpretation No. 45, Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees and Indebtedness of Others ("FIN 45"). FIN 45 elaborates on the disclosures to be made by a guarantor in its interim and annual financial statements about its obligations under certain guarantees that it has issued. FIN 45 also clarifies that a guarantor is required to recognize, at the inception of a guarantee, a liability for the fair value of the obligation undertaken in issuing the guarantee. We were required to adopt the provisions of FIN 45 on a prospective basis to guarantees issued or modified after December

Edgar Filing: TECHNITROL INC - Form 10-Q

31, 2002. We have not issued any guarantees for performance of third parties since December 31, 2002. Accordingly, adoption of this interpretation did not have a material effect on our revenue, operating results, financial position or liquidity.

In June 2002, the FASB issued Statement No. 146 Accounting for Costs Associated with Exit or Disposal Activities ("SFAS 146"). SFAS 146 superceded the Emerging Issues Task Force Issue No. 94-3, Liability Recognition for Certain Termination Benefits and Other Costs to Exit an Activity, ("EITF 94-3") The principal difference between SFAS 146 and EITF 94-3 is that SFAS 146 requires that a liability for a cost associated with an exit or disposal activity be recognized when the liability is incurred. Under EITF 94-3, a liability for an exit cost was recognized at the date of an entity's commitment to an exit plan. As such, under SFAS 146, an entity's commitment to a plan by itself, does not create a present obligation meeting the definition of a liability. We were required to adopt the provisions of SFAS for all exit or disposal activities initiated after December 15, 2002. These activities, which we

Page 20 of 32

refer to as restructuring and unusual and infrequent items, did have a material impact on our operating results in 2003. Although the underlying activities were material, the impact in changing from EITF 94-3 to SFAS 146 was not significant.

Page 21 of 32

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.

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, including the recent contraction, could result in a significant decrease in demand for our products and reduce our profitability.

Edgar Filing: TECHNITROL INC - Form 10-Q

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 and electrical equipment markets generally. Beginning in late 2000 and continuing into 2002, these markets, particularly the electronics market, have experienced a severe worldwide contraction. This contraction has resulted in a decrease in demand for our products, as our customers have:

- 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 has had a significant adverse effect on our operating results and profitability. We cannot predict how long a contraction will last nor the 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 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

Page 22 of 32

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.

Edgar Filing: TECHNITROL INC - Form 10-Q

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. 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.

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.

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 the past two years we have 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

Edgar Filing: TECHNITROL INC - Form 10-Q

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

Page 24 of 32

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.

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; and
- o price.

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

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

Edgar Filing: TECHNITROL INC - Form 10-Q

While our backlog consists of firm accepted orders with an express release date generally scheduled within six 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 have 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 France, Germany, Hungary, Italy, Mexico, the Peoples' Republic of China, or PRC, Spain and Turkey. In addition, much of our revenues are 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:

- o economic and political instability;
- o expropriation and nationalization;

Page 25 of 32

- o trade restrictions;
- 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 manufacture and sell our products.

In particular, Pulse has substantially all of its 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

Edgar Filing: TECHNITROL INC - Form 10-Q

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. In early 2003, we acquired the consumer business of Eldor Corporation. While this business is headquartered in Italy, all of its manufacturing operations are in Turkey. These operations in Turkey are subject to unique risks, including those associated with continuing Middle East geo-political conflicts.

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 special tax incentives commonly known as tax holidays in other countries such as the PRC. 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 replace 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.

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. 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 as this cash is transferred to the United States. These adverse consequences would occur if the transfer of cash into the United States is taxed and no offsetting foreign tax credit is available to offset the U.S. tax liability, resulting in lower earnings. In addition, we may be prohibited from transferring cash from the PRC. With the exception of approximately \$11.6 million of retained earnings as of June 27, 2003, primarily in 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.

Edgar Filing: TECHNITROL INC - Form 10-Q

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.

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;
- o wastewater 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. The order requires us to investigate and take corrective actions. Monitoring data is being collected to confirm and implement the corrective measures. We anticipate making additional environmental expenditures in future years to continue our environmental studies, analysis and remediation activities. 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.

Public Health Epidemics such as Severe Acute Respiratory Syndrome May Disrupt Operations in Affected Regions and Affect Operating Results.

Pulse maintains extensive manufacturing operations in the PRC, as do many of our customers and suppliers. A sustained interruption of our manufacturing operation, or those of our customers or suppliers, as a result of complications from severe acute respiratory syndrome, could have a material adverse effect on our business and results of operations.

Edgar Filing: TECHNITROL INC - Form 10-Q

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 27, 2002.

Item 4: Controls and Procedures

As of the end of the period covering this report, we carried out an evaluation, under the supervision and with the participation of management, including the Principal Executive Officer and Principal Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures pursuant to Exchange Act Rule 13a-14. Based upon that evaluation, and subject to the limitations of the immediately following paragraph, the Principal Executive Officer and Principal Financial Officer concluded that our disclosure controls and procedures are effective in alerting them, on a timely basis, to material information required to be included in our periodic SEC filings.

Our review of our internal controls was made within the context of the relevant professional auditing standards defining "internal controls," "reportable conditions," and "material weaknesses." "Internal controls" are processes designed to provide reasonable assurance that our transactions are properly authorized, our assets are safeguarded against unauthorized or improper use, and our transactions are properly recorded and reported, all to permit the preparation of our condensed consolidated financial statements in conformity with accounting principles generally accepted in the United States. "Significant deficiencies" are referred to as "reportable conditions," or control issues that could have a significant adverse effect on our ability to properly authorize transactions, safeguard our assets, or record, process, summarize or report financial data in the condensed consolidated financial statements. A "material weakness" is 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 condensed consolidated financial statements and not be detected within a timely period by employees in the normal course of performing their assigned functions. As part of our internal controls procedures, we also address other, less significant control matters that we identify, and we determine what revision or improvement to make, if any, in accordance with our on-going procedures. However, the design of any system of controls is based in part upon certain assumptions about the likelihood of future events and there is no certainty that any design will succeed in achieving its stated goal under all potential future considerations, regardless of how remote. In addition, our evaluation of the impact on our controls and procedures of our recent acquisition of the Eldor consumer business is still in process.

There have been no significant changes in our internal controls or in other factors that could significantly affect internal controls subsequent to the date we carried out this evaluation, nor were there any significant deficiencies or material weaknesses in our internal controls. As a result, no corrective actions were required or undertaken.

Page 28 of 32

PART II. OTHER INFORMATION

| | | |
|--------|---|------|
| Item 1 | Legal Proceedings | None |
| Item 2 | Changes in Securities and Use of Proceeds | None |

Edgar Filing: TECHNITROL INC - Form 10-Q

- Item 3 Defaults Upon Senior Securities None
- Item 4 Submission of Matters to a Vote of Security Holders None

The Annual Meeting of Shareholders was held on May 21, 2003. Messrs. John E. Burrows, Jr., Rajiv L. Gupta, and James M. Papada, III were elected to a three-year term as directors of the Company. The results of the votes were as follows:

| | For --- | Withhold Authority ----- |
|----------------------|------------|-----------------------------|
| John E. Burrows | 34,366,250 | 623,365 |
| Rajiv L. Gupta | 34,476,260 | 513,355 |
| James M. Papada, III | 34,317,575 | 672,040 |

In addition, each of the following directors continued in office after the meeting: Stanley E. Basara, David H. Hofmann, Graham Humes, C. Mark Melliar-Smith, and Edward M. Mazze.

- Item 5 Other Information None
- Item 6 Exhibits and Reports on Form 8-K

(a) Exhibits

The Exhibit Index is on page 30.

(b) Reports On Form 8-K

None

We filed a current report on Form 8-K dated April 21, 2003. This report pertains to our press release issued to announce our first quarter 2003 results.

Page 29 of 32

Exhibit Index

- 2.1 Agreement and Plan of Merger, dated as of May 23, 2001, as amended as of July 6, 2001, by and among Pulse Engineering, Inc., Pulse Acquisition Corporation, Excelsus Technologies, Inc., and certain principal shareholders of Excelsus Technologies, Inc. that are signatories thereto (incorporated by reference to Exhibit 2 to our Form 8-K dated August 21, 2001).
- 2.2 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 1 to our Registration Statement on Form 8-A/A dated April 10, 1998).
- 3.2 Amendment to Amended and Restated Articles of Incorporation (incorporated by reference to Exhibit 3(i)(a) to our Form 10-Q for the quarter ended June 29, 2001).
- 3.3 By-laws (incorporated by reference to Exhibit 3.3 to our Form 10-K for the year ended December 28, 2001).

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).
 - 10.2 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, Bank of America, N.A. as Agent and Lender, and certain other Lenders that are signatories thereto, dated as of June 20, 2001 (incorporated by reference to Exhibit 10.(a) to the Company's Form 10-Q for the quarter ended June 29, 2001).
 - 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).
- Page 30 of 32
- 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

- 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).
- 10.11 Form of Indemnity Agreement (incorporated by reference to Exhibit 10.11 to our Form 10-K for the year ended December 28, 2001).
- 10.12 Amendment 1 to Revolving Credit Agreement, by and among Technitrol, Inc. and certain of its subsidiaries, Bank of America, N.A. as Agent and Lender, and certain other Lenders that are signatories thereto, dated as of May 15, 2002 (incorporated by reference to Exhibit 10.12 to our Form 10-K for the year ended December 27, 2002).
- 10.13 Amendment 2 to Revolving Credit Agreement, by and among Technitrol, Inc. and certain of its subsidiaries, Bank of America, N.A. as Agent and Lender, and certain other Lenders that are signatories thereto, dated as of December 20, 2002 (incorporated by reference to Exhibit 10.13 to our Form 10-K for the year ended December 27, 2002).
- 10.14 Letter modification to Revolving Credit Agreement, by and among Technitrol, Inc. and certain of its subsidiaries, Bank of America, N.A. as Agent and Lender, and certain other Lenders that are signatories thereto, dated as of March 6, 2003 (incorporated by reference to Exhibit 10.14 to our Form 10-Q for the quarter ended March 28, 2003).
- 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.
- 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 31 of 32

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)

July 30, 2003

/s/ Drew A. Moyer

(Date)

Drew A. Moyer
Vice President, Corporate Controller and Secretary
(duly authorized officer, principal financial and

accounting officer)

Page 32 of 32