TRANSACT TECHNOLOGIES INC
Form 10-Q
November 08, 2012

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: September 30, 2012
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: 0-21121

(Exact name of registrant as specified in its charter)

Delaware	06-1456680
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)
One Hamden Center, 2319 Whitney Avenue, Suite 3B, Hamden, CT	06518
(Address of Principal Executive Offices)	(Zip Code)

(203) 859-6800
(Registrant's Telephone Number, Including Area Code)

(Former name, former address and former fiscal year, if changed since last report.)

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 ý No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (Sec.232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ý 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 o	Accelerated filer ý
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 ý

As of October 31, 2012, the number of shares outstanding of the Company's common stock, $0.01 par value, was 8,759,236.

TRANSACT TECHNOLOGIES INCORPORATED

INDEX

PART I - FINANCIAL INFORMATION

Item 1. FINANCIAL STATEMENTS

TRANSACT TECHNOLOGIES INCORPORATED
CONDENSED CONSOLIDATED BALANCE SHEETS
(unaudited)

	September 30, 2012	December 31, 2011
	(In thousands, except share data)	
Assets:		
Current assets:		
Cash and cash equivalents	$ 8,577	$ 6,863
Accounts receivable, net	9,814	9,583
Inventories	10,608	14,151
Prepaid income taxes	447	446
Deferred tax assets	1,636	1,636
Other current assets	750	375
Total current assets	31,832	33,054
Fixed assets, net	3,207	3,358
Goodwill	2,621	2,518
Deferred tax assets	882	890
Intangible assets, net of accumulated amortization of $1,168 and $730, respectively	2,445	2,861
Other assets	114	59
	9,269	9,686
Total assets	$ 41,101	$ 42,740
Liabilities and Shareholders' Equity:		
Current liabilities:		
Accounts payable	$ 3,928	$ 3,019
Accrued liabilities	3,267	2,672
Deferred revenue	183	141
Total current liabilities	7,378	5,832
Deferred revenue, net of current portion	176	224
Deferred rent, net of current portion	322	357
Accrued contingent consideration (Note 2)	680	680
Other liabilities	317	334
	1,495	1,595
Total liabilities	8,873	7,427
Commitments and contingencies (Note 9)		

Shareholders' equity:				
Common stock, $0.01 par value, 20,000,000 shares authorized; 10,891,577 and 10,851,955 shares issued, respectively; 8,759,236 and 9,390,262 shares outstanding, respectively		109		108
Additional paid-in capital		25,780		25,058
Retained earnings		23,352		21,613
Accumulated other comprehensive loss, net of tax		(55)		(71)
Treasury stock, at cost, 2,132,341 and 1,461,693 shares, respectively		(16,958)		(11,395)
Total shareholders' equity		32,228		35,313
Total liabilities and shareholders' equity	$	41,101	$	42,740

See notes to Condensed Consolidated Financial Statements.

TRANSACT TECHNOLOGIES INCORPORATED
CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
	(In thousands, except share data)			
Net sales	$ 15,358	$ 14,111	$ 48,770	$ 52,324
Cost of sales	9,679	8,761	30,471	33,379
Gross profit	5,679	5,350	18,299	18,945
Operating expenses:				
Engineering, design and product development	1,087	848	3,252	2,432
Selling and marketing	1,571	1,458	4,846	4,630
General and administrative	1,919	1,919	5,822	5,576
Legal fees associated with lawsuit (Note 9)	1,036	-	1,507	-
Business consolidation and restructuring (Note 5)	23	-	140	184
	5,636	4,225	15,567	12,822
Operating income	43	1,125	2,732	6,123
Interest and other income (expense):				
Interest, net	3	7	7	18
Other, net	(10)	(17)	(21)	-
	(7)	(10)	(14)	18
Income before income taxes	36	1,115	2,718	6,141
Income tax provision	13	276	979	2,035
Net income	$ 23	$ 839	$ 1,739	$ 4,106
Net income per common share:				
Basic	$ 0.00	$ 0.09	$ 0.19	$ 0.44
Diluted	$ 0.00	$ 0.09	$ 0.19	$ 0.43
Shares used in per-share calculation:				
Basic	8,822	9,471	9,110	9,435
Diluted	8,911	9,661	9,205	9,651

See notes to Condensed Consolidated Financial Statements.

4

TRANSACT TECHNOLOGIES INCORPORATED
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
	(In thousands)			
Net income	$ 23	$ 839	$ 1,739	$ 4,106
Foreign currency translation adjustment, net of tax	13	(8)	16	-
Comprehensive income	$ 36	$ 831	$ 1,755	$ 4,106

See notes to Condensed Consolidated Financial Statements.

TRANSACT TECHNOLOGIES INCORPORATED
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(unaudited)

	Nine Months Ended September 30, 2012	2011
	(In thousands)	
Cash flows from operating activities:		
Net income	$ 1,739	$ 4,106
Adjustments to reconcile net income to net cash provided by operating activities:		
Share-based compensation expense	402	445
Incremental tax benefits from stock options exercised	(42)	(439)
Depreciation and amortization	1,314	1,177
(Gain) loss on disposal of fixed assets	(12)	24
Foreign currency transaction loss (gain)	31	(2)
Changes in operating assets and liabilities:		
Accounts receivable	(228)	1,292
Inventories	3,397	(1,108)
Prepaid income taxes	17	-
Other current and long term assets	(433)	(327)
Accounts payable	909	(3,055)
Accrued liabilities and other liabilities	690	380
Net cash provided by operating activities	7,784	2,493
Cash flows from investing activities:		
Capital expenditures	(675)	(472)
Additions to capitalized software	(23)	(568)
Acquisitions	-	(4,000)
Proceeds from sale of assets	14	1
Net cash used in investing activities	(684)	(5,039)
Cash flows from financing activities:		
Proceeds from stock option exercises	145	863
Purchases of common stock for treasury	(5,563)	(2,075)
Incremental tax benefits from stock options exercised	42	439
Payment of deferred financing costs	-	(18)
Net cash used in financing activities	(5,376)	(791)
Effect of exchange rate changes on cash and cash equivalents	(10)	(14)
Change in cash and cash equivalents	1,714	(3,351)

Cash and cash equivalents, beginning of period	6,863	11,285
Cash and cash equivalents, end of period	$ 8,577	$ 7,934

See notes to Condensed Consolidated Financial Statements.

TRANSACT TECHNOLOGIES INCORPORATED
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

1. Basis of presentation

The accompanying unaudited financial statements of TransAct Technologies Incorporated have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America to be included in full year financial statements. In the opinion of management, all adjustments considered necessary for a fair statement of the results for the periods presented have been included. The December 31, 2011 Condensed Consolidated Balance Sheet data was derived from audited financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States of America. These interim financial statements should be read in conjunction with the audited financial statements for the year ended December 31, 2011 included in our Annual Report on Form 10-K.

The financial position and results of operations of our U.K. foreign subsidiary are measured using local currency as the functional currency. Assets and liabilities of such subsidiary have been translated at the end of period exchange rates, and related revenues and expenses have been translated at the weighted average exchange rates with the resulting translation gain or loss recorded in accumulated other comprehensive income (loss) in the Condensed Consolidated Balance Sheets. Transaction gains and losses are included in other income in the Condensed Consolidated Statements of Income.

The results of operations for the three and nine months ended September 30, 2012 are not necessarily indicative of the results to be expected for the full year. Certain prior period amounts in the Condensed Consolidated Financial Statements have been reclassified to conform with the current period presentation.

2. Business acquisitions

On August 19, 2011, we completed the acquisition of Printrex, Inc. (“Printrex”), a leading manufacturer of specialty printers primarily sold into the oil and gas exploration and medical markets which serves commercial and industrial customers primarily in the United States, Canada, Europe and Asia. We have included the financial results of Printrex in our Condensed Consolidated Financial Statements from the date of acquisition. The total purchase price for Printrex was $4,000,000 in cash and potential future contingent consideration. As of December 31, 2011, we recorded $2,280,000 of identifiable intangible assets, $1,351,000 of net tangible assets, $680,000 of contingent consideration, each based on their estimated fair values, and $1,049,000 of residual goodwill.

During the nine months ended September 30, 2012, we recorded a purchase price adjustment to the fair value of inventory of $103,000 which increased the carrying value of Goodwill related to the Printrex acquisition to $1,152,000. As of September 30, 2012, we have completed our analysis of fair value attributes of the assets acquired through the Printrex acquisition and the final assessment of values did not differ materially from our preliminary assessment.

In connection with the acquisition of Printrex, we entered into a contingent consideration arrangement which resulted in a liability, at fair value, of $680,000 at September 30, 2012, unchanged since December 31, 2011. The undiscounted fair value related to the contingent liability could range from $100,000 to $1,800,000. Refer to Note 4, Business acquisitions, of the Company’s 2011 Annual Report on Form 10-K for the year ended December 31, 2011 for the specific terms of this contingent consideration arrangement.

The following unaudited pro forma consolidated results of operations are provided for illustrative purposes only and assume that the acquisition of Printrex occurred on January 1, 2010. This unaudited pro forma information should not be relied upon as being indicative of the historical results that would have been obtained if the acquisition had occurred on that date, nor of the results that may be obtained in the future.

	Nine months ended September 30, 2011 (In thousands)
Sales	$ 56,049
Net income	$ 4,378

7

TRANSACT TECHNOLOGIES INCORPORATED
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

3. Inventories

The components of inventories are:

	September 30, 2012	December 31, 2011
	(In thousands)	
Raw materials and purchased component parts	$ 7,674	$ 6,863
Work-in-process	14	71
Finished goods	2,920	7,217
	$ 10,608	$ 14,151

4. Accrued product warranty liability

We generally warrant our products for up to 36 months and record the estimated cost of such product warranties at the time the sale is recorded. Estimated warranty costs are based upon actual past experience of product repairs and the related estimated cost of labor and material to make the necessary repairs.

The following table summarizes the activity recorded in the accrued product warranty liability during the nine months ended September 30, 2012:

	(In thousands)
Balance, beginning of period	$ 421
Accruals for warranties issued during the period	70
Changes in estimates	4
Settlements during the period	(198)
Balance, end of period	$ 297

Approximately $89,000 of the accrued product warranty liability is classified as long-term in Other liabilities at September 30, 2012 in the Condensed Consolidated Balance Sheets.

5. Accrued business consolidation and restructuring expenses

As discussed in Note 4, Business acquisitions, of the Company's 2011 Annual Report on Form 10-K for the year ended December 31, 2011, in January 2012, we determined that we no longer need to maintain the existing Printrex manufacturing facility in San Jose, California, along with certain redundant headcount. We estimate that these restructuring activities will cause us to incur costs of approximately $140,000 in 2012 for employee termination benefits related to these employee reductions as well as moving costs. The closing of the San Jose manufacturing operations was substantially completed as of September 30, 2012. During the three and nine months ended September 30, 2012, we recorded restructuring charges of $23,000 and $140,000, respectively, in accordance with ASC 420-10-25-4 "Exit or Disposal Cost Obligations." This charge has been included within Business consolidation and restructuring expenses in the accompanying Condensed Consolidated Statements of Income. Cash payments made under this restructuring plan were completed by October 2012.

In May 2011, we closed our New Britain, CT service facility which primarily serviced our first generation legacy lottery printers for GTECH Corporation ("GTECH") and incurred $184,000 in facility closure and severance costs in the second quarter of 2011. These restructuring activities reduced the number of employees and closed a facility, which caused us to incur costs for employee termination benefits related to these employee reductions as well as lease termination costs and the disposal of fixed assets. Cash payments made under this restructuring plan were completed by April 2012.

The following table summarizes the activity recorded in accrued restructuring expenses during the nine months ended September 30, 2012 and is included in Accrued liabilities in the accompanying Condensed Consolidated Balance Sheets.

		(In thousands)
Accrual balance, beginning of period	$	45
Severance and moving charges		140
Cash payments		(169)
Accrual balance, end of period	$	16

TRANSACT TECHNOLOGIES INCORPORATED
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

6. Earnings per share

The following table sets forth the reconciliation of basic weighted average shares outstanding and diluted weighted average shares outstanding:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
	(In thousands, except per share data)			
Net income	$ 23	$ 839	$ 1,739	$ 4,106
Shares:				
Basic: Weighted average common shares outstanding	8,822	9,471	9,110	9,435
Add: Dilutive effect of outstanding options and restricted stock as determined by the treasury stock method	89	190	95	216
Diluted: Weighted average common and common equivalent shares outstanding	8,911	9,661	9,205	9,651
Net income per common share:				
Basic	$ 0.00	$ 0.09	$ 0.19	$ 0.44
Diluted	$ 0.00	$ 0.09	$ 0.19	$ 0.43

Unvested restricted stock is excluded from the calculation of weighted average common shares for basic EPS. For diluted EPS, weighted average common shares include the impact of unvested restricted stock under the treasury stock method.

For both the three and nine months ended September 30, 2012 and 2011, there were 585,125 and 163,750, respectively, potentially dilutive shares consisting of stock options, and non-vested restricted stock (for the nine months ended September 30, 2011 only), that were excluded from the calculation of earnings per diluted share.

7. Shareholders' equity

Changes in shareholders' equity for the nine months ended September 30, 2012 were as follows (in thousands):

Balance at December 31, 2011	$35,313
Net income	1,739
Share-based compensation expense	402
Proceeds from stock option exercises	145

Issuance of deferred stock units	134
Incremental tax benefits from stock options exercised	42
Foreign currency translation adjustment	16
Purchases of common stock for treasury	(5,563)
Balance at September 30, 2012	$32,228

We paid a portion of the 2011 incentive bonus for the chief executive officer and chief financial officer in the form of deferred stock units. Such deferred stock units were granted in March 2012 and were fully vested at the time of grant.

On September 10, 2012, we announced that our Board of Directors has approved the initiation of a quarterly cash dividend of $0.06 per share of common stock outstanding. On November 2, 2012, our Board of Directors declared a quarterly cash dividend of $0.06 per share which will be payable on or about December 12, 2012 to common shareholders of record at the close of business on November 21, 2012.

TRANSACT TECHNOLOGIES INCORPORATED
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

8. Income taxes

We recorded an income tax provision for the third quarter of 2012 of $13,000 at an effective tax rate of 36.1%, compared to an income tax provision during the third quarter of 2011 of $276,000 at an effective tax rate of 24.8%. For the nine months ended September 30, 2012, we recorded an income tax provision of $979,000 at an effective tax rate of 36.0%, compared to an income tax provision during the nine months ended September 30, 2011 of $2,035,000 at an effective tax rate of 33.1%. Our effective tax rate for the third quarter and nine months of 2012 is higher than the corresponding 2011 periods because it does not include any benefit from the federal research and development credit that expired at the end of 2011. Additionally, the effective tax rate for the third quarter and nine months ended September 30, 2011 was favorably impacted by the recognition of $53,000 for certain discrete tax benefits.

We are subject to U.S. federal income tax as well as income tax of certain state and foreign jurisdictions. We have substantially concluded all U.S. federal income tax, state and local, and foreign tax matters through 2003. During 2008, a limited scope examination of our 2005 and 2006 federal tax returns was completed. However, our federal tax returns for the years 2004 through 2011 remain open to examination. Various state and foreign tax jurisdiction tax years remain open to examination as well, though we believe that any additional assessment would be immaterial to the Condensed Consolidated Financial Statements. No federal, state or foreign tax jurisdiction income tax returns are currently under examination. As of September 30, 2012, we had $228,000 of total gross unrecognized tax benefits that, if recognized, would favorably affect the effective income tax rate in any future periods.

9. Commitments & contingencies

On June 8, 2012, Avery Dennison Corporation (“AD”) filed a civil complaint against the Company and a former employee of the Company and of AD, in the Court of Common Pleas in Lake County, Ohio. The complaint alleges that this former employee and the Company misappropriated unspecified trade secrets and confidential information related to the design of our food safety terminals from AD. The complaint requests a preliminary and permanent injunction against the Company from manufacturing and selling our Ithaca® 9700 and 9800 food safety terminals. On July 16, 2012, the Company filed its answer, affirmative defenses and counterclaims, seeking all available damages including legal fees. A hearing on the plaintiff's motion for preliminary injunction took place in August 2012 and we are awaiting a ruling from the Court on this matter.

We are currently unable to estimate any potential liability or range of loss, if any, associated with this litigation. Accordingly, no amounts other than corresponding legal fees of approximately $491,000 have been accrued in the Condensed Consolidated Balance Sheets related to this matter.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Forward Looking Statements

Certain statements included in this report, including without limitation statements in this Management's Discussion and Analysis of Financial Condition and Results of Operations, which are not historical facts are "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. Forward-looking statements generally can be identified by the use of forward-looking terminology, such as "may", "will", "expect", "intend", "estimate", "anticipate", "believe", "project" or "cont negative thereof or other similar words. All forward-looking statements involve risks and uncertainties, including, but not limited to those listed in Item 1A of our most recently filed Annual Report on Form 10-K. Actual results may differ materially from those discussed in, or implied by, the forward-looking statements. The forward-looking statements speak only as of the date of this report and we assume no duty to update them.

Overview

TransAct Technologies Incorporated ("TransAct") designs, develops and sells market-specific solutions, including printers, terminals, software and other products for transaction-based and other industries. These world-class products are sold under the Epic, EPICENTRALTM, Ithaca® and Printrex® brand names. Known and respected worldwide for innovative designs and real-world service reliability, our thermal, inkjet and impact printers generate top-quality transaction records such as receipts, tickets, coupons, register journals and other documents as well as printed logging and plotting of data. We focus on the following core markets: food safety, banking and point-of-sale ("POS"), casino and gaming, lottery, oil and gas and medical and mobile. We sell our products to original equipment manufacturers ("OEMs"), value-added resellers ("VARs"), selected distributors, as well as directly to end-users. Our product distribution spans across the Americas, Europe, the Middle East, Africa, Asia, Australia, the Caribbean Islands and the South Pacific. Beyond printers, TransAct provides world-class printer service, spare parts, accessories and printing supplies required by its worldwide installed base of printers.. Through our TransAct Services Group ("TSG") we provide a complete range of supplies and consumables used in the printing and scanning activities of customers in the hospitality, banking, retail, food safety, gaming, government and oil and gas exploration markets. Through our webstore, www.transactsupplies.com, and our direct selling team, we address the on-line demand for these products. We operate in one reportable segment: the design, development, assembly and marketing of transaction printers and providing printer-related services, supplies and spare parts.

On August 19, 2011, we completed the acquisition of Printrex, Inc. ("Printrex") for $4,000,000 in cash and potential future contingent consideration. Printrex is a leading manufacturer of specialty printers primarily sold into the oil and gas exploration and medical and mobile markets. Printrex serves commercial and industrial customers primarily in the United States, Canada, Europe and Asia. This acquisition was completed to complement our existing product offerings.

Critical Accounting Judgments and Estimates

Our discussion and analysis of our financial condition and results of operations are based upon our Condensed Consolidated Financial Statements, which have been prepared by us in accordance with accounting principles generally accepted in the United States of America. The presentation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenue and expenses, and disclosure of contingent assets and liabilities. Our estimates include those related to revenue recognition, inventory obsolescence, the valuation of deferred tax assets and liabilities, depreciable lives of equipment, warranty obligations, and contingent liabilities. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances.

For a complete description of our accounting policies, see Item 7 - Management's Discussion and Analysis of Financial Condition and Results of Operations, "Critical Accounting Policies and Estimates," included in our Annual

Report on Form 10-K for the year ended December 31, 2011. We have reviewed those policies and determined that they remain our critical accounting policies for the nine months ended September 30, 2012 in addition to the policy described below.

Revenue recognition: We have developed a new software solution, the EPICENTRALTM Print System ("EPICENTRALTM"), that will enable casino operators to create promotional coupons and marketing messages and to print them in real-time at the slot machine. Revenue arrangements for EPICENTRALTM include multiple deliverables and as a result such arrangements are accounted for in accordance with both ASC 605-25, "Multiple-Element Arrangements" and ASC 985-605, "Software." EPICENTRALTM is primarily comprised of both a software component, which is licensed, and a hardware component, which can either be leased or sold to end users, and both components are integrated to deliver the system's full functionality. Under leasing arrangements, revenue is generally recognized ratably over the lease term, excluding revenue allocated to installation, which is recognized upon completion. In an arrangement where the hardware is purchased, revenue, inclusive of software license fees, is generally recognized upon installation and formal acceptance by the customer. Also, refer to the Revenue Recognition policy included in Item 7 - Management's Discussion and Analysis of Financial Condition and Results of Operations, "Critical Accounting Policies and Estimates," included in our Annual Report on Form 10-K for the year ended December 31, 2011 for further discussion.

Results of Operations: Three months ended September 30, 2012 compared to three months ended September 30, 2011

Net Sales. Net sales, which include printer and software sales and sales of replacement parts, consumables and repair and other services, by market for the three months ended September 30, 2012 and 2011 were as follows (in thousands, except percentages):

	Three months ended September 30, 2012		Three months ended September 30, 2011		Change $	Change %
Banking and POS	$ 1,829	11.9%	$ 2,818	20.0%	$ (989)	(35.1%)
Casino and gaming	6,100	39.7%	5,861	41.5%	239	