LEAR CORP
Form 10-Q
November 05, 2008

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

(Mark One)

þ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended September 27, 2008.

o **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: 1-11311

LEAR CORPORATION

(Exact name of registrant as specified in its charter)

Delaware	**13-3386776**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
21557 Telegraph Road, Southfield, MI	**48033**
(Address of principal executive offices)	(Zip code)

(248) 447-1500

(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 þ No o

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 the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer þ	Accelerated filer o	Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

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

As of October 31, 2008, the number of shares outstanding of the registrant s common stock was 77,163,266 shares.

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LEAR CORPORATION
PART I FINANCIAL INFORMATION
ITEM 1 CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
INTRODUCTION TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

We have prepared the condensed consolidated financial statements of Lear Corporation and subsidiaries, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States have been condensed or omitted pursuant to such rules and regulations. We believe that the disclosures are adequate to make the information presented not misleading when read in conjunction with the financial statements and the notes thereto included in our Annual Report on Form 10-K/A, as filed with the Securities and Exchange Commission, for the year ended December 31, 2007.

The financial information presented reflects all adjustments (consisting of normal recurring adjustments) which are, in our opinion, necessary for a fair presentation of the results of operations and cash flows and statements of financial position for the interim periods presented. These results are not necessarily indicative of a full year s results of operations.

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LEAR CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
(In millions, except share data)

	September 27, 2008 (Unaudited)	December 31, 2007
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$ 523.2	$ 601.3
Accounts receivable	1,985.8	2,147.6
Inventories	682.3	605.5
Other	452.0	363.6
Total current assets	3,643.3	3,718.0
LONG-TERM ASSETS:		
Property, plant and equipment, net	1,321.9	1,392.7
Goodwill, net	2,052.4	2,054.0
Other	637.8	635.7
Total long-term assets	4,012.1	4,082.4
	$ 7,655.4	$ 7,800.4
LIABILITIES AND STOCKHOLDERS EQUITY		
CURRENT LIABILITIES:		
Short-term borrowings	$ 30.8	$ 13.9
Accounts payable and drafts	2,240.0	2,263.8
Accrued liabilities	1,186.1	1,230.1
Current portion of long-term debt	11.8	96.1
Total current liabilities	3,468.7	3,603.9
LONG-TERM LIABILITIES:		
Long-term debt	2,297.3	2,344.6
Other	757.8	761.2
Total long-term liabilities	3,055.1	3,105.8
STOCKHOLDERS EQUITY:		
Common stock, $0.01 par value, 150,000,000 shares authorized; 82,549,501 shares and 82,547,651 shares issued as of September 27, 2008 and December 31, 2007, respectively	0.8	0.8
Additional paid-in capital	1,382.0	1,373.3
Common stock held in treasury, 5,396,753 shares as of September 27, 2008, and 5,357,686 shares as of December 31, 2007, at cost	(189.3)	(194.5)

Retained deficit		(130.5)		(116.5)
Accumulated other comprehensive income		68.6		27.6
Total stockholders equity		1,131.6		1,090.7
	$	7,655.4	$	7,800.4

The accompanying notes are an integral part of these condensed consolidated balance sheets.

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LEAR CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited; in millions, except per share data)

	Three Months Ended		Nine Months Ended	
	September 27, 2008	September 29, 2007	September 27, 2008	September 29, 2007
Net sales	$ 3,133.5	$ 3,574.6	$ 10,970.1	$ 12,136.0
Cost of sales	3,004.8	3,307.3	10,284.2	11,220.2
Selling, general and administrative expenses	127.8	159.3	416.6	428.6
Divestiture of Interior business		(17.1)		7.8
Interest expense	46.5	47.5	139.5	150.3
Other expense, net	31.7	17.5	41.8	42.8
Income (loss) before provision for income taxes	(77.3)	60.1	88.0	286.3
Provision for income taxes	20.9	19.1	89.7	71.8
Net income (loss)	$ (98.2)	$ 41.0	$ (1.7)	$ 214.5
Basic net income (loss) per share	$ (1.27)	$ 0.53	$ (0.02)	$ 2.80
Diluted net income (loss) per share	$ (1.27)	$ 0.52	$ (0.02)	$ 2.74

The accompanying notes are an integral part of these condensed consolidated statements.

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LEAR CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited; in millions)

	Nine Months Ended September 27, 2008	Nine Months Ended September 29, 2007
Cash Flows from Operating Activities:		
Net income (loss)	$ (1.7)	$ 214.5
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Divestiture of Interior business		7.8
Depreciation and amortization	227.5	220.9
Net change in recoverable customer engineering and tooling	(12.4)	23.6
Net change in working capital items	(145.6)	(89.7)
Net change in sold accounts receivable	133.7	(67.3)
Other, net	33.6	(0.3)
Net cash provided by operating activities	235.1	309.5
Cash Flows from Investing Activities:		
Additions to property, plant and equipment	(133.8)	(114.1)
Divestiture of Interior business		(48.3)
Other, net	(11.5)	(28.8)
Net cash used in investing activities	(145.3)	(191.2)
Cash Flows from Financing Activities:		
Primary credit facility repayments, net	(3.0)	(3.0)
Repayment of senior notes	(130.8)	
Other long-term debt repayments, net	(22.8)	(9.7)
Short-term debt repayments, net	(0.2)	(11.1)
Proceeds from exercise of stock options		7.4
Repurchase of common stock	(4.2)	
Decrease in drafts	(4.1)	(8.4)
Net cash used in financing activities	(165.1)	(24.8)
Effect of foreign currency translation	(2.8)	5.8
Net Change in Cash and Cash Equivalents	(78.1)	99.3
Cash and Cash Equivalents as of Beginning of Period	601.3	502.7

Cash and Cash Equivalents as of End of Period	$ 523.2	$ 602.0
Changes in Working Capital Items:		
Accounts receivable	$ 99.8	$ (338.2)
Inventories	(74.0)	(44.8)
Accounts payable	(78.6)	113.3
Accrued liabilities and other	(92.8)	180.0
Net change in working capital items	$ (145.6)	$ (89.7)
Supplementary Disclosure:		
Cash paid for interest	$ 120.1	$ 140.7
Cash paid for income taxes	$ 82.0	$ 74.7

The accompanying notes are an integral part of these condensed consolidated statements.

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LEAR CORPORATION AND SUBSIDIARIES
NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(1) Basis of Presentation

The condensed consolidated financial statements include the accounts of Lear Corporation (Lear or the Parent), a Delaware corporation and the wholly owned and less than wholly owned subsidiaries controlled by Lear (collectively, the Company). In addition, Lear consolidates variable interest entities in which it bears a majority of the risk of the entities potential losses or stands to gain from a majority of the entities expected returns. Investments in affiliates in which Lear does not have control, but does have the ability to exercise significant influence over operating and financial policies, are accounted for under the equity method.

The Company and its affiliates design and manufacture complete automotive seat systems, electrical distribution systems and select electronic products. Through the first quarter of 2007, the Company also supplied automotive interior systems and components, including instrument panels and cockpit systems, headliners and overhead systems, door panels and flooring and acoustic systems (Note 2, Divestiture of Interior Business). The Company s main customers are automotive original equipment manufacturers. The Company operates facilities worldwide.

Certain amounts in the prior period s financial statements have been reclassified to conform to the presentation used in the quarter ended September 27, 2008.

(2) Divestiture of Interior Business

On March 31, 2007, the Company completed the transfer of substantially all of the assets of the Company s North American interior business (as well as its interests in two China joint ventures and $27.4 million of cash) to International Automotive Components Group North America, Inc. and International Automotive Components Group North America, LLC (together, IAC North America). In connection with this transaction, the Company recorded a loss on divestiture of interior business of $611.5 million, of which $4.6 million was recognized in 2007 ($1.5 million in the first nine months of 2007) and $606.9 million was recognized in 2006. The Company also recognized additional costs related to the divestiture, including $7.5 million recorded as cost of sales and $2.5 million recorded as selling, general and administrative expenses in the accompanying condensed consolidated statement of operations for the nine months ended September 29, 2007.

The divestiture of the Company s North American interior business substantially completed the disposition of the Company s interior business. In 2006, the Company completed the contribution of substantially all of its European interior business to International Automotive Components Group, LLC (IAC Europe), in exchange for a one-third equity interest in IAC Europe. In connection with this transaction, the Company recorded a loss on divestiture of interior business of $35.2 million, of which $6.1 million was recognized in 2007 ($6.3 million in the first nine months of 2007) and $29.1 million was recognized in 2006.

(3) Restructuring Activities

In 2005, the Company implemented a comprehensive restructuring strategy intended to (i) better align the Company s manufacturing capacity with the changing needs of its customers, (ii) eliminate excess capacity and lower the operating costs of the Company and (iii) streamline the Company s organizational structure and reposition its business for improved long-term profitability. In connection with these restructuring actions, the Company incurred pretax restructuring costs of $350.9 million through 2007.

In 2008, the Company expects to incur restructuring and related manufacturing inefficiency costs of approximately $150 million. In light of current industry conditions and recent customer announcements in North America, the Company expects restructuring and related investments of approximately $100 million in 2009. Restructuring and related manufacturing inefficiency costs include employee termination benefits, asset impairment charges and contract termination costs, as well as other incremental costs resulting from the restructuring actions. These incremental costs principally include equipment and personnel relocation costs. The Company also expects to incur incremental manufacturing inefficiency costs at the operating locations impacted by the restructuring actions during the related restructuring implementation period. Restructuring costs are recognized in the Company s consolidated financial statements in accordance with accounting principles generally accepted in the United States. Generally, charges are recorded as elements of the restructuring strategy are finalized.

In connection with the Company s prior restructuring actions and current activities, the Company recorded restructuring charges of $114.0 million in the first nine months of 2008, including $96.1 million recorded as cost of sales, $17.3 million recorded as selling, general and administrative expenses and $0.6 million recorded as other expense, net. The 2008 charges consist of employee termination benefits of $91.0 million, fixed asset impairment charges of $4.5 million, contract termination costs of $3.3 million and other related costs of $15.2 million. Employee termination benefits were recorded based on existing union and employee contracts, statutory requirements and completed negotiations. Asset impairment charges relate to the disposal of machinery and equipment with carrying values of $4.5 million in excess of related estimated fair values. Contract termination costs include lease cancellation costs of

LEAR CORPORATION AND SUBSIDIARIES
NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Continued)

$1.0 million, pension benefit curtailment charges of $2.5 million, a reduction in previously recorded repayments of various government-sponsored grants of ($1.6) million and various other costs of $1.4 million.

A summary of 2008 charges, excluding pension benefit curtailment charges of $0.1 million, related to prior restructuring actions is shown below (in millions):

	Accrual as of December 31, 2007	2008 Charges	Utilization Cash	Utilization Non-cash	Accrual as of September 27, 2008
Employee termination benefits	$ 68.7	$ 21.9	$ (66.4)	$	$ 24.2
Asset impairments		3.4		(3.4)	
Contract termination costs (credits)	5.9	(0.5)			5.4
Other related costs		9.8	(9.8)		
Total	$ 74.6	$ 34.6	$ (76.2)	$ (3.4)	$ 29.6

A summary of 2008 charges, excluding pension benefit curtailment charges of $2.4 million, related to 2008 activities is shown below (in millions):

	2008 Charges	Utilization Cash	Utilization Non-cash	Accrual as of September 27, 2008
Employee termination benefits	$ 69.1	$ (41.2)	$	$ 27.9
Asset impairments	1.1		(1.1)	
Contract termination costs	1.3	(0.1)		1.2
Other related costs	5.4	(5.4)		
Total	$ 76.9	$ (46.7)	$ (1.1)	$ 29.1

(4) Inventories

Inventories are stated at the lower of cost or market. Cost is determined using the first-in, first-out method. Finished goods and work-in-process inventories include material, labor and manufacturing overhead costs. A summary of inventories is shown below (in millions):

	September 27, 2008	December 31, 2007
Raw materials	$ 498.6	$ 463.9
Work-in-process	43.0	37.5
Finished goods	140.7	104.1
Inventories	$ 682.3	$ 605.5

(5) Property, Plant and Equipment

Property, plant and equipment is stated at cost. Depreciable property is depreciated over the estimated useful lives of the assets, principally using the straight-line method. A summary of property, plant and equipment is shown below (in millions):

	September 27, 2008	December 31, 2007
Land	$ 147.0	$ 138.8
Buildings and improvements	639.2	619.9
Machinery and equipment	2,139.6	2,055.2
Construction in progress	5.2	6.9
Total property, plant and equipment	2,931.0	2,820.8
Less accumulated depreciation	(1,609.1)	(1,428.1)
Net property, plant and equipment	$ 1,321.9	$ 1,392.7

LEAR CORPORATION AND SUBSIDIARIES
NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Continued)

Depreciation expense was $74.3 million and $69.3 million in the three months ended September 27, 2008 and September 29, 2007, respectively, and $223.4 million and $217.0 million in the nine months ended September 27, 2008 and September 29, 2007, respectively.

Costs associated with the repair and maintenance of the Company s property, plant and equipment are expensed as incurred. Costs associated with improvements which extend the life, increase the capacity or improve the efficiency or safety of the Company s property, plant and equipment are capitalized and depreciated over the remaining life of the related asset.

(6) Goodwill

A summary of the changes in the carrying amount of goodwill, by reportable operating segment, for the nine months ended September 27, 2008, is shown below (in millions):

	Seating	Electrical and Electronic	Total
Balance as of January 1, 2008	$ 1,097.5	$ 956.5	$ 2,054.0
Foreign currency translation and other	7.5	(9.1)	(1.6)
Balance as of September 27, 2008	$ 1,105.0	$ 947.4	$ 2,052.4

(7) Long-Term Debt

A summary of long-term debt and the related weighted average interest rates, including the effect of hedging activities described in Note 17, Financial Instruments, is shown below (in millions):

	September 27, 2008		December 31, 2007	
	Long-Term Debt	Weighted Average Interest Rate	Long-Term Debt	Weighted Average Interest Rate
Primary Credit Facility	$ 988.0	6.60%	$ 991.0	7.61%
8.50% Senior Notes, due 2013	300.0	8.50%	300.0	8.50%
8.75% Senior Notes, due 2016	600.0	8.75%	600.0	8.75%
5.75% Senior Notes, due 2014	399.5	5.64%	399.4	5.64%
8.125% Euro-denominated Senior Notes, due 2008		N/A	81.0	8.125%
8.11% Senior Notes, due 2009		N/A	41.4	8.11%
Zero-coupon Convertible Senior Notes, due 2022	0.8	4.75%	0.8	4.75%
Other	20.8	6.44%	27.1	7.04%
	2,309.1		2,440.7	
Current portion	(11.8)		(96.1)	
Long-term debt	$ 2,297.3		$ 2,344.6	

Primary Credit Facility

On July 3, 2008, the Company amended its existing primary credit facility (amended primary credit facility) to, among other things, extend certain of the revolving credit commitments thereunder from March 23, 2010 to January 31, 2012. The extension was offered to each revolving lender, and lenders consenting to the amendment had their revolving credit commitments reduced by 33.33% on July 11, 2008. After giving effect to the amendment, the Company had outstanding approximately $1.3 billion of revolving credit commitments, $467.5 million of which mature on March 23, 2010, and $821.7 million of which mature on January 31, 2012. The amended primary credit facility provides for multicurrency borrowings in a maximum aggregate amount of $400 million, Canadian borrowings in a maximum aggregate amount of $100 million and swing-line borrowings in a maximum aggregate amount of $200 million, the commitments for which are part of the aggregate amended revolving credit commitments. The amendment had no effect on the Company s $1.0 billion term loan facility issued under the prior primary credit facility, which continues to have a maturity date of April 25, 2012. As of September 27, 2008 and December 31, 2007, the Company had $988.0 million and $991.0 million, respectively, in borrowings outstanding under the term loan facility, with no additional availability, and there were no amounts outstanding under the revolving credit facility. In October 2008, the Company elected to borrow $400 million under the revolving credit facility to protect against possible short-term disruptions in the credit markets.

The Company s obligations under the amended primary credit facility are secured by a pledge of all or a portion of the capital stock of certain of its subsidiaries, including substantially all of its first-tier subsidiaries, and are partially secured by a security interest in the Company s assets and the assets of certain of its domestic subsidiaries. In addition, the Company s obligations under the amended

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primary credit facility are guaranteed, on a joint and several basis, by certain of its subsidiaries, all of which are directly or indirectly 100% owned by the Company.

The amended primary credit facility contains certain affirmative and negative covenants, including (i) limitations on fundamental changes involving the Company or its subsidiaries, asset sales and restricted payments, (ii) a limitation on indebtedness with a maturity shorter than the term loan facility, (iii) a limitation on aggregate subsidiary indebtedness to an amount which is no more than 5% of consolidated total assets, (iv) a limitation on aggregate secured indebtedness to an amount which is no more than $100 million and (v) requirements that the Company maintains a leverage coverage ratio of not more than 3.50 to 1, as of September 27, 2008, with decreases over time and an interest coverage ratio of not less than 2.75 to 1, as of September 27, 2008, with increases over time. As of December 31, 2008, the required leverage coverage ratio covenant will decrease to 3.25 to 1 and the required interest coverage ratio covenant will increase to 3.00 to 1. The amended primary credit facility also contains customary events of default, including an event of default triggered by a change of control of the Company.

The leverage and interest coverage ratios, as well as the related components of their computation, are defined in the amended primary credit facility. The leverage coverage ratio is calculated as the ratio of consolidated indebtedness to the credit facility-operating earnings measure. For the purpose of the covenant calculation, (i) consolidated indebtedness is generally defined as reported debt, net of cash and cash equivalents up to $700 million and certain secured borrowings and excluding transactions related to the Company s asset-backed securitization and factoring facilities and (ii) the credit facility-operating earnings measure is generally defined as net income (loss) excluding income taxes, interest expense, depreciation and amortization expense, other income and expense, minority interests in income of subsidiaries in excess of net equity earnings in affiliates, certain historical restructuring and other non-recurring charges, extraordinary gains and losses and other specified non-cash items. The credit facility-operating earnings measure is a non-GAAP financial measure that is presented not as a measure of operating results but rather as a measure used to determine covenant compliance under the Company s amended primary credit facility. The interest coverage ratio is calculated as the ratio of the credit facility-operating earnings measure to consolidated interest expense. For the purpose of the covenant calculation, consolidated interest expense is generally defined as interest expense plus any discounts or expenses related to the Company s asset-backed securitization facility less amortization of deferred financing fees, interest income and bank facility and other fees. As of September 27, 2008, the Company was in compliance with all covenants set forth in its amended primary credit facility. The Company s leverage and interest coverage ratios were 2.5 to 1 and 4.1 to 1, respectively.

Reconciliations of (i) consolidated indebtedness to reported debt, (ii) the credit facility-operating earnings measure to income (loss) before provision for income taxes and (iii) consolidated interest expense to reported interest expense are shown below (in millions):

		September 27, 2008
Consolidated indebtedness	$	1,799.1
Certain secured borrowings		17.6
Cash and cash equivalents (subject to $700 million limitation)		523.2
Reported debt	$	2,339.9

	Three Months Ended	Nine Months Ended

	September 27, 2008	September 27, 2008
Credit facility-operating earnings measure	$ 87.9	$ 531.6
Depreciation and amortization	(75.6)	(227.5)
Consolidated interest expense	(41.5)	(127.9)
Other expense, net (excluding certain amounts related to the asset-backed securitization facility)	(31.7)	(41.5)
Non-cash asset impairment charges	(1.2)	(4.5)
Non-cash stock-based compensation expense	(5.7)	(15.3)
Other postretirement net periodic benefit cost	(6.1)	(18.4)
License fees	(0.2)	(1.0)
Amortization of deferred financing fees		