

PULSE ELECTRONICS CORP
Form 10-K
March 20, 2015

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

FORM 10-K

Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the fiscal year ended December 26, 2014

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 No. 1-5375
PULSE ELECTRONICS CORPORATION
(Exact name of registrant as specified in Charter)

PENNSYLVANIA (State or other jurisdiction of Incorporation or organization)	23-1292472 (IRS Employer Identification Number)
12220 World Trade Drive, San Diego, California (Address of principal executive offices)	92128 (Zip Code)
Registrant's telephone number, including area code:	858-674-8100

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

Title of each class
Common Stock, par value \$0.125 per share

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

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 for such shorter period that the registrant was required to file such reports), and (2) has been subject to the filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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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, a non-accelerated filer, or a smaller reporting company.
(as defined in Rule 12b-2 of the Act). Large accelerated filer Accelerated filer Non-accelerated filer
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

The aggregate market value of voting stock held by non-affiliates as of June 27, 2014, is \$13,515,067 computed by reference to the closing price on the New York Stock Exchange on such date.

Title of each class	Number of shares outstanding March 20, 2015
Common stock, par value \$0.125 per share	17,549,295

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Cautionary Note Regarding Forward-Looking Statements

Our disclosures and analysis in this report contain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21A of the Securities Exchange Act of 1934. Forward-looking statements reflect our current expectations of future events or future financial performance. You can identify these statements by the fact that they do not relate strictly to historical or current facts. They often use words such as “anticipate”, “estimate”, “expect”, “project”, “intend”, “plan”, “believe” and other similar terms. These forward-looking statements are based on our current plans and expectations. We intend that all forward-looking statements be subject to the “safe harbor” provisions of the Private Securities Litigation Reform Act of 1995.

Any or all of our forward-looking statements in this report may prove to be incorrect. They may be affected by inaccurate assumptions we might make or by risks and uncertainties which are either unknown or not fully known or understood. Accordingly, actual outcomes and results may differ materially from what is expressed or forecasted in this report.

The risks and uncertainties described under “Risk Factors” as well as other risks identified from time to time in other Securities and Exchange Commission reports, registration statements and public announcements, among others, should be considered in evaluating our prospects for the future. We undertake no obligation to release updates or revisions to any forward-looking statement, whether as a result of new information, future events or otherwise.

Part I

Item 1 Business

General

We were incorporated in Pennsylvania on April 10, 1947 and are headquartered in San Diego, California. Our mailing address is 12220 World Trade Drive, San Diego, CA 92128-3797, and our telephone number is 858-674-8100. Our website is www.pulseelectronics.com. Information contained on our website is not incorporated into this Annual Report. On October 16, 2014, we voluntarily delisted our common stock from the New York Stock Exchange. Our common stock currently trades on the on the Over-the-Counter (“OTC”) markets under the symbol “PULS”.

Pulse Electronics Corporation is a global producer of precision-engineered electronic components and modules. We sometimes refer to Pulse Electronics Corporation as “Pulse Electronics”, “Pulse”, “the Company”, “we” or “our.” Based on our estimates of the total annual revenues in our primary markets and our share of those markets relative to our competitors, we believe we are a leading global producer of electronic components and modules in the primary markets we serve.

Definitive Merger Agreement with Oaktree Capital Management, L.P.

On February 28, 2015, we entered into an Investment Agreement and Agreement and Plan of Merger (the “Merger Agreement”) with OCM PE Holdings, L.P., a Delaware limited partnership (“Parent”), and OCM PE Merger Sub, Inc., a Pennsylvania corporation and wholly-owned subsidiary of Parent (“Merger Sub”). Parent and affiliates of investment funds managed by Oaktree Capital Management, L.P. (“Oaktree”) currently own approximately 68.8% of the outstanding shares of common stock, par value \$0.125 per share, of the Company (“Common Stock”).

The Merger Agreement provides for the following transactions: (i) the extension of a loan (the “Loan”) by Parent or its affiliates to the Company or one or more of its subsidiaries in the amount of \$8.5 million within 30 days of the date of

the Merger Agreement, subject to the execution of mutually acceptable definitive loan, guarantee or collateral documentation and the satisfaction of certain other specified conditions precedent; (ii) at the closing, the contribution by Parent of \$17.0 million in cash less the principal amount of the Loan, if any, to the Company, and the conversion of any such Loan, in exchange for such number of shares of Common Stock as shall be determined by dividing the aggregate investment amount of \$17.0 million (together with accrued interest, dividends or other amounts accrued thereon) by \$1.50, with the result that Parent and affiliates of investment funds managed by Oaktree will own in excess of 80% of the outstanding shares of Common Stock (collectively, the “Investment”); and (iii) following the consummation of the Investment, the short-form merger of Merger Sub with and into the Company (the “Merger”), with the Company continuing as the surviving corporation in accordance with Section 1924(b)(1)(ii) and Section 1924(b)(3) of the Pennsylvania Business Corporation Law of 1988, as amended (“PBCL”).

Upon the consummation of the Merger, each outstanding share of Common Stock (other than shares held by Parent, Oaktree or their affiliates and shares as to which the holder has properly exercised statutory dissenters rights under the PBCL)

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will be canceled and converted into the right to receive cash in an amount equal to \$1.50 per share, without interest. Following the Merger, the Company will terminate its reporting obligations to the Securities and Exchange Commission under the Securities Exchange Act of 1934, as amended, and the Common Stock will no longer be publicly traded on the over-the-counter markets.

Upon the recommendation of a special committee of independent directors, the Merger Agreement and the transactions contemplated thereby have been unanimously approved by the Board of Directors of the Company other than Kaj Vazales, the director designated to the Board of Directors by Oaktree, who abstained from such decision. The Investment and the Merger are subject to customary closing conditions, and there can be no assurance that the transactions will close on the terms described herein, or at all. The Merger Agreement also contains certain termination rights for both Parent and the Company, and further provides that, upon termination of the Merger Agreement under specified circumstances, the Company may be required to reimburse Parent for its reasonable expenses incurred in connection with the Merger Agreement and the transactions contemplated thereby.

The description of the terms of the Merger Agreement contained in this Form 10-K does not purport to be complete and is qualified in its entirety by reference to the full text of the Merger Agreement, which was filed as an exhibit to the Company's Current Report on Form 8-K on March 2, 2014.

Segment Overview

We operate our business in three segments: our Network product group (“Network”), our Power product group (“Power”) and our Wireless product group (“Wireless”).

Network

Network produces a variety of passive components that manage and regulate electronic signals for use in a variety of devices used in local area and wide area networks. These products operate by filtering out radio frequency interference, shaping waveforms, splitting signals, suppressing noise, matching impedances and other functions. These passive products are often referred to as connectors, filters, filtered connectors, transformers, splitters, micro-filters, baluns and chokes.

Network’s components are characterized by labor intensive manufacturing processes that can be highly customized. Generally, our Network products have relatively short life cycles due to process and cost improvements, which allow us to utilize our design, engineering and production expertise to meet our customers’ evolving needs. The markets Network serves have been, and are expected to be, characterized by ongoing product design and manufacturing innovation.

Network generated \$152.6 million, or 44.4% of our revenues, for the year ended December 26, 2014 and \$150.6 million, or 42.3% of our revenues, for the year ended December 27, 2013.

Power

Power primarily manufactures products that adjust and ensure proper current and voltage, limit distortion of voltage, sense and report current and voltage and cause mechanical movement or actuation. Power’s products include power transformers, chokes, current and voltage sensors, ignition coils, automotive coils, military and aerospace products and other power magnetic products.

While some of Power’s manufacturing is characterized by labor intensive processes, other portions of the business are highly automated and less variable with product life cycles that change as technology improves. These factors allow

us to utilize our design, engineering and production expertise to meet our customer design needs. The markets Power serves have been, and will continue to be, characterized by ongoing product design and manufacturing innovation.

Power generated \$105.9 million, or 30.8% of our revenues, for the year ended December 26, 2014 and \$111.5 million, or 31.4% of our revenues, for the year ended December 27, 2013.

Wireless

Wireless manufactures products that primarily capture or transmit wireless communication signals. Specifically, our Wireless segment produces antennas, antenna modules and antenna mounting components that capture and transmit communication signals in handsets, other terminal and portable devices, automobiles and wireless-to-wireline access points.

Our Wireless products are sold in a very dynamic market, which causes the life of an average Wireless product to be very short. Wireless utilizes our expertise in the design, engineering and production of antennas and antenna modules to evolve with

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our customer needs. We believe that the industries Wireless serves have been, and will continue to be, characterized by ongoing product design and manufacturing innovation. However, the manufacturing of our Wireless products tends to be more automated than Network and many Power products, requiring capital investment and changes in our production process for future innovation.

Wireless generated \$85.0 million, or 24.8% of our revenues, for the year ended December 26, 2014 and \$93.6 million, or 26.3% of our revenues, for the year ended December 27, 2013.

Products

The following table contains a list of some of the key products of our segments:

Primary Products	Function	Application
Network		
Discrete filter or choke	Separate high and low frequency signals, share incoming and outgoing signals to match industry templates	Network switches, routers, hubs and personal computers Phone, fax and alarm systems used with digital subscriber lines or DSL
Filtered connectors, which combines a filter with a connector and stand alone connector products	Remove interference, or noise, from circuitry and connects electronic equipment	Local area networks, or LANs, and wide area networks, or WANs, equipment for personal computers and video game consoles
Inductor/chip inductor	Regulate and control electrical energy in a communication circuit	AC/DC & DC/DC power supplies Mobile phones and portable devices
Balun	Connect lines that are balanced to lines that are unbalanced	Cable television and other networks carrying high frequency signals
Transformer	Transfer electrical energy from one circuit to another and provide an impedance match between circuits	Electronic devices that are connected by a wire including PCs, laptops, game boxes, network switches, telephone equipment and DSL routers.
Splitter and diplexer	Split communication signals for further processing	Wide Area and telephone networks and cable television systems
Power		
Power transformer	Modify circuit voltage	AC/DC & DC/DC power supplies or, generally, anything that plugs in for power
Signal transformer	Limit distortion of signals as they pass from one medium to another	Analog circuitry, military/aerospace navigation and weapons guidance systems
Automotive ignition coils	Provide power for automotive ignition	Ignition systems for automotive gasoline engines
Other automotive coils	Provide power for a variety of automotive electronic functions. Create or control mechanical movement.	Automotive management systems such as safety, communication, navigation, fuel efficiency and emissions control
Inductor/chip inductor	Regulate and control electrical energy under conditions of varying loads	Point of load conversion for power on various electronic devices, including servers, switches, computers, game boxes and telephone network equipment

Current and voltage sensors	Sense the presence of, amount of or phase of current or voltage	Inverters, smart meters, charging stations, electric grid control, flight power generation, motor control and industrial control
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Wireless

Integrated antennas and integrated antenna modules	Capture and transmit voice, data and telemetry signals for mobile devices	Mobile phones, notebooks, tablets, laptops and wearable electronics such as smart watches
Mobile and portable antennas	Capture and transmit wireless signals, including Bluetooth, GPS, WiFi, RFID, NFC, VHF/UHF, 2G, 3G, and 4G	Global positioning systems, automotive antennas, wireless handsets/readers, femtocells, small cells, smart metering, and machine-to-machine communication
Mounts and cables	Mounting antennas onto mobile or stationary locations	Police cars, fire trucks, delivery vehicles, trains, base stations, masts, meters, indoor and outdoor building wireless infrastructure

Sales, Customers and Distribution

Each of our segments sells products predominantly through our worldwide direct sales forces. Given the highly technical nature of our customers' needs, our direct salespeople typically team up with members of our engineering staff to discuss a sale with a customer's purchasing and engineering personnel. During the sales process, there is close interaction between our engineers and those in our customers' organizations. This interaction extends throughout a product's life cycle, engendering strong customer relationships. Also, we believe that our coordinated sales effort provides a high level of market penetration and efficient coverage of our customers on a cost-effective basis. As of December 26, 2014, we had approximately 53 salespeople in seven sales offices worldwide.

We sell our products and services to original equipment manufacturers, original design manufacturers and electronic contract equipment manufacturers, which design, build and market end-user products. We refer to these companies as OEMs, ODMs and CEMs, respectively. ODMs typically contract with OEMs to design products, whereas CEMs contract with OEMs to manufacture products. Many OEMs use CEMs primarily or exclusively to build their products. Independent distributors sell components and materials to both OEMs and CEMs. While OEMs are often our design partners, most sales are to CEMs, as OEMs have generally outsourced procurement and manufacturing responsibilities to CEMs. In order to maximize our sales opportunities, our engineering and sales teams maintain close relationships with all outlets, including OEMs, ODMs, CEMs and other independent distributors. We provide support for our multinational customer base with local customer service and design centers in North America, Europe and Asia.

For the years ended December 26, 2014 and December 27, 2013, one individual customer in our Network segment accounted for 12.7% and 10.8% of our consolidated net sales, respectively. In addition, one customer in our Network segment, when aggregated with their CEM suppliers, represents more than 10% of our consolidated net sales. Sales to our 10 largest customers accounted for 54.1% of net sales for the year ended December 26, 2014 and 49.9% of net sales for the year ended December 27, 2013.

A large percentage of our net sales are made outside of the United States. For the years ended December 26, 2014 and December 27, 2013, 87.2% and 86.9% of our net sales were outside of the United States, respectively.

Manufacturing

We have developed custom manufacturing processes intended to maximize production efficiency without sacrificing the quality of our products. Specifically, Network's manufacturing of magnetic components, connectors, chokes and filters is labor intensive and can be highly variable. Our model enables flexibility of production to contain costs during slower periods, which reflects the often unpredictable nature of market demand for our product lines. As the

cost of labor increases, we are making investments in automation for this product line. However, our model may also prevent us from increasing production capacity over periods of intense demand in tight labor markets. Conversely, the manufacturing of our antennas and automotive products of our Wireless and Power segments is highly mechanized or, in some cases, automated, which causes costs and profitability related to these products to be sensitive to the volume of production. Our products are primarily manufactured in our four manufacturing facilities in China. All of our sites are certified to the ISO9000 series of quality standards to bring the highest possible level of compliance to international standards.

Generally, once our engineers design products to meet the end users' needs and a contract is awarded by, or orders are received from, the customer we begin to mass produce the products. To a much lesser extent, we also service customers that design their own components and outsource production of these components to us. In such case, we build the components to the customer's design. We also maintain a portfolio of catalog parts which our customers can easily design into their own products.

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We cannot accurately estimate or forecast the overall utilization of our production capacity at a given time. In each facility, maximum capacity and utilization periodically vary depending on our manufacturing strategies, the product being manufactured, current market conditions, customer demand and other non-specific variables.

Research, Development and Engineering

Our research, development and engineering efforts are focused on the design and development of innovative products in collaboration with our customers or their ODM partners. We work closely with OEMs and ODMs to identify their design and engineering requirements. We have design centers throughout the world in proximity to customers to enable better understanding of our end products and readily satisfy our customers' design and engineering needs. Our product lifecycle management system tracks the level of design activity per customer. This enables us to manage and improve our engineers' processes for designing products, which has created an overall disciplined and orderly design methodology. We typically own the customized designs used to make our products.

Research, development and engineering expenditures for the years ended December 26, 2014 and December 27, 2013, were \$19.6 million and \$22.2 million, respectively.

Competition

We do not believe that any one company competes with the breadth of our product lines on a global basis. However, each of our segments has strong competition within individual product lines, both domestically and internationally. In addition, several OEMs internally, or through CEMs, manufacture certain of our product offerings. We pursue opportunities to demonstrate to OEMs that our economies of scale, purchasing power and core competencies in manufacturing enable us to produce better engineered products more efficiently.

Competitive factors in the markets for our products include:

- engineering expertise;
- product quality and reliability;
- global design and manufacturing capabilities;
- breadth of product line;
- price;
- customer service; and
- delivery time.

We believe we are competitive with respect to each of these factors. Product quality and reliability, as well as design and manufacturing capabilities, are enhanced through our continuing commitment to invest in and improve our manufacturing and design resources and, also, our close relationships with our customers' engineers. In addition, the breadth of our segments' product offerings provides customers with the ability to satisfy multiple needs through one supplier. Also, our global presence enables us to deepen our relationships with customers and to better understand and more easily satisfy their needs in local markets. Our ability to purchase raw materials in large quantities reduces our production expenses, maximizes our capacity, continually lowers our manufacturing costs and enables us to price our products competitively.

Employees

As of December 26, 2014, we had approximately 9,400 full-time employees compared to approximately 10,000 at December 27, 2013. We utilize temporary staff to supplement our labor capacity, and we have excluded temporary staff from our full-time employment figures. Approximately 200 full-time employees were located in the United

States, approximately 100 were located in Europe, and approximately 9,100 were located in China. None of our employees were covered by collective-bargaining agreements during the year ended December 26, 2014. Also, we did not experience any major work stoppages during 2014, and we consider relationships with our employees to be in good standing.

Raw Materials

The primary raw materials necessary to manufacture all our segments' products include:

- base metals such as copper;
- ferrite cores;

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plastics and plastic resins; and
rare earth metals.

Currently, we do not have significant difficulty obtaining any raw materials integral to our manufacturing and do not anticipate that we will face any significant difficulty in the near future. However, some of these materials are produced by a limited number of suppliers. The limited amount of suppliers may restrict our ability to obtain these raw materials in sufficient quantities, at reasonable prices or in a timely manner to meet our customers' demand for our products. A lack of availability or a delay in obtaining any of the raw materials used in our products could adversely affect our manufacturing costs and profit margins. In addition, if the price of our raw materials increases significantly over a short period of time due to increased market demand or shortage of supply, customers may be unwilling to bear the increased price for our products and we may be forced to sell our products containing these materials at lower prices causing a reduction in our profit margins.

Backlog

Our backlog of unfilled orders at December 26, 2014 and December 27, 2013 was approximately \$53.3 million and \$40.8 million, respectively. Orders typically fluctuate from quarter to quarter based on customer demand and general business conditions. Unfilled orders may be canceled prior to shipment of goods. It is expected that all or a substantial portion of the backlog will typically be filled within six months. We do not believe that our backlog is an accurate indicator of near-term business activity because of variability in lead times, capacity, and demand uncertainty on the part of our customers, and, also, the increased use of vendor managed inventory and similar consignment type arrangements, tend to limit the significance of our backlog.

Intellectual Property

We utilize proprietary technology that is often developed and protected by us or, to a much lesser extent, licensed from others. Also, we require each of our employees with access to proprietary technology to enter into confidentiality agreements. We also restrict access to our proprietary information to only those employees essential to our products' creation.

Existing legal protections afford only limited advantage to us. For example, others may independently develop similar or competing products or attempt to copy or use aspects of our products that we regard as proprietary. Furt