

COINMACH SERVICE CORP

Form 10-Q

November 08, 2006

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**UNITED STATES SECURITIES AND 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 September 30, 2006**

**OR**

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

**For the transition period from \_\_\_\_\_ to \_\_\_\_\_**

**Commission file number: 001-32359**

**Coinmach Service Corp.**

(Exact name of registrant as specified in its charter)

**Delaware**

(State or other jurisdiction of  
incorporation or organization)

**20-0809839**

(I.R.S. Employer  
Identification No.)

303 Sunnyside Blvd., Suite 70, Plainview, New York

(Address of principal executive offices)

**11803**

(Zip Code)

**(516) 349-8555**

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act.

Large accelerated filer  Accelerated filer  Non-accelerated filer

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

Yes  No

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

Class

Outstanding at October 31, 2006

Class A common stock, \$0.01 par value per share

29,113,641 shares

Class B common stock, \$0.01 par value per share

23,374,450 shares

The registrant publicly trades Income Deposit Securities (IDSs) on the American Stock Exchange. Each IDS is comprised of one underlying share of Class A common stock and an underlying 11% senior secured note due 2024 in a principal amount of \$6.14. As of October 31, 2006, there were 13,003,511 IDSs outstanding.

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(in thousands of dollars, except share data)

	<b>September 30, 2006 (Unaudited)</b>	<b>March 31, 2006<sup>1</sup></b>
<b>ASSETS:</b>		
Current assets:		
Cash and cash equivalents	\$ 35,019	\$ 62,008
Receivables, net	7,250	5,635
Inventories	13,299	11,458
Prepaid expenses	4,406	4,375
Interest rate swap asset	779	2,615
Other current assets	2,229	1,796
Total current assets	62,982	87,887
Advance location payments	65,014	67,242
Property, equipment and leasehold improvements, net of accumulated depreciation and amortization of \$439,289 and \$403,204	250,069	252,398
Contract rights, net of accumulated amortization of \$121,438 and \$114,535	301,540	296,912
Goodwill	208,109	206,196
Other assets	10,379	11,531
Total assets	\$ 898,093	\$ 922,166
<b>LIABILITIES AND STOCKHOLDERS EQUITY:</b>		
Current liabilities:		
Accounts payable and accrued expenses	\$ 38,155	\$ 32,656
Accrued rental payments	33,003	33,044
Accrued interest	6,788	3,563
Current portion of long-term debt	4,296	11,151
Total current liabilities	82,242	80,414
Deferred income taxes	49,297	49,984
Long-term debt	653,737	653,102
Total liabilities	785,276	783,500
Stockholders equity:		
Class A Common Stock \$0.01 par value; 100,000,000 shares authorized; 29,113,641 shares issued and outstanding	291	291
Class B Common Stock \$0.01 par value; 100,000,000 shares authorized; 23,374,450 shares issued and outstanding	234	234
Capital in excess of par value	389,682	389,616

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Carryover basis adjustment	(7,988)	(7,988)
Accumulated other comprehensive income, net of tax	344	1,547
Accumulated deficit	(269,746)	(245,034)
Total stockholders' equity	112,817	138,666
Total liabilities and stockholders' equity	\$ 898,093	\$ 922,166

See accompanying notes.

- 1 The March 31, 2006 balance sheet has been derived from the audited consolidated financial statements as of that date.

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**COINMACH SERVICE CORP. AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**  
**(UNAUDITED)**

(in thousands of dollars, except share data)

	<b>Three Months Ended</b>		<b>Six Months Ended</b>	
	<b>September 30, 2006</b>	<b>September 30, 2005</b>	<b>September 30, 2006</b>	<b>September 30, 2005</b>
<b>REVENUES</b>	\$ 136,310	\$ 132,320	\$ 275,595	\$ 266,150
<b>COSTS AND EXPENSES:</b>				
Laundry operating expenses (exclusive of depreciation and amortization and amortization of advance location payments)	92,803	90,117	187,202	181,032
General and administrative (including stock-based compensation expense of \$38, \$0, \$76 and \$12, respectively)	3,102	3,047	6,136	5,570
Depreciation and amortization	18,389	18,929	37,013	37,861
Amortization of advance location payments	4,901	5,038	9,801	9,173
Amortization of intangibles	3,560	3,485	7,120	6,970
Other items, net		310		310
	122,755	120,926	247,272	240,916
<b>OPERATING INCOME</b>	13,555	11,394	28,323	25,234
<b>INTEREST EXPENSE</b>	13,931	15,315	27,361	30,646
<b>TRANSACTION COSTS</b>			845	
<b>(LOSS) INCOME BEFORE INCOME TAXES</b>	(376)	(3,921)	117	(5,412)
<b>PROVISION (BENEFIT) FOR INCOME TAXES:</b>				
Current	214		382	
Deferred	(189)	(1,633)	(56)	(2,149)
	25	(1,633)	326	(2,149)
<b>NET LOSS</b>	\$ (401)	\$ (2,288)	\$ (209)	\$ (3,263)
<b>Distributed earnings per share:</b>				
Class A Common Stock	\$ 0.21	\$ 0.21	\$ 0.41	\$ 0.41
Class B Common Stock	\$	\$	\$ 0.53	\$

**Basic and diluted net income****(loss) per share:**

Class A Common Stock	\$	0.09	\$	0.07	\$	(0.06)	\$	0.16
Class B Common Stock	\$	(0.12)	\$	(0.14)	\$	0.06	\$	(0.25)

**Weighted average common stock****outstanding:**

Class A Common Stock	29,050,722	18,911,532	29,048,625	18,911,532
Class B Common Stock	23,374,450	24,980,445	23,374,450	24,980,445

**Cash dividends per share:**

Class A Common Stock	\$	0.21	\$	0.21	\$	0.41	\$	0.41
Class B Common Stock	\$		\$		\$	0.53	\$	

See accompanying notes.



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**COINMACH SERVICE CORP. AND SUBSIDIARIES**  
**Condensed Consolidated Statement of Stockholders Equity**  
**For the Six Months Ended September 30, 2006**  
**(UNAUDITED)**  
(in thousands of dollars)

	Class A	Class B	Capital in Excess of Par Value	Carryover Basis Adjustment	Accumulated Other Comprehensive Income, net of tax	Accumulated Deficit	Stockholders Equity
Balance, March 31, 2006	\$ 291	\$ 234	\$ 389,616	\$ (7,988)	\$ 1,547	\$ (245,034)	\$ 138,666
Issuance costs			(9)				(9)
Comprehensive Income:							
Net loss						(209)	(209)
Loss on derivative instruments					(1,203)		(1,203)
Total comprehensive loss							(1,412)
Dividends						(24,503)	(24,503)
Stock based compensation			75				75
Balance, September 30, 2006	\$ 291	\$ 234	\$ 389,682	\$ (7,988)	\$ 344	\$ (269,746)	\$ 112,817

See accompanying notes.

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**COINMACH SERVICE CORP. AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**(UNAUDITED)**  
(in thousands of dollars)

	<b>Six Months Ended</b>	
	<b>September 30, 2006</b>	<b>September 30, 2005</b>
<b>OPERATING ACTIVITIES:</b>		
Net loss	\$ (209)	\$ (3,263)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation and amortization	37,013	37,861
Amortization of advance location payments	9,801	9,173
Amortization of intangibles	7,120	6,970
Deferred income taxes	(56)	(2,149)
Amortization of deferred issue costs	396	1,063
Write off of deferred issue costs	414	
Premium on redemption of 11% senior secured notes due 2024	417	
(Gain) loss on sale of equipment	(183)	27
Stock based compensation	76	12
Change in operating assets and liabilities, net of businesses acquired:		
Other assets	(481)	(1,190)
Receivables, net	(1,444)	784
Inventories and prepaid expenses	(1,445)	946
Accounts payable and accrued expenses, net	4,764	2,052
Accrued interest	3,225	(278)
Net cash provided by operating activities	59,408	52,008
<b>INVESTING ACTIVITIES:</b>		
Additions to property, equipment and leasehold improvements	(29,855)	(29,944)
Advance location payments to location owners	(6,361)	(7,130)
Acquisition of net assets related to acquisitions of businesses, net of cash acquired	(17,136)	(1,210)
Proceeds from sale of property and equipment	710	498
Net cash used in investing activities	(52,642)	(37,786)
<b>FINANCING ACTIVITIES:</b>		
Repayments under credit facility	(1,150)	(11,223)
Redemption of 11% senior secured notes due 2024	(5,649)	
Payment of premium on 11% senior secured notes due 2024	(417)	
Principal payments on capitalized lease obligations	(1,898)	(2,660)
Repayments from bank and other borrowings	(129)	(121)
Debt issuance costs	(9)	
Cash dividends paid	(24,503)	(7,797)
Net cash used in financing activities	(33,755)	(21,801)

Net decrease in cash and cash equivalents	(26,989)		(7,579)
<b>CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD</b>	62,008		57,271
<b>CASH AND CASH EQUIVALENTS, END OF PERIOD</b>	\$ 35,019	\$	49,692
<b>SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:</b>			
Interest paid	\$ 23,740	\$	29,861
Income taxes paid	\$ 144	\$	85
<b>NON CASH FINANCING ACTIVITIES:</b>			
Acquisition of fixed assets through capital leases	\$ 2,606	\$	3,958
Transfer of assets held for sale to fixed assets	\$	\$	1,936

See accompanying notes.

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**COINMACH SERVICE CORP. AND SUBSIDIARIES  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
(UNAUDITED)**

**1. Basis of Presentation**

The condensed consolidated financial statements include the accounts of Coinmach Service Corp., a Delaware corporation ( CSC ), and all of its subsidiaries, including Coinmach Corporation, a Delaware corporation ( Coinmach ). All significant intercompany profits, transactions and balances have been eliminated in consolidation. CSC was incorporated on December 23, 2003 as a wholly-owned subsidiary of Coinmach Holdings, LLC, a Delaware limited liability company ( Holdings ). Unless otherwise specified herein, references to the Company, we, us and our sha mean CSC and its subsidiaries.

CSC and its wholly-owned subsidiaries are providers of outsourced laundry equipment services for multi-family housing properties in North America. The Company s core business (which the Company refers to as the route business) involves leasing laundry rooms from building owners and property management companies, installing and servicing laundry equipment and collecting revenues generated from laundry machines. Through Appliance Warehouse of America, Inc., a Delaware corporation jointly-owned by CSC and Coinmach ( AWA ), the Company rents laundry machines and other household appliances to property owners, managers of multi-family housing properties, and to a lesser extent, individuals and corporate relocation entities. Super Laundry Equipment Corp., a Delaware corporation and a direct wholly-owned subsidiary of Coinmach ( Super Laundry ), constructs, designs and retrofits laundromats and distributes laundromat equipment.

The accompanying unaudited condensed consolidated financial statements of the Company have been prepared in conformity with U.S. generally accepted accounting principles ( GAAP ) for interim financial reporting and pursuant to the rules and regulations of the Securities and Exchange Commission. Accordingly, such financial statements do not include all of the information and footnotes required by GAAP for complete financial statements. GAAP requires the Company s management to make estimates and assumptions that affect the amounts reported in the financial statements. Actual results could differ from such estimates.

The interim results presented herein are not necessarily indicative of the results to be expected for the entire year.

In the opinion of management of the Company, these unaudited condensed consolidated financial statements contain all adjustments of a normal recurring nature necessary for a fair presentation of the financial statements for the interim periods presented. These unaudited condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements included in the Company s Annual Report on Form 10-K for the fiscal year ended March 31, 2006.

**The IDS Transactions and Class A Common Stock Offering**

On November 24, 2004, CSC completed its initial public offerings (collectively, the IPO ) of (i) 18,911,532 Income Deposit Securities ( IDSs ) (each IDS consisting of one share of Class A common stock, par value \$0.01 per share (the Class A Common Stock ) and an 11%

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**COINMACH SERVICE CORP. AND SUBSIDIARIES**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**(UNAUDITED)(continued)**

senior secured note due 2024 in a principal amount of \$6.14), and (ii) \$20.0 million aggregate principal amount of 11% senior secured notes due 2024 separate and apart from the IDSs (such notes, together with the 11% senior secured notes underlying IDSs, the 11% Senior Secured Notes ). In connection with the IPO, (i) Holdings became the sole holder of all outstanding shares of the Company's Class B common stock, par value \$0.01 per share (the Class B Common Stock ), and (ii) Coinmach Laundry Corporation, a Delaware corporation ( CLC or Laundry Corp. ), and AWA became wholly-owned subsidiaries of CSC. The IPO and the use of proceeds therefrom and the transactions related thereto are referred to herein collectively as the IDS Transactions.

On February 8, 2006, CSC completed a public offering of 12,312,633 shares of Class A Common Stock at a price to the public of \$9.00 per share (the Class A Offering ). Net proceeds from the Class A Offering were approximately \$102.7 million. As a result of the Class A Offering, the Company incurred approximately \$8.2 million in issuance costs, including underwriting discounts and commissions, which was recorded as a reduction of the proceeds from its sale of the Class A Common Stock. In addition to the issuance costs, CSC incurred certain expenses that were classified as transaction costs on the Consolidated Statements of Operations for the fiscal year ended March 31, 2006, which included (i) a premium (including an early tender payment of approximately \$0.5 million) paid with proceeds of the Class A Offering to redeem the 11% Senior Secured Notes of approximately \$4.8 million, (ii) the write-off of a proportionate amount of unamortized deferred financing costs of approximately \$3.4 million and (iii) certain direct expenses related to the Tender Offer (defined below) of approximately \$1.0 million which included approximately \$0.5 million relating to special bonuses.

The net proceeds of the Class A Offering, upon their distribution to CSC, were used (i) to purchase approximately \$48.4 million aggregate principal amount outstanding of 11% Senior Secured Notes pursuant to the Tender Offer further described in Note 4, and related fees and expenses, (ii) to repurchase 2,199,413 shares of Class A Common Stock owned by an affiliate of GTCR CLC, LLC (the controlling equity investor in Holdings) at a repurchase price of \$8.505 per share or approximately \$18.7 million in the aggregate, (iii) to repurchase 1,605,995 shares of Class B Common Stock that had been distributed to equity investors of Holdings (including CSC officers and certain directors) at a repurchase price of \$8.505 per share or approximately \$13.7 million in the aggregate and (iv) for general corporate purposes.

Subject to the satisfaction of certain conditions, the indenture governing the 11% Senior Secured Notes permits us to merge Laundry Corp. and Coinmach into CSC. We refer to such potential mergers collectively as the Merger Event. If we were to consummate the Merger Event in the future, CSC would become an operating company as well as the direct borrower under the Amended and Restated Credit Facility (as defined below) and sole owner of the capital stock of Coinmach's subsidiaries. We are not currently contemplating completion of the Merger Event.

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**COINMACH SERVICE CORP. AND SUBSIDIARIES**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**(UNAUDITED)(continued)**

**Dividends**

CSC currently intends to pay dividends on its Class A Common Stock on each March 1, June 1, September 1 and December 1 to holders of record as of the preceding February 25, May 25, August 25 and November 25, respectively, in each case with respect to the immediately preceding fiscal quarter. CSC currently intends to pay annual dividends on its Class B Common Stock on each June 1 to holders of record as of the preceding May 25 with respect to the immediately preceding fiscal year, subject to certain limitations and exceptions with respect to such dividends, if any. The payment of dividends by CSC on its common stock is subject to the sole discretion of the board of directors of CSC, various limitations imposed by the certificate of incorporation of CSC, the terms of outstanding indebtedness of CSC and Coinmach, and applicable law. Payment of dividends on all classes of CSC common stock will not be cumulative.

**2. Inventories**

Inventory costs for the route business and AWA are determined principally by using the average cost method and are stated at the lower of cost or net realizable value. Inventory costs for Super Laundry are valued at the lower of cost (first-in, first-out). Machine repair parts inventory is valued using a formula based on total purchases and the annual inventory turnover. Inventory consists of the following (in thousands):

	<b>September 30, 2006</b>	<b>March 31, 2006</b>
Laundry equipment	\$ 9,463	\$ 7,884
Machine repair parts	3,836	3,574
	<b>\$ 13,299</b>	<b>\$ 11,458</b>

**3. Goodwill and Contract Rights**

The Company accounts for goodwill in accordance with the provisions of Statement of Financial Accounting Standards ( SFAS ) No. 142 ( SFAS 142 ) Goodwill and Other Intangible Assets . SFAS 142 requires an annual impairment test of goodwill. Goodwill is further tested between annual tests if an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying amount. Based on present operating and strategic plans, management believes that there have not been any indications of impairment of goodwill. The fair value of the reporting units for these tests is based upon a discounted cash flow model. The Company has determined that its reporting units with goodwill consist of the route business, AWA and Super Laundry. Goodwill attributed to the route business, AWA and Super Laundry is as follows (in thousands):

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	<b>September 30, 2006</b>	<b>March 31, 2006</b>
Route	\$ 196,939	\$ 195,026
Rental	8,253	8,253
Distribution	2,917	2,917
	<b>\$ 208,109</b>	<b>\$ 206,196</b>

The Company performed its annual assessment of goodwill as of January 1, 2006 and determined that no impairment existed. There can be no assurances that future goodwill impairment tests will not result in a charge to income.

Contract rights represent the value of location contracts arising from the acquisition of laundry machines on location. These amounts, which arose primarily from purchase price allocations pursuant to acquisitions, are amortized using accelerated methods over periods ranging from 30 to 35 years. The Company does not record contract rights relating to new locations signed in the ordinary course of business.

Amortization expense for contract rights for the remainder of the fiscal year ending March 31, 2007 and each of the next five years is estimated to be as follows (in millions of dollars):

Years ending March 31,	
2007 (remainder of year)	\$ 7.0
2008	13.6
2009	13.2
2010	12.9
2011	12.6
2012	12.3

The Company assesses the recoverability of contract rights in accordance with the provisions of SFAS No. 144 ( SFAS 144 ) Accounting for the Impairment and Disposal of Long-Lived Assets. The Company has twenty-eight geographic regions to which contract rights have been allocated. The Company has contracts at every location/property, and analyzes revenue and certain direct costs on a contract-by-contract basis, however, the Company does not allocate common region costs and servicing costs to contracts, therefore regions represent the lowest level of identifiable cash flows in grouping contract rights. The assessment includes evaluating the financial results/cash flows and certain statistical performance measures for each region in which the Company operates. Factors that generally impact cash flows include commission rates paid to property owners, occupancy rates at properties, sensitivity to price increases, loss of existing machine base, and the regions general economic conditions. If as a result of this evaluation there are indicators of impairment that result in losses to the machine base, or an event occurs that would indicate that the carrying amounts may not be recoverable, the Company reevaluates the carrying value of contract rights based on future undiscounted cash

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**COINMACH SERVICE CORP. AND SUBSIDIARIES  
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(UNAUDITED)(continued)**

flows attributed to that region and records an impairment loss based on dis