

MODINE MANUFACTURING CO
Form 10-K
May 30, 2008

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D. C. 20549

FORM 10-K

(Mark One)

ANNUAL REPORT PURSUANT TO SECTION 13 or 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended March 31, 2008

or

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

For the transition period from _____ to _____

Commission file number 1-1373

MODINE MANUFACTURING COMPANY
(Exact name of registrant as specified in its charter)

WISCONSIN
(State or other jurisdiction of incorporation or organization)

39-0482000
(I.R.S. Employer Identification No.)

1500 DeKoven Avenue, Racine, Wisconsin
(Address of principal executive offices)

53403
(Zip Code)

Registrant's telephone number, including area code (262) 636-1200

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common Stock, \$0.625 par value	New York Stock Exchange

Securities Registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.
Yes No

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Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.

Yes No

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 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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large Accelerated Filer

Accelerated Filer

Non-accelerated Filer (Do not check if a smaller reporting company) Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes No

Approximately 73 percent of the outstanding shares are held by non-affiliates. The aggregate market value of these shares was approximately \$641 million based on the market price of \$27.34 per share on September 26, 2007, the last day of our most recently completed second fiscal quarter. Shares of common stock held by each executive officer and director and by each person known to beneficially own more than 5 percent of the outstanding common stock have been excluded in that such persons may be deemed to be affiliates. The determination of affiliate status is not necessarily a conclusive determination for other purposes.

The number of shares outstanding of the registrant's common stock, \$0.625 par value, was 32,262,884 at May 20, 2008.

An Exhibit Index appears at pages 101-103 herein.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the following documents are incorporated by reference into the parts of this Form 10-K designated to the right of the document listed.

Incorporated Document	Location in Form 10-K
Proxy Statement for the 2008 Annual Meeting of Shareholders	Part III of Form 10-K (Items 10, 11, 12, 13, 14)

TABLE OF CONTENTS

MODINE MANUFACTURING COMPANY - FORM 10-K
FOR THE YEAR ENDED MARCH 31, 2008

<u>PART I</u>		1
<u>ITEM 1.</u>	<u>BUSINESS.</u>	1
<u>ITEM 1A.</u>	<u>RISK FACTORS.</u>	11
<u>ITEM 1B.</u>	<u>UNRESOLVED STAFF COMMENTS.</u>	16
<u>ITEM 2.</u>	<u>PROPERTIES.</u>	16
<u>ITEM 3.</u>	<u>LEGAL PROCEEDINGS.</u>	17
<u>ITEM 4.</u>	<u>SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS.</u>	17
	<u>EXECUTIVE OFFICERS OF THE REGISTRANT.</u>	17
<u>PART II</u>		18
<u>ITEM 5.</u>	<u>MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES.</u>	18
<u>ITEM 6.</u>	<u>SELECTED FINANCIAL DATA.</u>	20
<u>ITEM 7.</u>	<u>MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.</u>	21
<u>ITEM 7A.</u>	<u>QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.</u>	43
<u>ITEM 8.</u>	<u>FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA.</u>	48
<u>ITEM 9.</u>	<u>CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE.</u>	96
<u>ITEM 9A.</u>	<u>CONTROLS AND PROCEDURES.</u>	96
<u>ITEM 9B.</u>	<u>OTHER INFORMATION.</u>	97
<u>PART III</u>		97

<u>ITEM 10.</u>	<u>DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE.</u>	97
<u>ITEM 11.</u>	<u>EXECUTIVE COMPENSATION.</u>	98
<u>ITEM 12.</u>	<u>SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS.</u>	98
<u>ITEM 13.</u>	<u>CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE.</u>	98
<u>ITEM 14.</u>	<u>PRINCIPAL ACCOUNTANT FEES AND SERVICES.</u>	98
<u>PART IV</u>		98
<u>ITEM 15.</u>	<u>EXHIBITS AND FINANCIAL STATEMENT SCHEDULES.</u>	98
	<u>SIGNATURES</u>	99
	<u>SCHEDULE II - VALUATION AND QUALIFYING ACCOUNTS</u>	100
	<u>EXHIBIT INDEX</u>	101

Table of Contents

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Table of Contents

PART I

ITEM 1. BUSINESS.

Modine is a global leader in thermal management technology, serving the vehicular, industrial, commercial, building HVAC&R (heating, ventilating, air conditioning and refrigeration) and fuel cell markets. Modine develops, manufactures, and markets thermal management products, components and systems for use in various original equipment manufacturer (“OEM”) applications and to a wide array of building and other commercial markets. Our primary customers across the globe are:

- Truck, automobile, bus, and specialty vehicle OEMs;
- Agricultural and construction OEMs;
- Heating and cooling OEMs;
- Construction contractors;
- Wholesalers of plumbing and heating equipment; and
- Fuel cell manufacturers.

In layman’s terms, when we discuss thermal management, we are talking about products, such as radiators, charge air coolers and oil coolers, that use a medium (air or liquid) to cool the heat that is produced by a vehicle engine. In addition, we also produce systems for maintaining vehicle passenger comfort which include components such as evaporators and condensers. We supply equipment for the temperature control needs of public and commercial buildings.

History

Modine was incorporated under the laws of the State of Wisconsin on June 23, 1916 by its founder, Arthur B. Modine. Mr. Modine’s “Spirex” radiators became standard equipment on the famous Ford Motor Company Model T. When he died at the age of 95, A.B. Modine had been granted a total of 120 U.S. patents for heat transfer innovations. The standard of innovation exemplified by A.B. Modine remains the cornerstone of Modine today.

Terms; Year References

When we use the terms “Modine,” “we,” “us,” the “Company,” or “our” in this report, unless the context requires otherwise, we are referring to Modine Manufacturing Company and its subsidiaries. Our fiscal year ends on March 31. All references to a particular year mean the fiscal year ended March 31 of that year, unless indicated otherwise.

Business Strategy and Results

Modine focuses on thermal management leadership and highly engineered product and service innovations for diversified, global markets and customers. We are committed to enhancing our presence around the world and serving our customers where they are located. We create value by focusing on customer partnerships and providing innovative solutions for our customers' thermal problems.

Modine’s strategy for improved profitability is grounded in diversifying our markets and customer base, differentiating our products and services, and partnering with customers on global OEM platforms. Modine’s top five customers are in three different markets – automotive, truck and off-highway – and its ten largest customers accounted for approximately 57 percent of the Company’s fiscal 2008 sales, as compared to 64 percent in fiscal 2007. In fiscal 2008, 70 percent of total revenues were generated from sales to customers outside of the U.S., 65 percent of which were generated by Modine’s international operations and 5 percent of which were generated by exports from the U.S. In fiscal 2007, 59 percent of total revenues were generated from sales to customers outside of the U.S., with 54 percent

generated by Modine's international operations and 5 percent generated by exports from the U.S.

During fiscal 2008, the Company achieved record revenue from continuing operations of \$1.85 billion, a 7 percent improvement from \$1.72 billion in fiscal 2007. Sales volumes were positively affected by strong foreign volumes in Europe and Brazil, as well as steady growth in our Commercial Products business. The loss from continuing operations of \$65.5 million, or a loss of \$2.05 per fully diluted share in fiscal 2008, was down from earnings from continuing operations of \$38.9 million, or earnings of \$1.21 per fully diluted share in fiscal 2007. The decrease in earnings from continuing operations was driven by a decline in gross margins related to weak North American truck volumes, manufacturing inefficiencies experienced as part of plant closures and consolidations and pricing pressure from customers. In addition, impairment charges of \$47.4 million were recorded primarily in North America and South Korea due to reduced outlook for these businesses. During fiscal 2008, the Company recorded a valuation allowance of \$64.6 million primarily against the net deferred tax assets in the U.S. and South Korean tax jurisdictions. This valuation allowance contributed to the increase in the provision for income taxes from \$6.2 million in fiscal 2007 to \$44.4 million in fiscal 2008.

Table of Contents

Operating cash flow for fiscal 2008 was \$67.4 million which represents a 34.1 percent decrease from the prior year of \$102.4 million due largely to reduced operating results in the Original Equipment – North America segment. The reduced operating cash flows were not sufficient to fully finance capital expenditures and working capital needs for the business during fiscal 2008, therefore requiring additional borrowings on the Company's revolving credit facility during the year. Total debt at the end of fiscal 2008 was \$226.5 million compared with \$179.3 million at the end of fiscal 2007. Additional net borrowings were made primarily to finance \$87.0 million of capital expenditures, the purchase of Company stock of \$7.7 million through the anti-dilutive portion of the stock repurchase program announced in fiscal 2006 and purchases of stock to satisfy tax withholding obligations upon the vesting of stock awards and a \$37.9 million increase in working capital. This significant increase in working capital is primarily due to the growing business volumes. Modine's days sales outstanding of 51 days at the end of fiscal 2008 has improved from the 53 days at the end of fiscal 2007 and is consistent with the 51 days at the end of fiscal 2006. Modine's inventory turns of 13.2 at the end of fiscal 2008 has improved from the end of fiscal 2007 of 12.9, but has decreased from 15.4 at the end of fiscal 2006.

During fiscal 2008, the Company recognized a decline in future growth prospects within the Original Equipment – North America business from previous management projections, including a lower margin outlook, which resulted in a goodwill impairment charge of \$23.8 million within this segment. Also during fiscal 2008, the South Korean business, which is included in the Original Equipment – Asia segment, continued to underperform expectations due to customer pricing pressures and a reduced outlook for this business, which resulted in a long-lived asset impairment charge of \$12.1 million. In addition to these charges, long-lived asset impairment charges of \$11.6 million were recorded during fiscal 2008 consisting of \$3.4 million in Original Equipment – North America, where a program was identified as being unable to support its asset base, \$4.7 million in Original Equipment – Europe for the Tübingen, Germany manufacturing facility which will be closed, and \$3.5 million in the Commercial Products segment for the cancellation of a product in its development stage. A deferred tax valuation allowance of \$64.6 million was recorded primarily against the net U.S. and South Korean deferred tax assets related to the existence of projected losses, which resulted in the determination that it was more likely than not that these deferred taxes would not be realized. In response to these business and market conditions, the Company implemented a number of cost and operational efficiency measures that are designed to improve our longer term competitiveness:

- Manufacturing realignment – The Company announced the closure of the Camdenton, Missouri; Pemberville, Ohio; and Logansport, Indiana facilities within the Original Equipment – North America segment and the Tübingen, Germany manufacturing facility within the Original Equipment – Europe segment. These closures are in addition to the previously announced four plant closures in North America, of which the Jackson, Mississippi and Clinton, Tennessee facility closures are still in process.
- Portfolio rationalization – The Company has a new organizational structure which has been in place for a little over a year. The new structure is organized around global product lines and a regional operating model. The Company is looking at product lines within and across the regions to assess them relative to Modine's competitive position and the overall business attractiveness in order to identify those lower margin product lines which should be divested or exited. Through these rationalization efforts, the Company completed the sale of its Electronics Cooling business on May 1, 2008.
- Capital allocation – The Company introduced an enhanced capital allocation process which is designed to allocate capital spending to the segments and programs that will provide the highest return on investment. The Company anticipates capital spending in the intermediate term to be near depreciation levels.
- Selling, general and administrative (SG&A) cost containment – The Company has a target of driving SG&A levels down to 11.5 percent of sales by fiscal 2011. Progress was made toward this goal during fiscal 2008, with SG&A as a percentage of sales declining from 13.4 percent in the prior year to 12.7 percent in the current year.

These initiatives are intended to support the Company's focus on increasing return on average capital employed. This is a financial measure of the profit generated on the total capital invested in the Company before interest expense payable to lenders, net of any tax effect. Management believes that return on average capital employed provides helpful supplemental information about the Company's performance, ability to provide an acceptable return on all the capital utilized by the Company, and ability to fund growth. Capital is allocated to each business unit based on performance, and that performance is evaluated against a risk-adjusted target rate of return. All business units are measured using specific performance standards and they all must earn the right to obtain capital to fund growth through their performance. This focus also allows us to identify underperforming business units, and to pursue opportunities that will contribute to our earnings and returns. We continue to take actions to enhance these returns into the future, with the long-term goal of achieving a return on average capital employed in the range of 11 percent to 12 percent.

2

Table of Contents

We focus our development efforts on the most promising new markets and new products. Our investment in research and development (“R&D”) has increased approximately 13 percent from fiscal 2007 to fiscal 2008. R&D is an investment in our future that returns new technologies for our core markets, such as our work with CO₂ as a refrigerant, fuel cell technologies and next generation aluminum radiators demonstrates. U.S., European and Asian emissions regulations are continuing to become more restrictive which requires new technologies and products in order to meet these emissions standards. Modine is a leader in exhaust gas recirculation (“EGR”) cooler technology and we have developed solutions that allow our customers to meet tighter government standards efficiently. EGR coolers recirculate “cooled” exhaust back into a diesel engine at a lower temperature thus reducing emissions of nitrous oxides (NO_x), a key pollutant that is being regulated. As the emissions standards tighten in the future, much higher amounts of recirculation is planned, possibly greater than 40 percent of the engine’s exhaust, which will put even greater emphasis on advanced EGR cooler technology. Through our proactive R&D, we are developing new technologies designed to keep our customers within federal and international guidelines and regulations well into the future.

We have made substantial investments in plants and equipment along with state-of-the-art technical centers. These are critical to our strategy of generating growth through technological leadership. Our wind tunnels, technical centers and administration buildings in Racine, Wisconsin and Bonlanden, Germany, and wind tunnel and technical center in Asan City, South Korea ensure better ongoing service for our global customers.

Discontinued Operations

On May 1, 2007, the Company announced it would explore strategic alternatives for its Electronics Cooling business and presented it as held for sale and as a discontinued operation in the consolidated financial statements for all periods presented. The Electronics Cooling business was sold on May 1, 2008 for \$13.2 million, resulting in a gain on sale. On July 22, 2005, the Company completed the spin off of its Aftermarket business and the immediate merger of the spun off business into Proliance International, Inc. (formerly known as Transpro, Inc.). The Aftermarket business has been presented as a discontinued operation in the consolidated financial statements. In fiscal 2006, the Company recorded a non-cash charge to earnings of \$53.5 million to reflect the difference between the value that Modine shareholders received in Proliance, a function of the price of Proliance at the time of the closing of the spin off, and the asset carrying value of Modine’s Aftermarket business. Reported results after earnings (loss) from discontinued operations and loss on spin off of discontinued operations for fiscal 2008, 2007 and 2006 was a net loss of \$65.6 million and net earnings of \$42.3 million and \$7.6 million, respectively, or loss per fully diluted share of \$2.05 and earnings per fully diluted share of \$1.31 and \$0.22, respectively.

Products

The Company offers a broad line of products that can be categorized generally as a percentage of net sales as follows:

Table of Contents

	Fiscal 2008	Fiscal 2007
Modules/Packages*	27%	28%
Oil Coolers	15%	13%
Radiators	14%	14%
Vehicular Air Conditioning	14%	14%
Charge-Air Coolers	9%	11%
Building HVAC	9%	9%
EGR Coolers	9%	8%
Miscellaneous	3%	3%

*Typically include components such as radiators, oil coolers, charge air coolers, condensers and other purchased components.

Competitive Position

The Company competes with several manufacturers of heat transfer products, some of which are divisions of larger companies and some of which are independent companies. The markets for the Company's products are increasingly competitive and have changed significantly in the past few years. The Company's traditional OEM customers in the U.S. are faced with dramatically increased international competition and have expanded their worldwide sourcing of parts to compete more effectively with lower cost imports. These market changes have caused the Company to experience competition from suppliers in other parts of the world that enjoy economic advantages such as lower labor costs, lower health care costs, and lower tax rates. In addition, our customers continue to ask the Company, as well as their other primary suppliers, to participate in research and development, design, and validation responsibilities. This should result in stronger customer relationships and more partnership opportunities for the Company.

The competitive landscape for Modine's core heat transfer products continues to change. We face increasing challenges from existing competitors and the threat of new, low cost competitors (specifically from China) continues to exist.

Business Segments

The Company has assigned specific businesses to a segment based principally on defined markets and geographical locations. Each Modine segment is managed at the regional vice president or managing director level and has separate financial results reviewed by its chief operating decision makers. These results are used by management in evaluating the performance of each business segment, and in making decisions on the allocation of resources among our various businesses. Our chief operating decision makers evaluate segment performance with an emphasis on gross margin, and secondarily based on operating income of each segment, which includes certain allocations of Corporate SG&A expenses. Additional information about Modine's business segments, including sales and assets by geography, is set forth in Note 25 of the Notes to Consolidated Financial Statements.

In the first quarter of fiscal 2008, the Company implemented certain management reporting changes which resulted in the Brazilian operation being reported in a newly established South America segment; the Original Equipment – Americas segment being renamed Original Equipment – North America; certain supporting departments previously included within Corporate and administrative being realigned into the Original Equipment – North America segment; the Commercial HVAC&R segment renamed Commercial Products; and the Other segment renamed to Fuel Cell since the Electronics Cooling business is presented as a discontinued operation. The Original Equipment – Asia and Original Equipment – Europe segment have no changes. The segment information for fiscal 2007 and 2006 has been revised to reflect these changes on a comparable basis.

Original Equipment – Asia, Europe and North America Segments

The continuing globalization of the Company's OEM customer base has led to the necessity of viewing Modine's strategic approach, product offerings and competitors on a global basis. In addition, the Company's customers continue to pressure their suppliers to lower prices continuously over the life of a program, emphasizing transparency in the quoting process, and in some cases have requested up front payments in return for the award of future business.