CLARION TECHNOLOGIES INC/DE/
Form 10-Q
August 16, 2005

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

FORM 10-Q

(Mark One)

[x] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended July 2, 2005

[ ] 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 0-24690

CLARION TECHNOLOGIES, INC.
(Exact name of registrant as specified in its charter)

Delaware	**91-1407411**
(State of Incorporation)	(I.R.S. Employer Identification No.)

38 W. Fulton, Suite 300, Grand Rapids, Michigan 49503
(Address of principal executive offices)
(Zip Code)

(616) 454-0055
(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. [X] Yes [ ] No

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). [ ] Yes [X] No

The number of shares outstanding of registrant s common stock was 45,406,367 as of August 16, 2005.

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PART I FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

CLARION TECHNOLOGIES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)

(In thousands, except per share data)

	Second Quarter Ended		Six Months ended	
	July 2, 2005	June 26, 2004	July 2, 2005	June 26, 2004
Net sales	$ 38,980	$ 28,127	$ 71,254	$ 57,721
Cost of sales	36,550	24,718	68,700	50,567
Gross profit	2,430	3,409	2,554	7,154
Operating expenses:				
Selling, general and administrative expenses	1,806	1,916	3,483	3,732
Restructuring and impairment credits	-	(117)	-	(117)
	1,806	1,799	3,483	3,615
Operating income (loss)	624	1,610	(929)	3,539
Interest expense	(1,284)	(1,120)	(2,591)	(2,240)
Other income, net	20	4	31	6
Income (loss) before income taxes	(640)	494	(3,489)	1,305
Provision for income taxes	-	-	-	-
Net income (loss)	$ (640)	$ 494	$(3,489)	$ 1,305
Basic and Diluted EPS calculation:				
Numerator:				
Net income (loss)	$ (640)	$ 494	$(3,489)	$ 1,305
Preferred stock dividends declared	(2,724)	(1,777)	(5,503)	(4,058)
Accretion of preferred stock to mandatory redemption value	(235)	(226)	(485)	(450)
Net loss attributable to common shareholders	$(3,599)	$(1,509)	$(9,477)	$(3,203)
Denominator:				
Average common shares outstanding (basic and diluted)	45,391	45,209	45,342	45,155
Loss per share attributable to common shareholders (basic and diluted)	$ (0.08)	$ (0.03)	$ (0.21)	$ (0.07)

See accompanying notes to condensed consolidated financial statements.

CLARION TECHNOLOGIES, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands)

	July 2, 2005 (UNAUDITED)	December 25, 2004 (AUDITED)
ASSETS		
Current assets:		
Cash and cash equivalents	$ 99	$ 109
Accounts receivable, net of allowance of $160	17,750	13,960
Inventories	6,102	4,909
Prepaid expenses and other current assets	674	798
Assets held for sale	-	1,479
Total current assets	24,625	21,255
Property, plant and equipment, net	24,103	24,461
Other assets:		
Goodwill	24,521	24,521
Deferred financing costs, net of accumulated amortization of $695 and $640	208	263
Other long-term assets	64	122
	24,793	24,906
	$ 73,521	$ 70,622
LIABILITIES AND SHAREHOLDERS' DEFICIT		
Current liabilities:		
Revolving line of credit	$ 7,500	$ 6,850
Accounts payable	21,725	16,467
Accrued liabilities	2,338	2,162
Mandatorily redeemable common stock	2,550	-
Current portion of long-term debt	8,154	7,115
Total current liabilities	42,267	32,594
Long-term debt, net of current portion	18,232	20,527
Mandatorily redeemable common stock	-	2,550
Accrued dividends	27,863	22,360
Other liabilities	6,205	4,618
Total liabilities	94,567	82,649
Redeemable Series A preferred stock	36,800	36,366
Redeemable Series B preferred stock	19,202	19,150
Shareholders' deficit:		
Common stock	45	45
Additional paid-in capital	33,017	33,416
Accumulated other comprehensive loss	(118)	(55)
Accumulated deficit	(109,992)	(100,949)
Total shareholders' deficit	(77,048)	(67,543)
	$ 73,521	$ 70,622

See accompanying notes to condensed consolidated financial statements.

CLARION TECHNOLOGIES, INC. AND SUBSIDIARIESCONDENSED CONSOLIDATED BALANCE SHEETS (In th

CLARION TECHNOLOGIES, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)
(In thousands)

	Six Months Ended	
	July 2, 2005	June 26, 2004
OPERATING ACTIVITIES:		
Net income (loss)	$(3,489)	$ 1,305
Depreciation and amortization	1,958	2,083
Restructuring and impairment credits	-	(117)
Changes in operating assets and liabilities	2,116	(1,520)
Loss on sale of property, plant, and equipment	181	39
Other, net	-	127
Cash provided by operating activities	766	1,917
INVESTING ACTIVITIES:		
Capital expenditures	(1,550)	(1,322)
Proceeds from sale of property, plant, and equipment	1,499	1,006
Cash used in investing activities	(51)	(316)
FINANCING ACTIVITIES:		
Net change in revolving credit borrowings	650	899
Payment of deferred financing costs	-	(53)
Proceeds from issuance of long-term debt	1,731	1,558
Repayments of long-term debt	(3,120)	(4,084)
Proceeds from issuance of capital stock	14	23
Cash used in financing activities	(725)	(1,657)
NET DECREASE IN CASH AND CASH EQUIVALENTS	(10)	(56)
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	109	107
CASH AND CASH EQUIVALENTS, END OF PERIOD	$ 99	$ 51

See accompanying notes to condensed consolidated financial statements.

CLARION TECHNOLOGIES, INC. AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

1. OPERATIONS AND BASIS OF PRESENTATION

The accompanying unaudited condensed consolidated financial statements of Clarion Technologies, Inc. and Subsidiaries (collectively referred to as Clarion or the Company) have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and with the instructions to Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals and other adjustments) considered necessary for a fair presentation have been included. The results of operations for any interim period are not necessarily indicative of the results to be expected for the full year. For further information, refer to the consolidated financial statements and notes thereto included in the Company s annual report on Form 10-K for the fiscal year ended December 25, 2004.

Due to fiscal 2005 being comprised of a 53 week year, the first six months of fiscal 2005 included 27 weeks of activity, compared to 26 weeks in the first six months of fiscal 2004.

The Company has classified checks disbursed but not yet presented for payment as accounts payable. The amounts at July 2, 2005, and December 25, 2004, were $1,800,000 and $1,559,000, respectively.

The Company operates in a single geographic location, North America, and in a single reportable business segment, plastic injection molding. The accounting policies of this reportable business segment are described in the summary of significant accounting policies in the Company s Annual Report on Form 10-K for the fiscal year ended December 25, 2004.

New Accounting Standards

In December 2004, the Financial Accounting Standards Board (FASB) issued SFAS 123(R), *Share-Based Payment*, to revise SFAS 123, *Accounting for Stock-Based Compensation*, in several areas. SFAS 123(R) requires companies to measure the cost of employee services received in exchange for an award of an equity instrument based on the grant-date fair value of the award. The cost is recognized over the requisite service period (usually the vesting period) for the estimated number of instruments where service is expected to be rendered. SFAS 123(R) will be effective beginning in the first quarter of fiscal 2006. The Company does not expect the consolidated financial statements to be materially impacted from adopting SFAS 123(R).

Stock-Based Compensation

The Company accounts for stock-based employee and non-employee Director compensation using the intrinsic value method under APB Opinion No. 25, *Accounting for Stock Issued to Employees*, and interpretations. Accordingly, no compensation expense is recorded if the current market price of the underlying stock does not exceed the exercise price at the date of grant.

The following table (in thousands, except per share data) illustrates the effect on net loss and net loss per share attributable to common shareholders as if the Company had applied the fair value recognition provisions of SFAS No. 123, *Accounting for Stock-Based Compensation* (SFAS 123), to stock-based employee compensation and non-employee Director compensation.

	Second Quarter Ended		Six Months Ended	
	July 2, 2005	June 26, 2004	July 2, 2005	June 26, 2004
Net loss attributable to common shareholders	$(3,599)	$(1,509)	$(9,477)	$(3,203)
Deduct: Total stock-based compensation expense determined under fair value based method for all awards	6	23	17	81
Pro forma net loss attributable to common shareholders	$(3,605)	$(1,532)	$(9,494)	$(3,284)
Earnings per share:				
Basic and diluted, as reported	$(0.08)	$(0.03)	$(0.21)	$(0.07)
Basic and diluted, pro forma	$(0.08)	$(0.03)	$(0.21)	$(0.07)

For purposes of the SFAS 123 pro forma disclosures, the fair value of each option grant was estimated on the date of grant using the Black-Scholes model with the following assumptions:

	2005	2004
Dividend yield	0.0	0.0
Volatility, as a percent	69% to 102%	57% to 64%
Risk-free interest rate	4.3% to 5.0%	4.7% to 5.0%
Expected life in years after vest	9	9

Forfeitures are accounted for as they occur.

Comprehensive Income (Loss)

The Company s total comprehensive income (loss) is comprised of all changes in shareholders deficit during the period other than from transactions with shareholders. Comprehensive income (loss) consists of the following (in thousands):

	Second Quarter Ended		Six Months Ended	
	July 2, 2005	June 26, 2004	July 2, 2005	June 26, 2004
Net income (loss)	$(640)	$494	$(3,489)	$1,305
Other comprehensive income (loss):				
Market valuation adjustment of interest rate swap, net of tax	112	204	(63)	92
Comprehensive income (loss)	$(528)	$698	$(3,552)	$1,397

Interest Rate Swap Agreement

The Company is exposed to various market risks, which include changes in interest rates. In accordance with the terms of the Senior Credit Agreement discussed in Note 4, the Company has entered into interest rate swap agreements to reduce the impact of changes in interest rates on its variable rate borrowings. Interest rate swap agreements are contracts to exchange floating rates for fixed rate interest payments over the life of the agreements without the exchange of the underlying notional amounts. The notional amounts of interest rate swap agreements are used to measure interest to be paid or received and do not represent the amount of exposure to credit loss. The differential paid or received on interest rate swap agreements is recognized as an adjustment to interest expense. The Company does not use derivative financial instruments for trading purposes.

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The interest rate swap agreements essentially fix the interest rate on notional amounts of principal (an aggregate amount of $15,549,000 at July 2, 2005), each of which decreases with monthly settlements at a rate corresponding to the Company s actual principal payments on the related debt. The interest rate swap agreements expire in 2008 and 2010, and management currently has no intent to renew the agreements or enter into similar agreements in the near future. The net fair value of the swap agreements at July 2, 2005 was approximately ($118,000) and is recorded as other long-term liability on the balance sheet. Changes in the fair value of the swap agreements are reported as a component of other comprehensive income.

The counterparty to the Company s interest rate swap agreement is a commercial bank with which the Company has other financial relationships. While the Company is exposed to credit loss in the event of nonperformance by the counterparty, the Company does not anticipate nonperformance by the counterparty, and no material loss would be expected from such nonperformance. Fluctuations in interest rates are similarly not expected to have a material impact on the Company s future operating results.

The Company has formally documented the relationship between the interest rate swap and the variable rate long-term borrowings, as well as its risk-management objective and strategy for undertaking the hedge transaction. This process includes linking the derivative that has been designated as a cash flow hedge to the specific liability on the balance sheet. The Company also assesses, both at the hedge s inception and on an ongoing basis, whether the derivative used in the hedging transaction is highly effective in offsetting changes in the cash flows of the hedged item. If the Company determines that the derivative is not highly effective as a hedge or that it has ceased to be a highly effective hedge, the Company will discontinue hedge accounting prospectively.

Reclassifications

Certain amounts previously reported in prior fiscal years in the condensed consolidated balance sheets of the Company have been reclassified to conform with the presentation of the current quarter. In particular, gain/loss on the sale of property, plant , and equipment has been reclassified from Other income to Selling, general and administrative expenses.

2. INVENTORIES

Inventories are stated at the lower of cost or market. Cost is determined using the first-in, first-out (FIFO) method. The components of inventories are as follows (in thousands):

	July 2, 2005	December 25, 2004
Raw materials	$2,810	$2,185
Work in process	1,631	1,163
Finished goods	1,661	1,561
Total	$6,102	$4,909

3. ASSETS HELD FOR SALE

On January 31, 2005, the Company sold its manufacturing facility in South Haven, Michigan, which had been recorded as an asset held for sale. The Company sold the facility for $1,600,000. The Company is currently leasing this facility under a short-term lease arrangement with the purchaser.

4. DEBT

Debt consists of the following obligations (in thousands):

	July 2, 2005	December 25, 2004
Senior credit facility:		
Revolving credit facility	$ 7,500	$ 6,850
Term debt	8,854	11,133
Capital expenditure line of credit	3,000	1,271
Senior and other subordinated term notes, net of unaccreted discount of $498 and $622	9,502	9,378
Other subordinated promissory notes	4,418	5,190
Capital lease obligations	612	751
	33,886	34,492
Less current portion	15,654	13,965
Long term portion	$18,232	$20,527

The Company amended its senior credit facility on July 29, 2005. As amended, the revolving credit facility is scheduled to mature on September 30, 2005, and allows for aggregate borrowings of $10,000,000 at the prime rate plus 0.75% or, at the Company s option, one, two, three or six-month LIBOR plus 3.50%, subject to certain borrowing base limitations related to accounts receivable and inventory. In addition, an unused facility fee of 0.375% per annum is payable on the unused portion of the credit line. The term debt matures on April 15, 2007 and bears interest at the prime rate plus 0.75% or, at the Company s option, one, two, three or six month LIBOR plus 3.5% plus an applicable margin. The senior credit facility also permits draws to be made on a capital expenditure line of credit in the maximum amount of $3,000,000 at one-month LIBOR. All tangible and intangible assets of the Company are collateralized under the senior credit facility.

The Company s senior subordinated term notes currently bear interest at an annual rate of 15%. Payments of interest are currently deferred.

Other subordinated promissory notes are comprised primarily of a note due to Electrolux Home Products, a division of White Consolidated Industries, Inc. (Electrolux), and certain notes payable to the Company s senior subordinated lender and certain affiliates (A&M Notes). The Electrolux note was outstanding in the amount of $500,000 as of July 2, 2005, and is paid in equal monthly installments. The Electrolux note matures on September 30, 2005. The A&M Notes were outstanding in the amount of $2,758,000 as of July 2, 2005, and the payment of interest is currently deferred. The A&M Notes mature on September 30, 2005.

The senior credit facility requires the Company s subordinated debt holders and preferred shareholders to forego interest and dividend payments, respectively, unless approved by the bank. The senior credit facility and senior subordinated term notes also prohibit the payment of dividends on common stock.

Based on the contractual terms of all debt agreements (as amended), principal maturities and capital lease obligations for the twelve-month period ended July 2 are as follows: 2006 $15,654,000; 2007 $11,813,000; 2008 $6,909,000; 2009 $7,000

The Company was in compliance with the covenants under the terms of the Senior Credit Facility and Senior subordinated debt agreement, as amended on April 29, 2005, for the period ended July 2, 2005. Covenants related to targets for earnings before interest, taxes, depreciation, and amortization (EBITDA), fixed charge coverage ratios, senior and total debt to EBITDA ratios, total liabilities to tangible capital fund ratios, working capital levels, and limits on capital expenditures and operating leases.

5. EMPLOYEE STOCK PURCHASE PLAN

In June 2000, the Company s shareholders approved a noncompensatory employee stock purchase plan (ESPP) whereby 400,000 shares of common stock has been reserved for purchase by eligible employees through a payroll deduction program. The purchase price of the stock is 85% of the average closing price of the last 30 trading days of the respective quarter. Through the first quarter of fiscal 2005, the ESPP had issued 392,366 shares of common stock and therefore did not have enough shares remaining to cover additional quarterly purchases. Shareholder approval is required to authorize additional shares for the ESPP. The Board of Directors will not seek the required shareholder approval to authorize additional shares for the ESPP at this time. However, the Company s Management and Board of Directors will periodically evaluate the merits of seeking shareholder approval to issue more shares for the ESPP. The plan expires on June 30, 2010.

6. COMMITMENTS AND CONTINGENCIES

The Company is involved in certain claims and litigation arising in the normal course of business, including certain other litigation involving claims alleging damages under various contractual arrangements. After taking into consideration legal counsel s evaluation of these claims and actions, the Company is currently of the opinion that their outcome will not have a significant effect on the Company s consolidated financial position or future results of operations and cash flows.

7. OPERATING CONSIDERATIONS AND MANAGEMENT PLANS

As shown in the financial statements, the Company incurred a significant net loss in the first six months of fiscal 2005 and is highly leveraged. The Company also has a deficit position in working capital and shareholders equity.

In the first quarter of fiscal 2005, the Company s key customer was unable to order products from our Greenville facility for approximately five weeks. This was due to a fire at the manufacturing location of one of that customer s suppliers. This caused an immediate decrease in sales for the Company that negatively impacted profits in the first quarter. As of the beginning of March, this customer was running normal production volumes.

The Company has been proactively addressing its current liquidity and operational issues in an effort to improve cash flows. On April 14, 2003, the Company refinanced its senior debt and modified the terms of certain portions of its subordinated debt. The term debt portion of the Senior Credit Facility matures in two years and the line of credit matures on September 30, 2005. The terms of the Senior Credit Facility allow the Company to make payments on its subordinated debt, subject to certain limitations. In addition, since fiscal 2001, subordinated debt holders and preferred shareholders have agreed to defer interest and dividend payments through the maturity date of the senior debt, unless approved by the Company s senior lender. The Company s senior lender is allowing payments on the Company s Electrolux note and one other subordinated note.

The Company has implemented several operating initiatives and has successfully reduced costs. The Company continues to position itself to increase sales and profitability, including the successful completion of a supplier agreement that was entered into in May 2002, which increases sales each year through 2005. Also, the Company has been successful in obtaining additional business from other customers and expects to have increased growth in 2005.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

OVERVIEW

The following information should be read in conjunction with the accompanying Condensed Consolidated Financial Statements of the Company and Management s Discussion and Analysis of Financial Condition and Results of Operations set forth in the Company s Annual Report on Form 10-K for the fiscal year ended December 25, 2004.

We are primarily a company that provides our customers with plastic injection molding, post-molding assembly and finishing operations. Through the outsourcing of certain services, we also provide our customers with complex rapid prototyping, design and engineering services. We also provide certain of these services directly. By outsourcing certain services, we can cost effectively provide the ability to produce concept models, appearance models, engineering prototypes and pre-production samples. We believe, therefore, that we provide our customers with full service solutions, including access to modern design and machining equipment, including CAD/CAM systems, translators and plotters, electrical discharge machining equipment and miscellaneous support equipment.

We have six manufacturing facilities located in the United States that are full service custom injection molding plants with post-molding secondary operations. Our current facilities collectively house 171 horizontal injection-molding machines with capacities ranging from 55 tons to 1,500 tons of clamping force. Each machine utilizes a computerized process controller that continuously monitors key process parameters on a real time basis and signals the operator if any parameter falls outside predetermined statistical limits. The injection molding process is supported by automated systems for raw material drying, conveying and regrinding. All of our plants have received TS 16949 certification with the exception of our Ames, Iowa facility, which began production in the first quarter of 2005.

We offer our customers value added post-molding secondary services, including ultrasonic inserting and welding, heat staking, solvent bonding, finishing, machining, assembly and on-line packagin