ModusLink Global Solutions Inc
Form 10-Q
March 14, 2011
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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 January 31, 2011

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 000-23262

ModusLink Global Solutions, Inc.

(Exact name of registrant as specified in its charter)

Delaware	**04-2921333**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**
1100 Winter Street Waltham, Massachusetts	**02451**
(Address of principal executive offices)	**(Zip Code)**

(781) 663-5001

(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 x No ¨

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 (§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 ¨ No ¨

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.

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

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

As of March 4, 2011, there were 43,793,364 shares outstanding of the registrant s Common Stock, $.01 par value per share.

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MODUSLINK GLOBAL SOLUTIONS, INC.

FORM 10-Q

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MODUSLINK GLOBAL SOLUTIONS, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands, except per share and share amounts)

(Unaudited)

	January 31, 2011	July 31, 2010
ASSETS		
Current assets:		
Cash and cash equivalents	$ 154,217	$ 161,364
Available-for-sale securities	222	270
Accounts receivable, trade, net of allowance for doubtful accounts of $1,027 and $919, at January 31, 2011 and July 31, 2010, respectively	140,892	159,768
Inventories, net	79,667	74,096
Prepaid expenses and other current assets	12,084	14,226
Total current assets	387,082	409,724
Property and equipment, net	49,942	52,906
Investments in affiliates	12,997	13,016
Goodwill	3,058	16,207
Other intangible assets, net	6,798	24,173
Other assets	10,307	9,760
Total assets	$ 470,184	$ 525,786
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Current installments of obligations under capital leases	$ 38	$ 40
Accounts payable	111,205	132,098
Current portion of accrued restructuring	2,123	2,632
Accrued income taxes		48
Accrued expenses	38,755	45,729
Other current liabilities	6,949	4,773
Current liabilities of discontinued operations	1,686	1,791
Total current liabilities	160,756	187,111
Long-term portion of accrued restructuring	484	1,000
Obligations under capital leases, less current installments	10	29
Other long-term liabilities	15,791	15,656
Non-current liabilities of discontinued operations	2,587	3,289
Stockholders equity:		
Preferred stock, $0.01 par value per share. Authorized 5,000,000 shares; zero issued or outstanding at January 31, 2011 and July 31, 2010		
Common stock, $0.01 par value per share. Authorized 1,400,000,000 shares; 43,814,824 issued and outstanding shares at January 31, 2011; 44,039,938 issued and 43,729,338 outstanding shares at July 31, 2010	438	440
Additional paid-in capital	7,425,434	7,427,031
Treasury stock, at cost 310,600 shares at July 31, 2010		(1,992)
Accumulated deficit	(7,156,019)	(7,121,015)

Accumulated other comprehensive income	20,703	14,237
Total stockholders equity	290,556	318,701
Total liabilities and stockholders equity	$ 470,184	$ 525,786

See accompanying notes to unaudited condensed consolidated financial statements

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MODUSLINK GLOBAL SOLUTIONS INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except per share amounts)

(Unaudited)

	Three Months Ended January 31, 2011	Three Months Ended January 31, 2010	Six Months Ended January 31, 2011	Six Months Ended January 31, 2010
Net revenue	$ 234,150	$ 235,488	$ 470,529	$ 482,167
Cost of revenue	210,759	203,954	424,784	414,619
Gross profit	23,391	31,534	45,745	67,548
Operating expenses:				
Selling, general and administrative	20,458	23,917	43,009	46,874
Amortization of intangible assets	1,679	1,599	3,358	2,972
Impairment of goodwill and intangible assets	27,166		27,166	
Restructuring and other, net	412	36	1,201	165
Total operating expenses	49,715	25,552	74,734	50,011
Operating income (loss)	(26,324)	5,982	(28,989)	17,537
Other income (expense):				
Interest income	88	82	129	203
Interest expense	(120)	(158)	(241)	(285)
Other losses, net	(372)	(289)	(2,297)	(580)
Equity in losses of affiliates and impairments	(370)	(848)	(1,016)	(1,712)
Total other income (expense)	(774)	(1,213)	(3,425)	(2,374)
Income (loss) from continuing operations before income taxes	(27,098)	4,769	(32,414)	15,163
Income tax expense	1,132	2,174	2,441	4,055
Income (loss) from continuing operations	(28,230)	2,595	(34,855)	11,108
Discontinued operations, net of income taxes:				
Income (loss) from discontinued operations	(104)	(29)	(149)	16
Net income (loss)	$ (28,334)	$ 2,566	$ (35,004)	$ 11,124
Basic and diluted earnings (loss) per share:				
Income (loss) from continuing operations	$ (0.65)	$ 0.06	$ (0.81)	$ 0.25
Income (loss) from discontinued operations	$	$	$	$
Net income (loss)	$ (0.65)	$ 0.06	$ (0.81)	$ 0.25
Shares used in computing basic earnings per share:	43,279	44,208	43,284	44,504
Shares used in computing diluted earnings per share:	43,279	44,301	43,284	44,623

See accompanying notes to unaudited condensed consolidated financial statements

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MODUSLINK GLOBAL SOLUTIONS, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

(Unaudited)

	Six Months Ended January 31, 2011	Six Months Ended January 31, 2010
Cash flows from operating activities of continuing operations:		
Net income (loss)	$ (35,004)	$ 11,124
Income (loss) from discontinued operations	(149)	16
Income (loss) from continuing operations	(34,855)	11,108
Adjustments to reconcile income (loss) from continuing operations to net cash (used) provided by continuing operations:		
Depreciation	8,193	8,450
Impairment of goodwill and intangible assets	27,166	
Amortization of intangible assets	3,358	2,972
Share-based compensation	1,897	2,396
Non-operating losses, net	2,297	580
Equity in losses of affiliates and impairments	1,016	1,712
Changes in operating assets and liabilities, excluding effects from acquisition:		
Trade accounts receivable, net	22,838	21,940
Inventories	(3,499)	949
Prepaid expenses and other current assets	2,246	992
Accounts payable, accrued restructuring and accrued expenses	(34,439)	(18,359)
Refundable and accrued income taxes, net	575	(1,129)
Other assets and liabilities	(1,227)	(1,525)
Net cash (used in) provided by operating activities of continuing operations	(4,434)	30,086
Cash flows from investing activities of continuing operations:		
Additions to property and equipment	(3,926)	(3,438)
Redemption of short-term investments		10,000
Proceeds from the sale of equity investments in affiliates	52	947
Business acquisition, net of cash acquired		(29,040)
Investments in affiliates	(996)	(3,102)
Net cash used in investing activities of continuing operations	(4,870)	(24,633)
Cash flows from financing activities of continuing operations:		
Repayments on capital lease obligations	(30)	(329)
Proceeds from issuance of common stock	125	128
Repurchase of common stock	(1,622)	(9,175)
Net cash used in financing activities of continuing operations	(1,527)	(9,376)
Cash flows from discontinued operations:		
Operating cash flows	(826)	(807)

Net cash used in discontinued operations	(826)	(807)
Net effect of exchange rate changes on cash and cash equivalents	4,510	(67)
Net decrease in cash and cash equivalents	(7,147)	(4,797)
Cash and cash equivalents at beginning of period	161,364	168,767
Cash and cash equivalents at end of period	$ 154,217	$ 163,970

See accompanying notes to unaudited condensed consolidated financial statements

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MODUSLINK GLOBAL SOLUTIONS, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

(1) NATURE OF OPERATIONS

ModusLink Global Solutions, Inc. (together with its consolidated subsidiaries, ModusLink Global Solutions or the Company), through its wholly owned subsidiaries, ModusLink Corporation (ModusLink), ModusLink PTS, Inc. (ModusLink PTS), and Tech for Less, LLC (TFL), is a leader in global supply chain business process management serving technology-based clients in the computing, software, consumer electronics, storage and communications markets. The Company designs and executes critical elements in our clients global supply chains to improve speed to market, product customization, flexibility, cost, quality and service. These benefits are delivered through a combination of innovative service solutions, integrated operations, proven business processes, an expansive global footprint and world-class technology.

The Company had fiscal 2010 revenue of approximately $924.0 million. As of January 31, 2011, the Company has an integrated network of strategically located facilities in various countries, including numerous sites throughout North America, Europe and Asia. The Company previously operated under the names CMGI, Inc. and CMG Information Services, Inc. and was incorporated in Delaware in 1986.

(2) BASIS OF PRESENTATION

The accompanying condensed consolidated financial statements have been prepared by the Company in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP) for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting of a normal recurring nature) considered necessary for fair presentation have been included. These condensed consolidated financial statements should be read in conjunction with the audited financial statements and related notes for the year ended July 31, 2010, which are contained in the Company s Annual Report on Form 10-K filed with the Securities and Exchange Commission (SEC) on October 14, 2010. The results for the three and six months ended January 31, 2011 are not necessarily indicative of the results to be expected for the full fiscal year.

All significant intercompany transactions and balances have been eliminated in consolidation.

The Company considers events or transactions that occur after the balance sheet date but before the issuance of financial statements to provide additional evidence relative to certain estimates or to identify matters that require additional disclosure. For the period ended January 31, 2011, the Company has evaluated subsequent events for potential recognition and disclosure through the date these financial statements were filed.

(3) RECENT ACCOUNTING PRONOUNCEMENTS

In September 2009, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2009-13, Revenue Recognition Topic 605: Multiple-Deliverable Revenue Arrangements (ASU 2009-13). ASU 2009-13 addresses the unit of accounting for multiple-element arrangements. In addition, ASU 2009-13 revises the method by which consideration is allocated among the units of accounting. The overall consideration is allocated to each deliverable by establishing a selling price for individual deliverables based on a hierarchy of evidence, including vendor-specific objective evidence, other third party evidence of the selling price, or the reporting entity s best estimate of the selling price of individual deliverables in the arrangement. ASU 2009-13 became effective for the Company on August 1, 2010. The adoption of ASU 2009-13 does not have a material impact on the Company s results of operations or financial position.

MODUSLINK GLOBAL SOLUTIONS, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(unaudited)

(4) GOODWILL AND INTANGIBLE ASSETS

The Company conducts its goodwill impairment test on July 31 of each fiscal year. In addition, if and when events or circumstances change that could reduce the fair value of any of its reporting units below its carrying value, an interim test would be performed. In making this assessment, the Company relies on a number of factors including operating results, business plans, economic projections, anticipated future cash flows, and transactions and marketplace data. The Company s reporting units are the same as the operating segments: Americas, Asia, Europe, e-Business, ModusLink PTS and TFL.

During the second quarter of fiscal year 2011, indicators of potential impairment caused the Company to conduct an interim impairment test for goodwill and other long-lived assets, which includes amortizable intangible assets for its ModusLink PTS and TFL reporting units in connection with the preparation of its quarterly financial statements for the quarter ended January 31, 2011. These indicators included continued operating losses, the departure of key personnel, and increasingly adverse trends that resulted in further deterioration of current operating results and future prospects for both the ModusLink PTS and TFL reporting units. These adverse trends include increased competition for and a decline in the supply of quality products at a reasonable cost for TFL, pricing pressure from existing customers for ModusLink PTS, and the emergence and growth of new competitors for both ModusLink PTS and TFL.

As a result of the impairment tests, the Company concluded that its goodwill was impaired and recorded a $13.2 million non-cash goodwill impairment charge, consisting of $7.1 million for ModusLink PTS and $6.1 million for TFL. The Company also determined that its intangible assets were impaired and recorded a $14.0 million non-cash intangible asset impairment charge, consisting of $8.8 million for ModusLink PTS and $5.2 million for TFL. The goodwill and intangible asset impairment charges for ModusLink PTS are not deductible for tax purposes. The goodwill and intangible asset impairment charges for TFL are deductible as amortization for tax purposes over time. The impairment charge did not affect the Company s liquidity or cash flows.

The estimated fair values of our reporting units for the goodwill impairment test were evaluated using an income approach by calculating the present value of estimated future cash flows. We believe the use of the income approach is appropriate due to lack of comparability to guideline companies and the lack of comparable transactions under the market approach. The income approach incorporates many assumptions including future growth rates, discount factors, expected capital expenditures and income tax cash flows. In developing an appropriate discount rate to apply in its estimated cash flow models the Company developed an estimate of its weighted average cost of capital for ModusLink PTS and TFL.

While performing the interim goodwill impairment test, the Company lowered its forecast of revenue growth and gross profit margins for ModusLink PTS and TFL for fiscal years 2011 to 2018. Revenue growth rates and gross profit margins are the variables which have the most significant impact to the discounted cash flow models for these reporting units. The decline in our forecasts for ModusLink PTS and TFL is attributable to our consideration of the operating losses for these reporting units during the first half of fiscal year 2011, the consideration of the impact that the departure of key personnel could have on our future operating results for these reporting units, and increasingly adverse trends that resulted in further deterioration of current and future operating results.

In connection with completing the goodwill impairment analysis the Company also evaluated the recoverability of its long-lived assets at the ModusLink PTS and TFL reporting units. The asset groups for both ModusLink PTS and TFL are at the reporting unit level. Recoverability of these asset groups is determined by comparing forecasted undiscounted net cash flows of the reporting units to their respective carrying values. If the

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MODUSLINK GLOBAL SOLUTIONS, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(unaudited)

asset group s cash flows are determined to be unable to recover the carrying amount of its net assets, then a loss is recognized equal to the amount by which the asset group s carrying value exceeds its fair value. The loss is then allocated amongst the long-lived assets based on their relative carrying amounts, with the exception that a loss allocated to an individual asset should not reduce the carrying amount of that asset below its fair value. Based upon this evaluation the Company determined that the estimated future undiscounted cash flows related to these asset groups were below their carrying values, and therefore these asset groups were impaired.

The Company s remaining goodwill of $3.1 million as of January 31, 2011 relates to the Company s e-Business reporting unit. There were no indicators of impairment identified related to the Company s e-Business reporting unit during the second quarter of fiscal year 2011.

The carrying amount of goodwill allocated to the Company s reportable segments is as follows:

	Americas	Asia	Europe	TFL (in thousands)	All Other	Consolidated Total
Balance as of July 31, 2010						
Goodwill	$ 94,477	$ 73,948	$ 30,108	$ 16,299	$ 5,857	220,689
Accumulated impairment charges	(87,427)	(73,948)	(30,108)	(10,200)	(2,799)	(204,482)
	$ 7,050	$	$	$ 6,099	$ 3,058	$ 16,207
Impairment of goodwill	(7,050)			(6,099)		(13,149)
Balance as of January 31, 2011						
Goodwill	94,477	73,948	30,108	16,299	5,857	220,689
Accumulated impairment charges	(94,477)	(73,948)	(30,108)	(16,299)	(2,799)	(217,631)
	$	$	$	$	$ 3,058	$ 3,058

The components of intangible assets are as follows (in thousands):

	January 31, 2011				July 31, 2010			
	Gross Carrying Amount	Accumulated amortization/ impairment	Net Book Value	Weighted average amortization period	Gross Carrying Amount	Accumulated amortization	Net Book Value	Weighted average amortization period
Client Relationships	$ 34,500	$ 30,459	$ 4,041	7 years	$ 34,500	$ 21,503	$ 12,997	7 to 10 years
Developed Technology	13,992	11,965	2,027	3 to 7 years	13,992	5,638	8,354	3 to 8 years
Trade Names	5,405	4,711	694	3 to 7 years	5,405	2,800	2,605	3 to 8 years
Non-competes	713	677	36	1 to 5 years	713	496	217	1 to 5 years
Total	$ 54,610	$ 47,812	$ 6,798		$ 54,610	$ 30,437	$ 24,173	

As of January 31, 2011, approximately $1.3 million, $0.7 million, $0.8 million and $4.1 million of the Company s remaining intangible assets relate to the Company s Americas, Asia, TFL and e-Business operating segments, respectively.

Amortization expense for intangible assets for the three and six months ended January 31, 2011 totaled approximately $1.7 million and $3.4 million, respectively.

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MODUSLINK GLOBAL SOLUTIONS, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(unaudited)

Estimated annual amortization expense for intangible assets for the next five years ending July 31, is as follows:

Fiscal Year	Amount (in thousands)
Remaining six months ended July 31, 2011	$ 2,108
2012	$ 1,325
2013	$ 1,322
2014	$ 1,281
2015	$ 762

(5) SHARE-BASED PAYMENTS

Stock options for the purchase of approximately 0.2 million shares of the Company s common stock were awarded to executives during the six months ended January 31, 2011 at a weighted average exercise price of $6.37 per share. The weighted average option fair value was $2.94 per share. The weighted average option fair value was calculated using the binominal-lattice model with the following weighted average assumptions: expected volatility of 62.8%, risk-free rate of 1.03% and expected life of 4.27 years.

Additionally, approximately 0.2 million nonvested shares were awarded to executives during the six months ended January 31, 2011 at a weighted average fair value of $6.37 per share. The fair value of nonvested shares is determined based on the market price of the Company s common stock on the grant date.

The following table summarizes share-based compensation expense related to employee stock options, employee stock purchases and nonvested shares for the three and six months ended January 31, 2011 and 2010, which was allocated as follows:

	Three Months Ended January 31,		Six Months Ended January 31,	
	2011	2010	2011	2010
	(in thousands)			
Cost of goods sold	$ 93	$ 84	$ 192	$ 175
Selling, general and administrative	901	1,241	1,705	2,221
	$ 994	$ 1,325	$ 1,897	$ 2,396

(6) OTHER LOSSES, NET

The following table reflects the components of Other losses, net :

	Three Months Ended January 31,		Six Months Ended January 31,	
	2011	2010	2011	2010

	(in thousands)			
Foreign currency exchange losses	$ (304)	$ (225)	$ (1,991)	$ (496)
Gain on sale of investments	51	101	51	101
Gain (loss) on disposal of assets	(1)	(52)	41	(68)
Other, net	(118)	(113)	(398)	(117)
	$ (372)	$ (289)	$ (2,297)	$ (580)

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MODUSLINK GLOBAL SOLUTIONS, INC. AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(unaudited)

The Company recorded foreign exchange losses of approximately $0.3 million and $2.0 million during the three and six months ended January 31, 2011, respectively. These net losses primarily related to realized and unrealized losses from foreign currency exposures and settled transactions in the Americas, Asia and Europe. During the three months ended January 31, 2011, the Company recorded gains of approximately $0.1 million related to distribution of proceeds from the acquisition by third parties of H2Gen Innovations, Inc. and M2E Power due to the satisfaction of conditions leading to the release of funds held in escrow.

The Company recorded foreign exchange losses of approximately $0.2 million and $0.5 million during the three and six months ended January 31, 2010, respectively. These net losses related primarily to realized and unrealized losses from foreign currency exposures and settled transactions in the Americas, Asia and Europe. During the three months ended January 31, 2010, the Company recorded a gain of approximately $0.1 million to adjust a previously recorded gain on the acquisition by a third party of Virtual Ink, Inc. due to the satisfaction of conditions leading to the release of funds held in escrow.

(7) RESTRUCTURING AND OTHER CHARGES

The following table summarizes the activity in the restructuring accrual for the three and six months ended January 31, 2011:

	Employee Related Expenses	Contractual Obligations	Asset Impairments	Total
		(in thousands)		
Accrued restructuring balance at July 31, 2010	$ 181	$ 3,451	$	$ 3,632
Restructuring charges	816			816
Restructuring adjustments		(27)		(27)
Cash paid	(244)	(486)		(730)
Accrued restructuring balance at October 31, 2010	$ 753	$ 2,938	$	$ 3,691