

EnerSys  
Form 10-Q  
February 07, 2007  
Table of Contents

---

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

---

**FORM 10-Q**

---

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**  
For the quarterly period ended December 31, 2006

**TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**  
For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number: 001-32253

---

**EnerSys**

(Exact name of registrant as specified in its charter)

---

**Delaware**  
(State of Incorporation)

**23-3058564**  
(I.R.S. Employer Identification No.)

**2366 Bernville Road**

**Reading, Pennsylvania 19605**

(Address of principal executive offices)

**Telephone Number: 610-208-1991**

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

## Edgar Filing: EnerSys - Form 10-Q

### Common Stock, \$0.01 par value

---

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  NO.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Securities Exchange Act of 1934.

Large accelerated filer  Accelerated filer  Non-accelerated filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Securities Exchange Act of 1934).  
 YES  NO.

**Common Stock outstanding at February 2, 2007: 46,918,471 shares**

---

**Table of Contents**

**ENERSYS**

**INDEX FORM 10-Q**

	<b>Page</b>
Item 1. <u>Financial Statements</u>	
<u>Condensed Consolidated Balance Sheets December 31, 2006 (Unaudited), and March 31, 2006</u>	3
<u>Condensed Consolidated Statements of Income (Unaudited) For the Three Fiscal Months Ended December 31, 2006, and January 1, 2006</u>	4
<u>Condensed Consolidated Statements of Income (Unaudited) For the Nine Fiscal Months Ended December 31, 2006, and January 1, 2006</u>	5
<u>Condensed Consolidated Statements of Cash Flows (Unaudited) For the Nine Fiscal Months Ended December 31, 2006, and January 1, 2006</u>	6
<u>Condensed Consolidated Statements of Comprehensive Income (Loss) (Unaudited) For the Three and Nine Fiscal Months Ended December 31, 2006, and January 1, 2006</u>	7
<u>Notes to Condensed Consolidated Financial Statements (Unaudited)</u>	8
Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	23
Item 3. <u>Quantitative and Qualitative Disclosures about Market Risk</u>	34
Item 4. <u>Controls and Procedures</u>	36
PART II <u>OTHER INFORMATION</u>	
Item 1. <u>Legal Proceedings</u>	37
Item 1a. <u>Risk Factors</u>	37
Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	38
Item 6. <u>Exhibits</u>	39
<u>SIGNATURES</u>	40
<u>EXHIBIT INDEX</u>	41

**Table of Contents****PART I FINANCIAL INFORMATION****Item 1. Financial Statements**

## ENERSYS

**Condensed Consolidated Balance Sheets**

(In Thousands, Except Share and Per Share Data)

	December 31, 2006 (Unaudited)	March 31, 2006
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 37,135	\$ 15,217
Accounts receivable, net	326,298	308,625
Inventories, net	221,836	179,537
Deferred taxes	21,754	20,338
Prepaid and other current assets	30,355	23,978
Total current assets	637,378	547,695
Property, plant, and equipment, net	295,189	281,744
Goodwill	322,819	308,767
Other intangible assets, net	80,590	80,831
Deferred taxes	14,007	13,843
Other assets	30,030	31,068
Total assets	\$ 1,380,013	\$ 1,263,948
<b>Liabilities and stockholders equity</b>		
Current liabilities:		
Short-term debt	\$ 13,388	\$ 6,571
Current portion of long-term debt and capital lease obligations	10,521	9,592
Accounts payable	167,010	157,792
Accrued expenses	182,211	159,671
Deferred taxes	3,307	2,635
Total current liabilities	376,437	336,261
Long-term debt and capital lease obligations	382,115	386,327
Deferred taxes	58,183	55,357
Other liabilities	41,969	40,815
Total liabilities	858,704	818,760
Stockholders equity:		
Common Stock, \$0.01 par value, 135,000,000 shares authorized, and 46,913,137 shares issued and outstanding at December 31, 2006; 46,560,940 shares issued and outstanding at March 31, 2006	469	466
Preferred Stock, \$0.01 par value, 1,000,000 shares authorized, no shares issued and outstanding		
Additional paid-in capital	337,786	335,263
Unearned stock grant compensation		(3,090)
Retained earnings	88,861	54,270
Accumulated other comprehensive income	94,193	58,279

Edgar Filing: EnerSys - Form 10-Q

Total stockholders' equity	521,309	445,188
Total liabilities and stockholders' equity	\$ 1,380,013	\$ 1,263,948

See accompanying notes.

**Table of Contents**

## ENERSYS

**Condensed Consolidated Statements of Income (Unaudited)**

(In Thousands, Except Share and Per Share Data)

	Three fiscal months ended	
	December 31, 2006	January 1, 2006
Net sales	\$ 377,881	\$ 321,793
Cost of goods sold	300,970	252,209
<b>Gross profit</b>	<b>76,911</b>	<b>69,584</b>
Operating expenses	55,725	49,891
Restructuring and other charges		2,574
Operating earnings	21,186	17,119
Interest expense	7,113	6,353
Other expense (income), net	928	(194)
Earnings before income taxes	13,145	10,960
Income tax expense	2,166	3,193
<b>Net earnings</b>	<b>\$ 10,979</b>	<b>\$ 7,767</b>
Net earnings per common share:		
Basic	\$ 0.24	\$ 0.17
Diluted	\$ 0.23	\$ 0.17
Weighted-average shares of common stock outstanding:		
Basic	46,597,387	46,249,384
Diluted	47,699,968	46,949,052

See accompanying notes.

**Table of Contents**

## ENERSYS

**Condensed Consolidated Statements of Income (Unaudited)**

(In Thousands, Except Share and Per Share Data)

	Nine fiscal months ended	
	December 31, 2006	January 1, 2006
Net sales	\$ 1,090,839	\$ 930,067
Cost of goods sold	859,106	729,742
<b>Gross profit</b>	<b>231,733</b>	<b>200,325</b>
Operating expenses	163,998	147,130
Restructuring and other charges		8,553
Litigation settlement income	(3,753)	
<b>Operating earnings</b>	<b>71,488</b>	<b>44,642</b>
Interest expense	21,176	18,475
Other expense (income), net	2,559	(1,805)
<b>Earnings before income taxes</b>	<b>47,753</b>	<b>27,972</b>
Income tax expense	13,162	8,926
<b>Net earnings</b>	<b>\$ 34,591</b>	<b>\$ 19,046</b>
<b>Net earnings per common share:</b>		
Basic	\$ 0.74	\$ 0.41
Diluted	\$ 0.73	\$ 0.41
<b>Weighted-average shares of common stock outstanding:</b>		
Basic	46,469,119	46,210,187
Diluted	47,538,258	46,738,021

See accompanying notes.

**Table of Contents**

## ENERSYS

**Condensed Consolidated Statements of Cash Flows (Unaudited)**

(In Thousands)

	Nine fiscal months ended	
	December 31, 2006	January 1, 2006
<b>Cash flows from operating activities</b>		
Net earnings	\$ 34,591	\$ 19,046
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Non-cash restructuring		8,222
Depreciation and amortization	35,123	32,480
Provision for doubtful accounts	523	(45)
Provision for deferred taxes, less amounts related to restructuring	(639)	(322)
Stock-based compensation	2,225	
Loss on disposal of fixed assets	538	308
Changes in assets and liabilities, net of effects of acquisitions:		
Accounts receivable	(621)	(35,708)
Inventory	(30,872)	(11,171)
Prepaid expenses and other current assets	(190)	(543)
Other assets	575	(275)
Accounts payable	(1,102)	20,045
Accrued expenses	13,886	(6,688)
Other liabilities	(1,844)	(603)
Net cash provided by operating activities	52,193	24,746
<b>Cash flows from investing activities</b>		
Capital expenditures	(27,488)	(29,615)
Acquisitions	(6,379)	(38,088)
Proceeds from disposal of property, plant, and equipment	186	825
Net cash used in investing activities	(33,681)	(66,878)
<b>Cash flows from financing activities</b>		
Net increase in short-term debt	5,480	5,173
Proceeds from the issuance of long-term debt	127	29,876
Payments of long-term debt	(4,737)	(3,092)
Payments of capital lease obligations, net	(1,009)	(465)
Exercise of stock options	2,442	1,162
Tax benefits from exercise of stock options	949	
Deferred financing costs	(343)	(376)
Net cash provided by financing activities	2,909	32,278
Effect of exchange rate changes on cash	497	(170)
Net increase (decrease) in cash and cash equivalents	21,918	(10,024)
Cash and cash equivalents at beginning of period	15,217	21,341
Cash and cash equivalents at end of period	\$ 37,135	\$ 11,317

See accompanying notes.





**Table of Contents**

## ENERSYS

**Condensed Consolidated Statements of Comprehensive Income (Loss) (Unaudited)**

(In Thousands)

	<b>Fiscal quarters ended</b>		<b>Nine fiscal months ended</b>	
	<b>December 31, 2006</b>	<b>January 1, 2006</b>	<b>December 31, 2006</b>	<b>January 1, 2006</b>
Net earnings	\$ 10,979	\$ 7,767	\$ 34,591	\$ 19,046
Other comprehensive income:				
Net unrealized gain on derivative instruments, net of tax	1,193	835	344	2,092
Minimum pension liability, net of tax	(99)		(205)	
Foreign currency translation adjustments	17,218	(7,584)	35,775	(31,044)
Total comprehensive income (loss)	\$ 29,291	\$ 1,018	\$ 70,505	\$ (9,906)

See accompanying notes.

---

**Table of Contents**

**ENERSYS**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)**

(In Thousands, Except Share and Per Share Data)

**NOTE 1: BASIS OF PRESENTATION**

The accompanying interim unaudited condensed consolidated financial statements of EnerSys (the Company) have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all the information and notes required for complete financial statements. In the opinion of management, the interim unaudited condensed consolidated financial statements include all adjustments considered necessary for the fair presentation of the financial position, results of operations, and cash flows for the interim periods presented. The financial statements should be read in conjunction with the Consolidated Financial Statements and Notes thereto included in the Company's 2006 Annual Report on Form 10-K (SEC File No. 001-32253) dated June 14, 2006.

The Company reports interim financial information for 13-week periods, except for the first quarter, which always begins on April 1, and the fourth quarter, which always ends on March 31. The four fiscal quarters in 2007 end on July 2, 2006, October 1, 2006, December 31, 2006, and March 31, 2007, respectively. The four fiscal quarters in 2006 ended on July 3, 2005, October 2, 2005, January 1, 2006, and March 31, 2006, respectively.

**NOTE 2: ACCOUNTING PRONOUNCEMENTS PENDING ADOPTION**

In September 2006, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans - an amendment of FASB No. 87, 88, 106, and 132(R)* (SFAS 158). SFAS 158 requires an entity to recognize in its statement of financial position an asset for a defined benefit postretirement plan's overfunded status or a liability for a plan's underfunded status, measure a defined benefit postretirement plan's assets and obligation that determine its funded status as of the end of the employer's fiscal year, and recognize changes in the funded status of a defined benefit postretirement plan in comprehensive income in the year in which the change occurs. The new standard is effective for the Company for the fiscal year ended March 31, 2007. The requirement to measure plan assets and benefit obligations as of the date of the employer's fiscal year-end statements of financial position is effective for the Company for the fiscal year ended March 31, 2009. The Company is in the process of reviewing SFAS 158 and does not expect that it will have a material effect on the consolidated financial statements.

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157, *Fair Value Measurements* (SFAS 157). SFAS 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles (GAAP), and expands disclosures about fair value measurements. The statement applies under other accounting pronouncements that require or permit fair value measurements. Accordingly, SFAS 157 does not require any new fair value measurements. However, for some entities, the application of SFAS 157 will change current practice. The Company is required to adopt SFAS No. 157 in the first quarter of fiscal year 2009. The Company is in the process of reviewing SFAS 157 and has not determined the effects on the consolidated financial statements.

In June 2006, the FASB issued FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes - an Interpretation of FASB Statement No. 109* (FIN No. 48). FIN No. 48 establishes threshold and measurement attributes for financial statement measurement and recognition of tax positions taken or expected to be taken in a tax return. FIN No. 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. FIN No. 48 is effective for the Company in the first quarter of fiscal 2008. The Company is currently evaluating the impact that adoption of FIN No. 48 will have on its financial position, results of operations and cash flows.

**Table of Contents****NOTE 3: ACQUISITIONS**

On August 22, 2006, the Company acquired the assets, including manufacturing facilities, of Chaozhou Xuntong Power Source Company Limited ( CFT ), located in Chaoan, China. This facility manufactures valve-regulated, lead-acid batteries. This acquisition provides the Company with additional capacity needed to meet the growing customer demand for reserve power batteries. The total purchase price for this transaction was approximately \$5,700 and was financed using existing EnerSys credit facilities.

On May 18, 2006, the Company purchased the assets of Alliant Techsystems (NYSE:ATK) lithium primary battery business, located at its Power Sources Center ( PSC ) in Horsham, PA. The total purchase price for this transaction was approximately \$2,200 and was financed using existing EnerSys credit facilities. PSC produces lithium power sources, primarily for aerospace and defense applications. As part of the transaction, ATK has signed a 5-year supply agreement for all of its requirements for products produced at PSC. PSC is now known as EnerSys Advanced Systems Inc. ( EAS ).

On October 11, 2005, the Company completed the acquisition of Gerate- und Akkumulatorwerk Zwickau GmbH ( GAZ ), based in Zwickau, Germany. The total purchase price net of cash received for this transaction was approximately \$2,700 (excluding assumed debt of approximately \$760) and was financed using existing EnerSys credit facilities. GAZ is a producer of specialty nickel-based batteries utilized primarily in the energy, rail, telecommunications and uninterruptible power supply (UPS) industries worldwide. The acquisition resulted in the recognition of \$1,891 of goodwill in the Company's financial statements.

On June 1, 2005, the Company acquired the motive power battery business of FIAMM, S.p.A. ( FIAMM ). The total purchase price net of cash received for this transaction was approximately \$32,700 and financing was completed on June 15, 2005, using primarily a Euro 25,000 Credit Facility Agreement. This acquisition, which complements the Company's existing European motive power business, resulted in the recognition of \$6,435 of goodwill in the Company's financial statements.

In connection with its acquisitions, the Company assesses and formulates plans related to the future integration of the respective acquired business. This process begins during due diligence and is concluded within twelve months of the acquisition. Where necessary, the Company accrues estimates for certain costs related primarily to the business integration, anticipated at the date of the acquisition, in accordance with Emerging Issues Task Force Issue No. 95-3, *Recognition of Liabilities in Connection with a Purchase Business Combination*, SFAS 141, *Business Combinations* and SFAS 5, *Accounting for Contingencies*. Adjustments to these estimates are made up to 12 months from the acquisition date as plans are finalized.

**NOTE 4: INVENTORIES**

Inventories, net consist of:

	December 31, 2006	March 31, 2006
Raw materials	\$ 54,417	\$ 44,453
Work-in-process	61,805	50,472
Finished goods	105,614	84,612
Total	\$ 221,836	\$ 179,537

Inventory reserves for obsolescence and other estimated losses were \$11,982 and \$8,711 at December 31, 2006 and March 31, 2006, respectively, and have been included in the net amounts shown above.

**Table of Contents****NOTE 5: ACCOUNTING FOR DERIVATIVES**

The Company accounts for derivative instruments and hedging activities in accordance with SFAS 133, *Accounting for Derivative Instruments and Hedging Activities*, as amended by SFAS 138, *Accounting for Certain Derivative Instruments and Certain Hedging Activities* and SFAS 149, *Amendment of Statement 133 on Derivative Instruments and Hedging Activities* (collectively, SFAS 133). SFAS 133 establishes accounting and reporting standards for derivative instruments and hedging activities. SFAS 133 requires that all derivatives be recognized as either assets or liabilities at fair value. The Company does not enter into derivative contracts for speculative trading purposes. Derivatives are used to hedge the volatility arising from movements in a portion of the cost of lead purchases as well as to hedge certain interest rates and foreign exchange rate risks. The changes in the fair value of these contracts are recorded in Accumulated Other Comprehensive Income until the related purchased lead, incurred interest rates or foreign currency exposures are charged to earnings. At that time, the portion recorded in Accumulated Other Comprehensive Income is recognized in the Statements of Income. The amounts of Accumulated Other Comprehensive Income related to interest rates, lead and foreign exchange contracts at December 31, 2006 and March 31, 2006, net of tax, were unrecognized gains of \$2,252 and \$1,907, respectively.

**NOTE 6: INCOME TAXES**

The Company's income tax provisions for all periods consist of federal, state and foreign income taxes. The tax provisions for the fiscal 2007 and 2006 interim periods were based on the estimated effective tax rates applicable for the full years ending March 31, 2007 and March 31, 2006, respectively, after giving effect to items specifically related to the interim periods. The effective income tax rates for the third fiscal quarter and nine fiscal months of 2007 were 16.5% and 27.6%, respectively, and both periods included a \$2,000 benefit from the settlement of a prior year tax matter. The effective income tax rates for the third fiscal quarter and nine fiscal months of 2006 were 29.1% and 31.9%, respectively. The effective income tax rate for the fiscal year ended March 31, 2006 was 31.4%. The prior year tax matter related to the Energy Storage Group (ESG) of Invensys plc which the Company acquired in 2002. In addition to the amount credited to income tax expense, \$1,983, which relates to the period prior to 2002, was credited to goodwill at December 31, 2006. This entry eliminates a reserve for a potential tax liability and corresponding goodwill amount that had been established at the time of the initial purchase accounting.

**NOTE 7: WARRANTY**

The Company provides for estimated product warranty expenses when the related products are sold, with related liabilities within accrued expenses. Because warranty estimates are forecasts that are based on the best available information, primarily historical claims experience, claims costs may differ from amounts provided. An analysis of changes in the liability for product warranties is as follows:

	Fiscal quarters ended		Nine fiscal months ended	
	December 31, 2006	January 1, 2006	December 31, 2006	January 1, 2006
Balance at beginning of period	\$ 28,200	\$ 24,459	\$ 26,652	\$ 22,786
Current period provisions	2,888	4,260	9,365	11,966
Cost incurred	(2,830)	(3,635)	(7,759)	(9,668)
Balance at end of period	\$ 28,258	\$ 25,084	\$ 28,258	\$ 25,084

---

**Table of Contents**

**NOTE 8: COMMITMENTS, CONTINGENCIES AND LITIGATION**

**Litigation**

The Company is involved in litigation incidental to the conduct of its business, the results of which, in the opinion of management, are not likely to be material to the Company's financial condition, results of operations, or cash flows (see Note 18 to the Consolidated Financial Statements included in the Company's 2006 Annual Report on Form 10-K).

**Litigation Settlement Income**

In the nine fiscal months of 2007, the Company recorded litigation settlement income of \$3,753, net of fees and expenses, due to the settlement of two separate legal matters. The amount of the settlements has been recorded as an increase in operating income in the nine fiscal months of 2007, as the costs related to these matters were previously recorded as an element of operating earnings.

**Exide Litigation**

When the Company acquired Yuasa's North and South American industrial battery business in 2000, it acquired the worldwide right to use the Exide trademark on industrial batteries. Yuasa had acquired an exclusive, perpetual, worldwide and transferable license to use the Exide name on industrial batteries in 1991 when it bought Exide Technologies' industrial battery business.

On April 15, 2002, Exide Technologies filed for protection under Chapter 11 of the U.S. Bankruptcy Code in the United States Bankruptcy Court for the District of Delaware. During the course of its Chapter 11 proceedings, Exide Technologies sought to reject certain agreements related to the 1991 sale of Exide Technologies' industrial battery business to Yuasa, including the trademark. The Company opposed Exide Technologies' attempt to reject these agreements. On April 3, 2006, the Court found in favor of Exide Technologies. On June 30, 2006, the Court entered a supplemental order pursuant to which (a) EnerSys was afforded until October 3, 2007, to discontinue the use of the Exide trademark on industrial batteries; (b) Exide Technologies was required to refrain from using the Exide trademark on industrial batteries until April 3, 2008; and (c) EnerSys' motion for a stay pending appeal of the court order granting Exide Technologies' motion to reject the agreements was denied. On July 11, 2006, the Company appealed the court's decision. In the opinion of management, this litigation is not likely to have a material impact on the Company's financial condition, results of operations or cash flows.

**Environmental Issues**

As a result of its operations, the Company is subject to various federal, state, local, and foreign environmental laws and regulations and is exposed to the costs and risks of handling, processing, storing, transporting, and disposing of hazardous substances, especially lead and acid. The Company's operations are also subject to federal, state, local and foreign occupational safety and health regulations, including laws and regulations relating to exposure to lead in the workplace.

As more fully described in Note 18 to the Consolidated Financial Statements included in the Company's 2006 Annual Report on Form 10-K, the Company is involved in ongoing environmental issues at certain of its United States and foreign facilities. The Company may have potential environmental issues at its Manchester, England and Sumter, South Carolina facilities and has established reserves in accrued restructuring and accrued expenses of \$8,938 and \$8,183 at December 31, 2006, and March 31, 2006, respectively. The increase in the reserve is due to changes in currency translation rates. The Company believes it is indemnified in whole or in part by former owners of these facilities for some of these environmental matters. Based on information available at this time, management believes that its reserves are sufficient to satisfy its environmental liabilities. The Company has described in Note 9, Restructuring Plans, the changes in the reserves associated with the environmental costs at its Manchester, England and Sumter, South Carolina locations.

---

**Table of Contents**

**Lead Contracts**

To stabilize its costs, the Company has entered into contracts with financial institutions to fix the price of lead. Each such contract is for a period not extending beyond one year. Under these contracts, at December 31, 2006, and March 31, 2006, the Company was committed to lead price hedge contracts for 53.3 and 32.8 million pounds of lead, respectively, for total purchase prices of \$36,366 and \$17,420, respectively. The estimated fair value of the Company's lead hedge contract was an asset of \$4,088 and \$468 at December 31, 2006, and March 31, 2006, respectively, as estimated based on quotes from financial institutions.

**Foreign Currency Forward Contracts**

The Company quantifies and monitors its global foreign currency exposures. On a selective basis the Company will enter into foreign currency forward contracts to reduce the volatility from currency movements that affect the Company. The Company's largest exposure is from the purchase and conversion of U.S. dollar based lead costs into local currencies in Europe and China. Additionally, the Company has currency exposures from intercompany trade transactions. To hedge these exposures, the Company has entered into foreign currency forward contracts with financial institutions. Each contract is for a period not extending beyond one year. As of December 31, 2006, and March 31, 2006, the Company had entered into a total \$39,400 and \$34,300, respectively, of foreign currency forward contracts. The estimated fair value of the Company's foreign currency forward contracts was a (liability) asset of (\$1,327) and \$135 at December 31, 2006, and March 31, 2006, respectively, as estimated based on quotes from financial institutions.

**Interest Rate Swap Agreements**

The Company is exposed to changes in variable U.S. interest rates on borrowings under its credit agreements. On a selective basis, from time to time, the Company enters into interest rate swap agreements to reduce the negative impact that increases in interest rates could have on its outstanding variable debt interest expense. Such agreements effectively convert \$203,000 of the Company's variable-rate debt to a fixed-rate basis, utilizing the three-month London Interbank Offered Rate, or LIBOR, as a floating rate reference. Fluctuations in LIBOR and fixed rates affect both the Company's net financial investment position and the amount of cash to be paid or received by it under these agreements. The estimated fair value of the Company's interest rate swap agreements was an asset of \$728 and \$2,368 at December 31, 2006, and March 31, 2006, respectively, as estimated based on quotes from financial institutions.

**NOTE 9: RESTRUCTURING PLANS**

As more fully described in Note 23 to the Consolidated Financial Statements included in the Company's 2006 Annual Report on Form 10-K, the Company has two acquisition related restructuring plans and three non-acquisition related restructuring plans.

**Acquisition related restructuring**

These plans were initiated in connection with the acquisitions of assets, stock and business of substantially all of the subsidiaries and affiliates comprising the Energy Storage Group of Invensys plc ( ESG ) in 2002 and the motive power battery business of FIAMM, S.p.A. ( FIAMM ) in 2006. They have been aggregated in the table below as the FIAMM activity is not considered significant. The ESG plan has two significant costs remaining; the final payment due in March 2007 of \$1,425 for the cancellation of a steam contract in Hagen, Germany and \$6,739 related to environmental costs at the facility in Manchester, England.

**Table of Contents**

As discussed in Note 8, Commitments, Contingencies and Litigation, the Company may have potential environmental issues at its Manchester, England and Sumter, South Carolina facilities. The environmental reserves related to Manchester are in the rollforward of the acquisition related restructuring reserves below while those for Sumter are included in the non-acquisition related restructuring plans rollforward, also below. The Company relied upon Emerging Issues Task Force Issue No. 95-3, *Recognition of Liabilities in Connection with a Purchase Business Combination*, SFAS 141, *Business Combinations* and SFAS 5, *Accounting for Contingencies*, for the timing and measurement of these costs.

The Company continues taking actions consistent with its original plan to resolve these issues. A rollforward of the acquisition related restructuring reserve for the nine fiscal months of 2007 is as follows:

	<b>Employee Severance</b>	<b>Contractual Obligations</b>	<b>Environmental</b>	<b>Plant Closures &amp; Other</b>	<b>Total</b>
Balance at March 31, 2006	\$ 1,829	\$ 2,002	\$ 5,983	\$ 1,167	\$ 10,981
Costs incurred	(692)	(20)		(263)	(975)
Foreign currency impact and other	147	277	756	52	1,232
Balance at December 31, 2006	\$ 1,284	\$ 2,259	\$ 6,739	\$ 956	\$ 11,238

**ESG acquisition**

On March 22, 2002, the Company acquired ESG. The Company formulated an exit and restructuring plan for certain ESG facilities in North America and Europe. Two of the facilities in the plan remain open after significant restructuring and now operate at a lower operating cost base and the third facility, identified in the United States, has been closed. The Manchester, England facility that was included in the plan has significantly reduced operations and may incur costs related to potential environmental issues (as more fully described in Note 8, Commitments, Contingencies and Litigation); this is the only significant item that remains unresolved. The balance of the ESG acquisition-related restructuring reserve at December 31, 2006 is \$11,188, which the Company anticipates spending primarily during fiscal 2007, with the exception of the environmental reserves related to the Manchester facility.

**FIAMM acquisition**

On June 1, 2005, the Company acquired FIAMM. In the third fiscal quarter of 2006, management completed the assessment of the FIAMM restructuring plan and reduced the restructuring reserve to \$5,868, which included \$2,661 related to the termination of 132 manufacturing, selling and distribution employees, and the balance of \$3,207 for plant and warehouse closure costs, including lease terminations. The balance of the FIAMM reserve at December 31, 2006, is \$50, which the Company anticipates spending primarily during the balance of fiscal 2007.

**Non-acquisition related restructuring plans**

The three non-acquisition related restructuring plans were initiated in connection with cost-reduction initiatives. The Company based its accounting and disclosures primarily on the requirements of SFAS 146, *Accounting for Costs Associated with Exit or Disposal Activities* which resulted in direct charges to the determination of net earnings in the periods in which the plans were initiated, liabilities were incurred and provisions were determined. These three individual plans are not significant and have been aggregated.



**Table of Contents**

A rollforward of these non-acquisition related restructuring reserves for the nine fiscal months of 2007 is as follows:

	<b>Employee Severance</b>	<b>Contractual Obligations</b>	<b>Environmental</b>	<b>Plant Closures &amp; Other</b>	<b>Total</b>
Balance at March 31, 2006	\$ 2,474	\$ 682	\$ 2,505	\$ 1,131	\$ 6,792
Costs incurred	(1,729)	(694)	(96)	(711)	(3,230)
Foreign currency impact and other	171	12		35	218
Balance at December 31, 2006	\$ 916	\$	\$ 2,409	\$ 455	\$ 3,780

During the fiscal year ended March 31, 2002, the Company decided to close and downsize certain manufacturing locations in North and South America, reduce product offerings, reduce sales and distribution facilities, and implement other consolidation initiatives. As of December 31, 2006, the reserve balance associated with these actions is \$2,765, a small portion of which the Company expects to spend in the current fiscal year and the balance, primarily related to environmental costs, at an indeterminate time in the future.

During fiscal 2006, the Company incurred restructuring charges of \$6,217, primarily for the Motive Power segment, to cover estimated costs in Europe of staff reductions of 112 employees, exiting of a product line, and closing several ancillary locations. The charges included a non-cash write-off of \$1,410, primarily of machinery and equipment. As of December 31, 2006, the reserve balance associated with these actions is \$916, which mostly represents severance obligations the Company expects to spend in the current fiscal year or as directed by the individual employees.

Also during fiscal 2006, the Company incurred a charge of \$1,063 to cover estimated restructuring programs to transfer certain existing European assembly operations to the newly acquired GAZ facility in Zwickau, Germany. It is anticipated that the remaining obligations of \$99 at December 31, 2006, will be spent primarily in the current fiscal year.

**NOTE 10: DEBT**

Effective November 27, 2006, the Company amended its Euro 25,000 Credit Agreement, and effective June 29, 2006, the Company amended its senior credit facility, which consisted of a \$355,900 term loan B and a \$100,000 revolving credit line. Under the amendments, the lenders approved the elimination of the covenants relating to the Company's senior secured debt leverage ratio (while maintaining the covenants relating to its total debt leverage ratio) and several minor technical changes in the agreement. The Company pursued these amendments to provide greater operating flexibility and to increase its borrowing capacity for potential acquisition opportunities.

The Company's financing agreements contain various covenants that, absent prepayment in full of the indebtedness and other obligations, or the receipt of waivers, would limit the Company's ability to conduct certain specified business transactions including incurring debt, mergers, consolidations or similar transactions, buying or selling assets out of the ordinary course of business, engaging in sale and leaseback transactions, paying dividends and certain other actions. The Company was in compliance with all such covenants at December 31, 2006. The Company's debt is more fully described in Note 9 to the Consolidated Financial Statements included in the Company's 2006 Annual Report on Form 10-K.

**Table of Contents****NOTE 11: RETIREMENT PLANS**

The following table presents the interim disclosure requirements of components of the Company's net periodic benefit cost related to its defined benefit pension plans.

	United States Plans Fiscal quarters ended		International Plans Fiscal quarters ended	
	December 31, 2006	January 1, 2006	December 31, 2006	January 1, 2006
Service cost	\$ 62	\$ 51	\$ 790	\$ 975
Interest cost	136	126	459	408
Expected return on plan assets	(150)	(143)	(367)	(250)
Recognized actuarial losses	39		33	
Amortization and deferral	1	39		
Net periodic benefit cost	\$ 88	\$ 73	\$ 915	\$ 1,133

	United States Plans Nine fiscal months ended		International Plans Nine fiscal months ended	
	December 31, 2006	January 1, 2006	December 31, 2006	January 1, 2006
Service cost	\$ 165	\$ 154	\$ 2,315	\$ 2,684
Interest cost	396	379	1,351	1,214
Expected return on plan assets	(449)	(431)	(1,074)	(730)
Recognized actuarial losses	112		97	
Amortization and deferral	4	119		
Net periodic benefit cost	\$ 228	\$ 221	\$ 2,689	\$ 3,168

Significant assumptions used in the accounting for the pension benefit plans are as follows:

	United States Plans Nine fiscal months ended		International Plans Nine fiscal months ended	
	December 31, 2006	January 1, 2006	December 31, 2006	January 1, 2006
Discount rate	6.0 %	6.0 %	4.0 - 5.0 %	2.5 - 5.8 %
Expected return on plan assets	8.0 %	9.0 %	8.0 %	6.0 - 7.8 %
Rate of compensation increase	N/A	N/A	2.0 - 3.0 %	1.0 - 4.0 %

The Company presently anticipates contributing a total of \$3,000 to its defined benefit pension plans in fiscal 2007, based on current actuarial information.

The Company has a 401(k) plan covering all U.S. based employees who are not covered by a collective bargaining agreement. Company contributions to the plan are at the discretion of the Company's Board of Directors.

**Table of Contents****NOTE 12: STOCK-BASED COMPENSATION PLANS**

The Company maintains three management equity plans that reserve 11,289,232 shares of Common Stock for the grant of restricted shares, various classes of nonqualified stock options and other forms of equity based compensation. Non-qualified stock options have been granted to employees under these plans at prices not less than the fair market value of the shares on the dates the options were granted. Generally, options vest over a four-year period and become exercisable in annual installments over the vesting period. Options generally expire in 10 years. The 2000 Management Equity Plan and the 2004 Equity Incentive Plan are described more fully in Note 16 to the Consolidated Financial Statements included in the Company's 2006 Annual Report on Form 10-K. The 2006 Equity Incentive Plan is described below.

**2006 Equity Incentive Plan**

On July 20, 2006, the Company's stockholders approved the Company's 2006 Equity Incentive Plan (the 2006 EIP), which became effective on June 16, 2006. The 2006 EIP authorizes the grant of non-qualified stock options, incentive stock options, stock appreciation rights, restricted stock, restricted stock units and other stock-based awards to Company employees, directors and affiliates. A maximum of 2,600,000 shares of the Company's common stock may be subject to awards under the 2006 EIP. The maximum number of shares of common stock that may be granted in connection with awards granted under the 2006 EIP to any participant during any calendar year may not exceed 300,000 shares. Vesting of awards granted under the 2006 EIP may be subject to the satisfaction of one or more performance goals established by the Compensation Committee of the Board of Directors. The 2006 EIP is described more fully in Exhibit 10.2 to this Quarterly Report on Form 10-Q, the Company's Current Report on Form 8-K, as filed with the Securities and Exchange Commission on July 26, 2006, and in Proposal 2 (Approval of EnerSys 2006 Equity Incentive Plan) on pages 10-13 of the Company's 2006 Proxy Statement, as filed with the Securities and Exchange Commission on June 19, 2006.

**SFAS 123(R)**

On April 1, 2006, the Company adopted, using the modified prospective application, Statement of Financial Accounting Standards No. 123(revised 2004), *Share-Based Payment* (SFAS 123(R)). SFAS 123(R) requires all share-based payments to employees, including grants of employee stock options and shares purchased under an employee stock purchase plan (if certain parameters are not met), to be recognized in the financial statements based on their fair values and did not change the accounting guidance for share-based payment transactions with parties other than employees provided in SFAS 123, *Accounting for Stock Based Compensation* (SFAS 123), as originally issued and Emerging Issues Task Force (EITF) 96-18, *Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services*. SFAS 123(R) did not address the accounting for employee share ownership plans, which are subject to Statement of Position (SOP) 93-6, *Employers' Accounting for Employee Stock Ownership Plans*. Under the modified prospective method, prior interim period and prior fiscal year financial statements will not reflect any restated amounts for the adoption of SFAS 123(R).

Upon adoption of SFAS 123(R), the Company began recording compensation cost related to the continued vesting of all stock options that remained unvested as of April 1, 2006, as well as for all stock options granted, modified or cancelled after the adoption date. The compensation cost to be recorded is based on the fair value at the grant date. The adoption of SFAS 123(R) did not have an effect on the Company's recognition of compensation expense relating to the vesting of restricted stock grants.

Prior to the adoption of SFAS 123(R), cash flows resulting from the tax benefit related to equity-based compensation was presented in operating cash flows, along with other tax cash flows, in accordance with the provisions of EITF 00-15, *Classification in the Statement of Cash Flows of the Income Tax Benefit Received by a Company upon Exercise of a Nonqualified Employee Stock Option*, (EITF 00-15). SFAS 123(R) superseded EITF 00-15, amended SFAS 95, *Statement of Cash Flows*, and requires tax benefits relating to excess equity-based compensation deductions to be prospectively presented in the statement of cash flows as financing cash inflows.

**Table of Contents**

The adoption of SFAS 123(R) had the effect of reducing operating earnings, earnings before income taxes, net earnings and basic and diluted earnings per share for the three and nine fiscal months ended December 31, 2006, and resulted in a change in net cash provided by operating activities and net cash provided by financing activities. The table that follows shows what these data would have been if we had not adopted SFAS 123(R) (in thousands, except per share data):

	Fiscal quarter ended December 31, 2006	Nine fiscal months ended December 31, 2006
Operating earnings, as reported	\$ 21,186	\$ 71,488
Effect of adopting SFAS 123(R) on operating earnings	254	952
<b>Operating earnings</b>	<b>\$ 21,440</b>	<b>\$ 72,440</b>
Earnings before income taxes, as reported	\$ 13,145	\$ 47,753
Effect of adopting SFAS 123(R) on earnings before income taxes	254	952
<b>Earnings before income taxes</b>	<b>\$ 13,399</b>	<b>\$ 48,705</b>
Net earnings, as reported	\$ 10,979	\$ 34,591
Effect of adopting SFAS 123(R) on net earnings	173	649
<b>Net earnings</b>	<b>\$ 11,152</b>	<b>\$ 35,240</b>
Net cash provided by operating activities, as reported	\$ 27,933	\$ 52,193
Effect of adopting SFAS 123(R) on net cash provided by operating activities	173	649
<b>Net cash provided by operating activities</b>	<b>\$ 28,106</b>	<b>\$ 52,842</b>
Net cash provided by financing activities, as reported	\$ 407	\$ 2,909
Effect of adopting SFAS 123(R) on net cash provided by financing activities	(173)	(649)
<b>Net cash provided by financing activities</b>	<b>\$ 234</b>	<b>\$ 2,260</b>
Net earnings per common share, as reported:		
Basic	\$ 0.24	\$ 0.74
Diluted	\$ 0.23	\$ 0.73
Effect of adopting SFAS 123(R) on net earnings per common share:		
Basic	\$	\$ 0.02
Diluted	\$	\$ 0.01
Net earnings per common share:		
Basic	\$ 0.24	\$ 0.76
Diluted	\$ 0.23	\$ 0.74

**Table of Contents**

Prior to the Company's adoption of SFAS 123(R), the Company accounted for equity-based compensation under the provisions and related interpretations of Accounting Principles Board No. 25, *Accounting for Stock Issued to Employees* ( APB 25 ). Accordingly, the Company was not required to record compensation expense when stock options were granted to employees as long as the exercise price was not less than the fair market value of the stock at the grant date. Also, the Company was not required to record compensation expense when it issued common stock under the Employee Stock Purchase Plan as long as the purchase price was not less than 85% of the fair market value of the Company's common stock on the grant date. In December 1995, the FASB issued SFAS 123, which allowed the Company to continue to follow the guidelines of APB 25, but required pro-forma disclosures of net income and earnings per share as if the Company had adopted the provisions of SFAS 123. In December 2002, the FASB issued SFAS 148, *Accounting for Stock-Based Compensation: Transition and Disclosure - an Amendment of FASB 123*, which provided alternative methods of transition for an entity that voluntarily changes to the fair value based method of accounting for equity-based employee compensation. The Company continued to account for equity-based compensation under the provisions of APB 25 using the intrinsic value method.

If the compensation cost for the Company's equity-based compensation plans had been determined based on the fair value at the grant dates for awards under those plans in accordance with the provisions of SFAS 123, then the Company's net earnings and net earnings per share for the fiscal quarter and nine fiscal months ended January 1, 2006, would have been as follows (in thousands, except per share data):

	<b>Fiscal quarter ended January 1, 2006</b>	<b>Nine fiscal months ended January 1, 2006</b>
Net earnings, as reported	\$ 7,767	\$ 19,046
Add: Equity-based compensation included in net earnings, as reported		
Subtract: Equity-based compensation under SFAS 123	(270)	(496)
Pro forma net earnings	\$ 7,497	\$ 18,550
Reported net earnings per common share:		
Basic	\$ 0.17	\$ 0.41
Diluted	\$ 0.17	\$ 0.41
Pro forma net earnings per common share:		
Basic	\$ 0.16	\$ 0.40
Diluted	\$ 0.16	\$ 0.40

**Table of Contents****Stock Options**

A summary of the changes in stock options outstanding under the Company's equity-based compensation plans during the nine fiscal months ended December 31, 2006, is presented below:

	Number of Options	Weighted Average Remaining Contract Term (Years)	Weighted Average Exercise Price	Aggregate Intrinsic Value
Options outstanding at March 31, 2006	6,786,068		\$ 13.71	\$ 639
Granted	44,729		14.45	
Exercised	(862,337)		13.77	3,194
Canceled	(25,750)		12.19	98
Options outstanding at December 31, 2006	5,942,710	4.5	\$ 13.70	\$ 13,645
Options exercisable at December 31, 2006	5,523,752	4.1	\$ 13.59	\$ 13,325
Weighted average per-share fair value of options granted during the period	\$ 7.18			

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option pricing model. The Company's stock options have characteristics significantly different from those of publicly traded options. The weighted average assumptions used in the model are outlined in the following table:

	<b>Nine fiscal months ended December 31, 2006</b>
Weighted-average exercise price	\$ 13.77
Weighted-average grant date fair-value	\$ 7.18
<b>Assumptions:</b>	
Expected volatility	38.3%
Risk-free interest rate	5.1%
Dividend yield	0%
Expected life (in years)	7

The computation of the expected volatility is based on historical weekly stock prices. Expected life is based on annual historical employee exercise behavior of option grants with similar vesting periods and option expiration data. The risk-free interest rate is based on the yield of zero-coupon U.S. Treasury securities. There are no dividends to be paid.

In the nine fiscal months ended December 31, 2006, the Company recognized equity-based compensation expense of \$952 related to the vesting of stock options and the related tax benefit of \$303. At December 31, 2006, the Company had 2,744,639 options and restricted stock available to be granted under its equity-based compensation plans. This total includes 2,600,000 shares available under the 2006 EIP which was approved by the stockholders on July 20, 2006.

**Table of Contents****Restricted Stock**

Under the Company's 2004 Equity Incentive Plan (the "Plan"), the Company approved the issue of 1,000,000 shares of common stock through stock options or restricted stock grants. Through March 31, 2006, the Company granted 263,282 shares of restricted stock at an aggregated fair market value on the dates of grant of \$13.18 per share. This resulted in the recording of unearned stock grant compensation of \$3,471 in the equity section of the March 31, 2006 Condensed Consolidated Balance Sheets. The Company granted 9,000 shares of restricted stock at an average fair market value on the dates of grant of \$15.63 per share during the nine fiscal months of 2007. Compensation expense for these restricted shares will be charged to earnings over a four-year period.

In connection with the adoption of SFAS 123(R) on April 1, 2006, the unamortized balance of unearned stock grant compensation on that date was reclassified to additional paid-in capital. In the nine fiscal months ended December 31, 2006, the Company recognized equity-based compensation expense of \$1,271 related to the vesting of restricted stock and the related tax benefit of \$473.

A summary of the changes in restricted stock outstanding under the Company's management equity compensation plan during the nine fiscal months ended December 31, 2006, is presented below:

	Number of Restricted Stock	Weighed Average Grant Date Fair Value
Non-vested shares at March 31, 2006	263,282	\$ 13.18
Granted	9,000	15.63
Vested		
Canceled		
Non-vested shares at December 31, 2006	272,282	\$ 13.26

On January 1, 2007, subsequent to the end of the third fiscal quarter of 2007, but prior to the issuance of this Form 10-Q, 67,065 restricted shares vested and 20,093 of such shares were surrendered to the Company to satisfy a portion of the applicable aggregate withholding tax required to be paid upon such vesting.

**Employee Stock Purchase Plan**

On July 26, 2004, the Company adopted, and its stockholders approved, an Employee Stock Purchase Plan ("ESPP"). The Plan was amended by the Board of Directors on November 9, 2004. This ESPP is considered by the Company to be non-compensatory and no compensation expense is recorded when shares are issued under the ESPP.

**Table of Contents****NOTE 13: EARNINGS PER SHARE**

Net earnings per share basic is based on the weighted average number of shares of common stock outstanding. Net earnings per share diluted gives effect to all dilutive potential common shares that were outstanding during the period. At December 31, 2006, the Company had outstanding stock options and restricted stock which could potentially dilute basic earnings per share in the future. Weighted average common shares and common shares diluted were as follows:

	Fiscal quarter ended		Nine fiscal months ended	
	December 31, 2006	January 1, 2006	December 31, 2006	January 1, 2006
Weighted average shares of common stock outstanding	46,597,387	46,249,384	46,469,119	46,210,187
Assumed exercise of stock options, net of shares assumed reacquired	1,102,581	699,668	1,069,139	527,834
Weighted average common shares diluted	47,699,968	46,949,052	47,538,258	46,738,021
Antidilutive options and non-vested restricted stock not included in weighted average common shares	1,078,882	2,768,551	1,611,830	2,786,738

On January 1, 2007, subsequent to the end of the third fiscal quarter of 2007, but prior to the issuance of this Form 10-Q, 67,065 restricted shares vested and 20,093 of such shares were surrendered to the Company to satisfy a portion of the applicable aggregate withholding tax required to be paid upon such vesting.

**NOTE 14: BUSINESS SEGMENTS**

The Company has the following two reportable business segments:

**Reserve power batteries** are used for backup power for the continuous operation of critical applications in telecommunications systems, uninterruptible power systems or UPS applications for computer and computer-controlled systems, and other specialty power applications, including security systems and motor and recreational vehicles, switchgear and electrical control systems used in electric utilities and energy pipelines, and commercial and military aircraft, submarines and tactical military vehicles.

**Motive power batteries** are used to provide power for manufacturing, warehousing and other material handling equipment, primarily electric industrial forklift trucks, mining equipment, and for diesel locomotive starting, rail car lighting and rail signaling equipment.



**Table of Contents**

The following table provides selected financial data for the Company's reportable business segments:

	Reserve Power	Motive Power	Consolidated
<b>Three fiscal months ended December 31, 2006:</b>			
Net sales	\$ 157,005	\$ 220,876	\$ 377,881
Operating earnings	\$ 7,413	\$ 13,773	\$ 21,186
<b>Three fiscal months ended January 1, 2006:</b>			
Net sales	\$ 140,764	\$ 181,029	\$ 321,793
Operating earnings	\$ 5,848	\$ 11,271	\$ 17,119
<b>Nine fiscal months ended December 31, 2006:</b>			
Net sales	\$ 474,251	\$ 616,588	\$ 1,090,839
Operating earnings	\$ 30,069	\$ 41,419	\$ 71,488
<b>Nine fiscal months ended January 1, 2006:</b>			
Net sales	\$ 417,014	\$ 513,053	\$ 930,067
Operating earnings	\$ 21,942	\$ 22,700	\$ 44,642

**NOTE 15: SECONDARY OFFERING OF 6,000,000 COMMON SHARES**

On December 7, 2006, certain of the Company's stockholders, including affiliates of Metalmark Capital LLC and certain other institutional stockholders, completed a secondary offering of 6,000,000 shares of the Company's common stock to Lehman Brothers Inc. The offering closed on December 12, 2006. The Company did not issue any shares or receive any proceeds in the offering.

**NOTE 16: SUBSEQUENT EVENT**

Effective January 1, 2007, the Company acquired the lead-acid battery business of Leclanché SA based in Yverdon-les-Bains, Switzerland. The total purchase price for this transaction was approximately \$800 and was financed using existing EnerSys credit facilities. The Company assumed the customers and existing contracts of the Leclanché lead-acid battery business along with certain sales and service employees in order to maintain relationships with current customers. The acquisition provides the Company greater access to the Swiss market.

On January 9, 2007 the Company announced that it reached an agreement to acquire a majority interest in Energia AD, a producer of industrial batteries, located in Targovishte, Bulgaria. The total purchase price for this transaction is expected to be approximately Euro 13 million (approximately \$17 million) including transaction costs and adjustments and will be financed using EnerSys existing and new European credit facilities. The acquisition provides the Company with an additional low cost manufacturing platform with substantial expansion potential and increases the Company's market presence in the rapidly growing Eastern European and Russian markets. Completion of the transaction is subject to the satisfaction of customary closing conditions, including the receipt of government consents. The transaction is expected to close in April 2007.

---

**Table of Contents**

**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS  
FORWARD-LOOKING STATEMENTS**

The Private Securities Litigation Reform Act of 1995 (the Reform Act) provides a safe harbor for forward-looking statements made by or on behalf of EnerSys. EnerSys and its representatives may, from time to time, make written or verbal forward-looking statements, including statements contained in our filings with the Securities and Exchange Commission and its reports to stockholders. Generally, the inclusion of the words believe, expect, intend, estimate, anticipate, will, and similar expressions identify statements that constitute forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934 and that are intended to come within the safe harbor protection provided by those sections. All statements addressing operating performance, events, or developments that EnerSys expects or anticipates will occur in the future, including statements relating to sales growth, earnings or earnings per share growth, and market share, as well as statements expressing optimism or pessimism about future operating results, are forward-looking statements within the meaning of the Reform Act. The forward-looking statements are and will be based on management's then-current views and assumptions regarding future events and operating performance, and are applicable only as of the dates of such statements.

Forward-looking statements involve risks, uncertainties and assumptions. Although we do not make forward-looking statements unless we believe we have a reasonable basis for doing so, we cannot guarantee their accuracy. Actual results may differ materially from those expressed in these forward-looking statements due to a number of uncertainties and risks, including the risks described in the Company's 2006 Annual Report on Form 10-K and other unforeseen risks. You should not put undue reliance on any forward-looking statements. These statements speak only as of the date of this Quarterly Report on Form 10-Q, and we undertake no obligation to update or revise these statements to reflect events or circumstances occurring after the date of this Quarterly Report on Form 10-Q.

Our actual results may differ materially from those contemplated by the forward-looking statements for a number of reasons, including the following factors:

general cyclical patterns of the industries in which our customers operate;

the extent to which we cannot control our fixed and variable costs;

the raw material in our products may experience significant fluctuations in market price and availability;

certain raw materials constitute hazardous materials that may give rise to costly environmental and safety claims;

legislation regarding the restriction of the use of certain hazardous substances in electrical and electronic equipment;

risks involved in foreign operations such as disruption of markets, changes in import and export laws, currency restrictions and currency exchange rate fluctuations;

our ability to raise our selling prices to our customers when our product costs increase;

the extent to which we are able to efficiently utilize our global manufacturing facilities and optimize their capacity;

general economic conditions in the markets in which we operate;

## Edgar Filing: EnerSys - Form 10-Q

competitiveness of the global battery markets;

our timely development of competitive new products and product enhancements in a changing environment and the acceptance of such products and product enhancements by customers;

our ability to adequately protect our proprietary intellectual property, technology and brand names;

unanticipated litigation and regulatory proceedings to which we might be subject,

**Table of Contents**

changes in our market share in the business segments and regions where we operate;

our ability to implement our cost reduction initiatives successfully and improve our profitability;

unanticipated quality problems associated with our products;

our ability to implement business strategies, including our acquisition strategy, and restructuring plans;

our acquisition strategy may not be successful in locating advantageous targets;

our ability to successfully integrate any assets, liabilities, customers, systems and management personnel we acquire into our operations and our ability to realize related revenue synergies and cost savings within expected time frames;

our debt and debt service requirements which may restrict our operational and financial flexibility, as well as imposing unfavorable interest and financing costs;

adverse changes in our short- and long-term debt levels under our credit facilities;

our exposure to fluctuations in interest rates on our variable-rate debt;

our inability to attract and retain qualified personnel;

credit risk associated with our customers, including risk of insolvency and bankruptcy;

our ability to successfully recover in the event of a disaster affecting our infrastructure; and

terrorist acts or acts of war, whether in the United States or abroad, could cause damage or disruption to our operations, our suppliers, channels to market or customers, or could cause costs to increase, or create political or economic instability.

This list of factors that may affect future performance is illustrative, but by no means exhaustive. Accordingly, all forward-looking statements should be evaluated with the understanding of their inherent uncertainty.

**OVERVIEW**

We are the world's largest manufacturer, marketer and distributor of industrial batteries. We also manufacture, market and distribute related products such as chargers, power equipment and battery accessories, and provide related after-market and customer-support services for industrial batteries. We market our products globally to over 10,000 customers in more than 100 countries through a network of distributors, independent representatives and our internal sales force.

We have two business segments: reserve power and motive power. Net sales classifications by segment are as follows:

**Reserve power batteries** are used for backup power for the continuous operation of critical applications in telecommunications systems, uninterruptible power systems, or UPS, applications for computer and computer-controlled systems, and other specialty power applications, including security systems and motor and recreational vehicles, switchgear and electrical control systems used in electric utilities and energy pipelines, and commercial and military aircraft, submarines and tactical military vehicles.

**Motive power batteries** are used to provide power for manufacturing, warehousing and other material handling equipment, primarily electric industrial forklift trucks, mining equipment, and for diesel locomotive starting, rail car lighting and rail signaling equipment.

We evaluate business segment performance based primarily upon operating earnings. All corporate and centrally incurred regional costs are allocated to the business segments based principally on net sales. We evaluate business segment cash flow and financial position performance based primarily upon capital expenditures and primary working capital levels. Primary working capital for this purpose is trade accounts receivable, plus inventories, minus trade accounts payable and the resulting net amount is divided by the trailing three month net sales (annualized) for the respective business segment or reporting location, to derive a primary working capital percentage. Although we monitor the three elements of primary working

---

**Table of Contents**

capital (receivables, inventory and payables), our focus is on the primary working capital total amount and percentage due to the significant impact that primary working capital has on our cash flow and, as a result, our level of debt. Lastly, on a consolidated basis, we review short- and long-term debt levels, on a daily basis, and monitor corresponding leverage ratios.

We operate and manage our business in three primary geographic regions of the world – the Americas, Europe and Asia. Our business is highly decentralized with manufacturing and assembly locations throughout the world. Nearly 60% of our net sales for the nine fiscal months of 2007 and 2006 were generated outside of North America. Our management structure and financial reporting systems, and associated internal controls and procedures, are all consistent with our two business segments and three geographic regions in which we operate. We report on a March 31 fiscal year.

Our financial results are affected by the following factors, among others:

general cyclical patterns of the industries in which our customers operate;

changes in our market share in the business segments and regions where we operate;

changes in our selling prices and, in periods when our product costs increase, our ability to raise our selling prices to pass such cost increases through to our customers;

the extent to which we are able to efficiently utilize our global manufacturing facilities and optimize their capacity;

the extent to which we can control our fixed and variable costs, including those for our raw materials, manufacturing, distribution and operating activities;

changes in our level of debt and changes in the variable interest rates under our credit facilities; and

the size and number of acquisitions and our ability to achieve their intended benefits.

We have been subjected to continual and significant pricing pressures over the past several years. We anticipate heightened competitive pricing pressure as Chinese and other foreign producers, able to employ labor at significantly lower costs than producers in the U.S. and Western Europe, expand their export capacity and increase their marketing presence in our major U.S. and European markets. Our ability to maintain and improve our operating margins has depended, and continues to depend, on our ability to control our costs and increase our pricing.

Over the last three fiscal years, the costs of our raw materials (of which lead is our primary material) have risen significantly. We estimate that our average cost of lead per pound (excluding premiums), as it affects our operating results, has risen from approximately \$0.23 in fiscal 2004 to \$0.41 in fiscal 2006, and has risen from \$0.40 in the nine fiscal months of 2006 to \$0.52 in the nine fiscal months of 2007. Our estimated incremental lead cost, due to increased price, in the nine fiscal months of 2007 over in the nine fiscal months of 2006 was approximately \$42 million. We estimate that our average cost of lead per pound (excluding premiums), as it affects our operating results, will rise by 20% on a sequential, quarterly basis to approximately \$0.67 per pound in the fourth fiscal quarter of 2007. This will increase our estimated lead cost by approximately \$15 million. Because the cost of purchased lead is not reflected in our cost of goods sold until two to three months after purchase, we compare our actual cost to London Metal Exchange ( LME ) prices that are in effect two to three months prior to the income statement period being shown. On this basis, average LME prices per period were approximately \$0.44 and \$0.54 in fiscal 2006, and the nine fiscal months of 2007, respectively.

Our selling price increases approximated 2% of net sales for both fiscal 2005 and fiscal 2006 and approximated 4% of net sales for both the third fiscal quarter and nine fiscal months of 2007. We announced additional price increases in both November 2006 and January 2007; however, these pricing actions will not be fully realized until after the fourth fiscal quarter of 2007. Our business strategy in this environment of high

## Edgar Filing: EnerSys - Form 10-Q

commodity costs is to improve profitability by cost savings and pricing actions, as well as to tightly control operating cash flow and capital spending.

**Table of Contents****RESULTS OF OPERATIONS****NET SALES***Current quarter by segment*

	Fiscal quarter ended December 31, 2006		Fiscal quarter ended January 1, 2006		Increase	
	In Millions	Percentage of Total Net Sales	In Millions	Percentage of Total Net Sales	In Millions	Percentage
Reserve Power	\$ 157.0	41.5%	\$ 140.8	43.8%	\$ 16.2	11.5%
Motive Power	220.9	58.5	181.0	56.2	39.9	22.0
<b>Total</b>	<b>\$ 377.9</b>	<b>100.0%</b>	<b>\$ 321.8</b>	<b>100.0%</b>	<b>\$ 56.1</b>	<b>17.4%</b>

*Year to date by segment*

	Nine fiscal months ended December 31, 2006		Nine fiscal months ended January 1, 2006		Increase	
	In Millions	Percentage of Total Net Sales	In Millions	Percentage of Total Net Sales	In Millions	Percentage
Reserve Power	\$ 474.2	43.5%	\$ 417.0	44.8%	\$ 57.2	13.7%
Motive Power	616.6	56.5	513.1	55.2	103.5	20.2
<b>Total</b>	<b>\$ 1,090.8</b>	<b>100.0%</b>	<b>\$ 930.1</b>	<b>100.0%</b>	<b>\$ 160.7</b>	<b>17.3%</b>

*Current quarter by region*

	Fiscal quarter ended December 31, 2006		Fiscal quarter ended January 1, 2006		Increase	
	In Millions	Percentage of Total Net Sales	In Millions	Percentage of Total Net Sales	In Millions	Percentage
Americas	\$ 154.8	41.0%	\$ 135.4	42.1%	\$ 19.4	14.3%
Europe <sup>(1)</sup>	200.3	53.0	167.2	52.0	33.1	19.7
Asia	22.8	6.0	19.2	5.9	3.6	19.3
<b>Total</b>	<b>\$ 377.9</b>	<b>100.0%</b>	<b>\$ 321.8</b>	<b>100.0%</b>	<b>\$ 56.1</b>	<b>17.4%</b>

*Year to date by region*

	Nine fiscal months ended December 31, 2006	Nine fiscal months ended January 1, 2006	Increase Percentage
--	---	---	------------------------



## Edgar Filing: EnerSys - Form 10-Q

	In Millions	Percentage of Total Net Sales	In Millions	Percentage of Total Net Sales	In Millions	
						<b>Net Sales</b>
Americas	\$ 454.1	41.6%	\$ 388.2	41.8%	\$ 65.9	17.0%
Europe <sup>(1)</sup>	569.6	52.2	489.5	52.6	80.1	16.4
Asia	67.1	6.2	52.4	5.6	14.7	28.1
Total	\$ 1,090.8	100.0%	\$ 930.1	100.0%	\$ 160.7	17.3%

<sup>(1)</sup> Includes Europe, Middle East and Africa

Net sales increased \$56.1 million or 17.4% in the third fiscal quarter of 2007 and increased \$160.7 million or 17.3% in the nine fiscal months of 2007 over the comparable periods in fiscal 2006. This growth resulted primarily from four main factors: currency fluctuations, acquisitions, pricing and organic growth.

Stronger foreign currencies, primarily the euro compared to the U.S. dollar, resulted in an increase in net sales of approximately \$19 million or 6.0% in the third fiscal quarter of 2007 and \$35 million or 3.7% in the nine fiscal months of 2007, over the comparable periods in fiscal 2006. The euro exchange rate to the U.S. dollar averaged 1.30 (\$/€) in the third fiscal quarter of 2007 and 1.28 (\$/€) in the nine fiscal months of 2007, compared to 1.19 (\$/€) in the third fiscal quarter of 2006 and 1.22 (\$/€) in the nine fiscal months of 2006.

Acquisitions of FIAMM in June 2005, GAZ in October 2005, EAS in May 2006 and CFT in August 2006 contributed approximately \$26 million and \$66 million, respectively, to net sales in the third fiscal quarter and nine fiscal months of 2007, compared to approximately \$20 million and \$43 million, respectively, in the third fiscal quarter and nine fiscal months of 2006.

**Table of Contents**

Price increases were implemented to pass on the increased cost associated with lead and other key materials used in the manufacturing of our products. Price increases resulted in an increase in net sales by approximately \$14 million or 4 % in the third fiscal quarter of 2007 and \$37 million or 4% in the nine fiscal months of 2007, over the comparable periods in fiscal 2006.

Organic growth (increased net sales excluding the impact of currency, pricing and sales resulting from acquisitions), which had the largest impact on sales growth, contributed approximately \$20 million or 6% and \$70 million or 7%, respectively, to net sales in the third fiscal quarter and nine fiscal months of 2007. We believe our organic growth resulted from a combination of increased market share and overall market growth.

*Segment Analysis*

The growth experienced in our Motive Power segment in fiscal 2006 continued into the third fiscal quarter and nine fiscal months of 2007, with sales increasing 22.0% and 20.2%, respectively, compared to the third fiscal quarter and nine fiscal months of 2006. Motive Power segment sales achieved solid growth due, we believe, to an increase in overall market growth and our global market share. Also included in motive power segment sales were sales of FIAMM, S.p.A ( FIAMM ) (acquired in June 2005) of approximately \$21 million and \$55 million, respectively, in the third fiscal quarter and nine fiscal months of 2007, compared to approximately \$18 million and \$41 million, respectively, in the comparable periods in the prior year. Our Motive Power segment continues to realize a higher selling price recovery than our Reserve Power segment.

Our Reserve Power segment also achieved a strong improvement in sales of 11.5% and 13.7 %, respectively, in the third fiscal quarter and nine fiscal months of 2007, compared to the comparable periods in fiscal 2006, attributed primarily to currency translation, pricing and organic growth. Reserve Power segment sales include sales from GAZ acquired in October 2005, EAS acquired in May 2006 and CFT acquired in August 2006 of approximately \$5 million and \$11 million, respectively, in the third fiscal quarter and nine fiscal months of 2007, compared to approximately \$2 million in the third fiscal quarter and nine fiscal months 2006. Pricing recovery actions remain a primary focus of our company.

*Geographic Region Analysis*

Our three regions; Americas, Europe and Asia, all achieved solid growth in the third fiscal quarter and nine fiscal months of 2007, compared to the comparable periods of 2006, due primarily, we believe, to continued strength in all our end markets, favorable macro-economic conditions and an increase in our global market share.

**GROSS PROFIT**

	Fiscal quarter ended December 31, 2006		Fiscal quarter ended January 1, 2006		Increase	
	Percentage		Percentage			
	In Millions	of Total Net Sales	In Millions	of Total Net Sales	In Millions	Percentage
Gross Profit	\$ 76.9	20.4%	\$ 69.6	21.6%	\$ 7.3	10.5%

	Nine fiscal months ended December 31, 2006		Nine fiscal months ended January 1, 2006		Increase	
	Percentage		Percentage			
	In Millions	Net Sales	In Millions	Net Sales	In Millions	Percentage
Gross Profit	\$ 231.7	21.2%	\$ 200.3	21.5%	\$ 31.4	15.7%

**Table of Contents**

Excluding the effect of foreign currency translation, gross profit increased 6.6 % or \$4.6 million in the third fiscal quarter of 2007 when compared to the comparable period of 2006 and increased 12.9% or \$25.9 million in the nine fiscal months of 2007 when compared to the comparable period of 2006. Gross profit percentage of net sales decreased 120 basis points in the third fiscal quarter of 2007 and decreased 30 basis points in the nine fiscal months of 2007, in comparison to the comparable periods in fiscal 2006. The decrease in the gross profit percentage is primarily attributed to higher commodity costs, primarily from lead, partially offset by pricing recovery actions and our cost savings initiatives. We estimate that the cost of lead, our most significant raw material, increased our costs by approximately \$18 million in the third fiscal quarter of 2007 and by approximately \$42 million, in the nine fiscal months of 2007, over the comparable periods of 2006.

Efforts to pass through higher commodity costs via sales price increases continue to be made in all regions. As described previously, competitive conditions remain challenging in our industry. We estimated that selling price increases of approximately 2% were realized in fiscal 2006 (which represents roughly one-half of the commodity cost increases experienced during fiscal 2006), and 4% in the nine fiscal months of 2007 (which represents roughly two-thirds of the commodity cost increases experienced during the period). Our sales initiatives continue to emphasize pricing recovery for our products and we expect to realize additional price recovery in the fourth fiscal quarter of 2007 from pricing actions announced over the past quarters. Additionally, we remain highly focused on our long-standing cost reduction programs to help mitigate the rising cost of raw materials. These programs continue to be highly effective in reducing our costs and, accordingly, have had a significant impact in improving our operating results.

**OPERATING EXPENSES**

	Fiscal quarter ended December 31, 2006		Fiscal quarter ended January 1, 2006		Increase	
	In Millions	Percentage of Total Net Sales	In Millions	Percentage of Total Net Sales	In Millions	Percentage
Operating expenses	\$ 55.7	14.7%	\$ 49.9	15.5%	\$ 5.8	11.6%

	Nine fiscal months ended December 31, 2006		Nine fiscal months ended January 1, 2006		Increase	
	In Millions	Percentage of Total Net Sales	In Millions	Percentage of Total Net Sales	In Millions	Percentage
Operating expenses	\$ 164.0	15.0%	\$ 147.1	15.8%	\$ 16.9	11.5%

Operating expenses, excluding the effect of foreign currency translation, increased 4.8% or \$2.4 million in the third fiscal quarter of 2007 and increased 7.3% or \$10.9 million in the nine fiscal months of 2007, when compared to the comparable periods of 2006, due primarily to the inclusion of operating expenses from our new acquisitions and higher selling activities. Operating expenses as a percentage of net sales decreased 80 basis points in the third fiscal quarter of 2007 and nine fiscal months of 2007, when compared to the comparable periods of 2006.

Also included in the nine fiscal months of 2007 operating expenses is a reduction of approximately \$1 million in public company expenses, primarily attributable to lower Sarbanes-Oxley compliance costs. In addition, we continue to focus on expense saving initiatives and to further leveraging the fixed components of our operating expenses.

Selling expenses, our main component of operating expenses, were 60.6% and 61.0% of total operating expenses in the third fiscal quarter and the nine fiscal months of 2007, respectively, compared to 65.4% and 64.9%, respectively of total operating expenses in the third fiscal quarter and the nine fiscal months of 2006. The lower percentages of selling expenses to operating expenses are due to lower mix of commissionable sales and higher sales volume on fixed components of selling expenses, coupled with cost savings initiatives.

**Table of Contents****RESTRUCTURING CHARGES**

	Fiscal quarter ended December 31, 2006		Fiscal quarter ended January 1, 2006		Increase	
	Percentage of Total		Percentage of Total		In Millions	Percentage
	In Millions	Net Sales	In Millions	Net Sales		
Restructuring Charges	\$	%	\$ 2.6	0.8%	\$ (2.6)	(100.0)%

	Nine fiscal months ended				Increase	
	December 31, 2006		Nine fiscal months ended January 1, 2006		In Millions	Percentage
	Percentage of Total		Percentage of Total			
In Millions	Net Sales	In Millions	Net Sales			
Restructuring Charges	\$	%	\$ 8.6	0.9%	\$ (8.6)	(100.0)%

During the third quarter and nine months of fiscal 2006, the Company incurred restructuring and other charges of \$2.6 million and \$8.6 million, respectively, primarily for severance costs related to staff reductions, other restructuring activities in Europe, and the non-cash write-offs of fixed assets based on impairment testing as discussed in Note 9.

**LITIGATION SETTLEMENT INCOME**

	Nine fiscal months ended December 31, 2006		Nine fiscal months ended January 1, 2006		Increase	
	Percentage of Total		Percentage of Total		In Millions	Percentage
	In Millions	Net Sales	In Millions	Net Sales		
Litigation settlement income	\$ (3.8)	(0.3)%	\$	%	\$ (3.8)	(100.0)%

In the first and second fiscal quarters of 2007, we recorded litigation settlement income of \$2.8 million and \$1.0 million, respectively, net of fees and expenses, from the settlement of two separate legal matters. The amounts of the settlements have been recorded as increases in operating earnings in the first and second fiscal quarters of 2007, respectively, as the costs related to these matters were previously recorded as an element of operating earnings.

**Table of Contents****OPERATING EARNINGS***Current quarter by segment*

	Fiscal quarter ended December 31, 2006		Fiscal quarter ended January 1, 2006		Increase	
	In Millions	Percentage of Total Net Sales	In Millions	Percentage of Total Net Sales	In Millions	Percentage
Reserve Power	\$ 7.4	4.7%	\$ 5.9	4.2%	\$ 1.5	26.0%
Motive Power	13.8	6.2	11.2	6.3	2.6	22.0
<b>Total</b>	<b>\$ 21.2</b>	<b>5.6%</b>	<b>\$ 17.1</b>	<b>5.3%</b>	<b>\$ 4.1</b>	<b>23.8%</b>

*Year to date by segment*

	Nine fiscal months ended December 31, 2006		Nine fiscal months ended January 1, 2006		Increase	
	In Millions	Percentage of Total Net Sales	In Millions	Percentage of Total Net Sales	In Millions	Percentage
Reserve Power	\$ 30.1	6.3%	\$ 21.9	5.3%	\$ 8.2	36.6%
Motive Power	41.4	6.7	22.7	4.4	18.7	82.1
<b>Total</b>	<b>\$ 71.5</b>	<b>6.6%</b>	<b>\$ 44.6</b>	<b>4.8%</b>	<b>\$ 26.9</b>	<b>60.1%</b>

*Current quarter by region*

	Fiscal quarter ended December 31, 2006		Fiscal quarter ended January 1, 2006		Increase	
	In Millions	Percentage of Total Net Sales	In Millions	Percentage of Total Net Sales	In Millions	Percentage
Americas	\$ 13.8	8.9%	\$ 10.4	7.7%	\$ 3.4	31.9%
Europe <sup>(1)</sup>	6.1	3.0	5.1	3.1	1.0	20.0
Asia	1.3	5.7	1.6	8.3	(0.3)	(20.5)
<b>Total</b>	<b>\$ 21.2</b>	<b>5.6%</b>	<b>\$ 17.1</b>	<b>5.3%</b>	<b>\$ 4.1</b>	<b>23.8%</b>

*Year to date by region*

	Nine fiscal months ended December 31, 2006		Nine fiscal months ended January 1, 2006		Increase	
	In Millions	Percentage of Total Net Sales	In Millions	Percentage of Total Net Sales	In Millions	Percentage

## Edgar Filing: EnerSys - Form 10-Q

Americas	\$ 42.2	9.3%	\$ 27.6	7.1%	\$ 14.6	52.5%
Europe <sup>(1)</sup>	25.8	4.5	16.4	3.4	9.4	56.9
Asia	3.5	5.2	0.6	1.1	2.9	471.4
Total	\$ 71.5	6.6%	\$ 44.6	4.8%	\$ 26.9	60.1%

<sup>(1)</sup> Includes Europe, Middle East and Africa

Operating earnings, excluding the effect of foreign currency translation, increased 22.3 % or \$3.8 million in the third fiscal quarter of 2007 and increased 57.5% or \$25.7 million in the nine fiscal months of 2007, when compared to the comparable periods of 2006. Operating earnings as a percentage of net sales increased 30 basis points in the third fiscal quarter of 2007 and increased 180 basis points in the nine fiscal months of 2007, when compared to the comparable periods of 2006. As previously discussed, our operating earnings were significantly affected by higher raw material costs, however, we achieved earnings growth through sales volume increases, selling price increases, continued cost savings programs, and lower operating expenses. Also contributing to the improvement in operating earnings were \$3.8 million of favorable, litigation settlement income related to our Americas business in the first nine fiscal months of 2007 and restructuring charges relating to our European businesses of \$2.6 million and \$8.6 million, respectively, recorded in the third fiscal quarter and nine fiscal months of 2006.

**Table of Contents****INTEREST EXPENSE**

	Fiscal quarter ended December 31, 2006		Fiscal quarter ended January 1, 2006		Increase	
	In Millions	Percentage of Total Net Sales	In Millions	Percentage of Total Net Sales	In Millions	Percentage
Interest expense	\$ 7.1	1.9%	\$ 6.4	2.0%	\$ 0.7	12.0%

	Nine fiscal months ended December 31, 2006		Nine fiscal months ended January 1, 2006		Increase	
	In Millions	Percentage of Total Net Sales	In Millions	Percentage of Total Net Sales	In Millions	Percentage
Interest expense	\$ 21.2	1.9%	\$ 18.5	2.0%	\$ 2.7	14.6%

Interest expense of \$7.1 million in the third fiscal quarter of 2007 (net of interest income of \$0.1 million) was \$ 0.7 million higher than the \$6.4 million in the third fiscal quarter of 2006. Interest expense of \$21.2 million in the nine fiscal months of 2007 (net of interest income of \$0.1 million) was \$2.7 million higher than the \$18.5 million in the nine fiscal months of 2006. Our average debt outstanding was \$392.3 million and \$405.9 million, respectively, in the third fiscal quarter and nine fiscal months of 2007, compared to \$414.3 million and \$411.1 million, respectively, in the third fiscal quarter and nine fiscal months of 2006. Our average interest rates incurred in the third fiscal quarter and nine fiscal months of 2007 were 6.6% and 6.5%, respectively, compared to 5.8% in the third fiscal quarter and 5.6% in the nine fiscal months of 2006. Included in the third fiscal quarter and nine fiscal months of 2007 interest expense are non-cash charges of \$0.2 million and \$0.6 million for deferred financing fees, compared to non-cash charges of \$0.4 million and \$1.1 million, respectively, for deferred financing fees in the third fiscal quarter and nine fiscal months of 2006. The increases in interest expense in the third fiscal quarter and nine fiscal months of 2007 compared to the comparable periods in fiscal 2006 are attributed primarily to higher interest rates on variable rate borrowings.

**OTHER EXPENSE (INCOME), NET**

	Fiscal quarter ended December 31, 2006		Fiscal quarter ended January 1, 2006		Increase In Millions
	In Millions	Percentage of Total Net Sales	In Millions	Percentage of Total Net Sales	
Other expense (income), net	\$ 0.9	0.2 %	\$ (0.2 )	(0.1)%	\$ 1.1

	Nine fiscal months ended December 31, 2006		Nine fiscal months ended January 1, 2006		Increase In Millions
	In Millions	Percentage of Total Net Sales	In Millions	Percentage of Total Net Sales	
Other expense (income), net	\$ 2.6	0.2%	\$ (1.8 )	(0.2)%	\$ 4.4

Other expense was \$0.9 million in the third fiscal quarter of 2007 compared to other income of \$0.2 million in the comparable period of fiscal 2006. This \$1.1 million unfavorable change is primarily attributed to a \$0.4 million change in non-operating foreign currency net transaction losses and \$0.3 million in legal and professional fees associated with a secondary stock offering in the third fiscal quarter of 2007, as compared to the comparable period in fiscal 2006. Other expense of \$2.6 million was recorded in the nine fiscal months of 2007 compared to other income of \$1.8 million in the comparable period of fiscal 2006. The \$2.6 million expense in the nine fiscal months of 2007 is primarily attributed to \$1.0 million in legal and professional fees associated with the filing of a shelf registration statement and secondary stock offering and an abandoned acquisition, and \$1.6 million of non-operating foreign currency net transaction losses, as compared to a \$1.8 million gain, primarily non-operating foreign currency net transaction gains in the comparable period of fiscal 2006.





**Table of Contents****EARNINGS BEFORE INCOME TAXES**

	Fiscal quarter ended December 31, 2006		Fiscal quarter ended January 1, 2006		Increase	
	In Millions	Percentage of Total Net Sales	In Millions	Percentage of Total Net Sales	In Millions	Percentage
Earnings before income taxes	\$ 13.1	3.5%	\$ 11.0	3.4%	\$ 2.1	19.9%

	Nine fiscal months ended December 31, 2006		Nine fiscal months ended January 1, 2006		Increase	
	In Millions	Percentage of Total Net Sales	In Millions	Percentage of Total Net Sales	In Millions	Percentage
Earnings before income taxes	\$ 47.8	4.4%	\$ 28.0	3.0%	\$ 19.8	70.7%

As a result of the above, earnings before income taxes increased \$2.1 million or 19.9% in the third fiscal quarter of 2007 and increased \$19.8 million or 70.7% in the nine fiscal months of 2007 compared to the comparable period of fiscal 2006. Earnings before income taxes as a percentage of sales increased to 3.5% and 4.4% in the third fiscal quarter and nine fiscal months of 2007, respectively, in comparison to 3.4% and 3.0% in the third fiscal quarter and nine fiscal months of 2006, respectively.

**INCOME TAX EXPENSE**

	Fiscal quarter ended December 31, 2006		Fiscal quarter ended January 1, 2006		Increase	
	In Millions	Percentage of Total Net Sales	In Millions	Percentage of Total Net Sales	In Millions	Percentage
Income tax expense	\$ 2.2	0.6%	\$ 3.2	1.0%	\$ (1.0)	(32.2)%
Effective tax rate	16.5%		29.1%		(12.6)%	

  

	Nine fiscal months ended December 31, 2006		Nine fiscal months ended January 1, 2006		Increase	
	In Millions	Percentage of Total Net Sales	In Millions	Percentage of Total Net Sales	In Millions	Percentage
Income tax expense	\$ 13.2	1.2%	\$ 8.9	1.0%	\$ 4.3	48.3%
Effective tax rate	27.6%		31.9%		(4.3)%	

## Edgar Filing: EnerSys - Form 10-Q

The effective tax rate was 16.5% and 27.6%, respectively, in the third fiscal quarter and the nine fiscal months of 2007, compared to 29.1% and 31.9%, respectively, in the third fiscal quarter and nine fiscal months of fiscal 2006. These rate reductions are primarily due to a non-recurring tax benefit of approximately \$2 million in the third fiscal quarter of 2007, attributable to the favorable resolution of a prior year tax matter related to the Energy Storage Group ( ESG ) of Invensys plc, which the Company acquired in 2002. In fiscal 2007, changes in the mix of earnings among our various legal entities in multiple foreign jurisdictions have had a minimal effect on our effective tax rate.

**Table of Contents****NET EARNINGS**

	Fiscal quarter ended December 31, 2006		Fiscal quarter ended January 1, 2006		Increase	
	In	Percentage	In	Percentage	In	Percentage
	Millions	of Total Net Sales	Millions	of Total Net Sales	Millions	Percentage
Net earnings	\$ 11.0	2.9%	\$ 7.8	2.4%	\$ 3.2	41.4%

	Nine fiscal months ended December 31, 2006		Nine fiscal months ended January 1, 2006		Increase	
	In	Percentage	In	Percentage	In	Percentage
	Millions	of Total Net Sales	Millions	of Total Net Sales	Millions	Percentage
Net earnings	\$ 34.6	3.2%	\$ 19.0	2.0%	\$ 15.6	81.6%

As a result of the above, net earnings in the third fiscal quarter of 2007 were \$11.0 million (2.9% of net sales), or an increase of 41.4% over the third fiscal quarter of 2006. Net earnings for the nine fiscal months of 2007 were \$34.6 million (3.2% of net sales), or an increase of 81.6% over the nine fiscal months of 2006.

Net earnings per common share in the third fiscal quarter of 2007 were \$0.24 per basic share and \$0.23 per diluted share compared to \$0.17 per basic and diluted share in the third fiscal quarter of 2006. Net earnings per common share in the nine fiscal months of 2007 were \$0.74 per basic and \$0.73 per diluted share compared to \$0.41 per basic and diluted share in the nine fiscal months of 2006.

**LIQUIDITY AND CAPITAL RESOURCES**

Operating activities provided cash of \$52.2 million for the nine fiscal months of 2007, compared to \$24.7 million in the comparable period in fiscal 2006. This favorable change of \$27.5 million was primarily due to increased earnings before depreciation, amortization, special charges and non-cash stock-based compensation of \$12.2 million and a \$20.6 million improvement in the change in accrued expenses, partially offset by a \$5.8 million or 1.8 percentage point unfavorable change in primary working capital.

Primary working capital (as defined in the overview section) was \$381.1 million (yielding a primary working capital percentage of 25.2%) at December 31, 2006, and \$330.4 million (yielding a primary working capital percentage ratio of 23.4%) at March 31, 2006. The 1.8 percentage point increase in our primary working capital percentage compared to the same period in fiscal 2006, resulted primarily from a \$19.7 million increase in inventory required to support growth and improve our ability to meet customer requirements. A portion of the increase is temporary as we shift production of certain products among manufacturing locations. The \$20.6 million improvement in the accrued expense change compared to prior year was due primarily to higher income and other tax accruals and lower restructuring spending.

Investing activities for the nine fiscal months of 2007 used cash of \$33.7 million and included \$27.5 million of capital expenditures and \$6.4 million for our acquisitions. Investing activities for the nine fiscal months of 2006 used cash of \$66.9 million and included \$29.6 million of capital expenditures and acquisitions of \$38.1 million.

---

**Table of Contents**

Financing activities provided cash of \$2.9 million in the nine fiscal months of 2007, primarily the proceeds from the exercise of stock options. For the nine fiscal months of 2006, financing activities provided cash of \$32.3 million, primarily the proceeds from the new debt financing of 25.0 million (approximately \$29.9 million) related to the June 2005 FIAMM acquisition.

Effective November 27, 2006, we amended our Euro 25 million Credit Agreement, and effective June 29, 2006, we amended our senior credit facility, which consists of a \$355.9 million term loan B and a \$100.0 million revolving credit line. Under the amendment, the lenders approved the elimination of the covenants relating to our senior secured debt leverage ratio (while maintaining the covenants relating to our total debt leverage ratio) and several minor technical changes in the agreement. This amendment will provide greater operating flexibility and increase our borrowing capacity for potential acquisition opportunities.

All obligations under our U.S. Credit Agreement are secured by, among other things, substantially all of our U.S. assets. All obligations under our Euro Credit Agreement are secured by a pledge of the shares of our Italian subsidiary and a guaranty of our subsidiary, EnerSys Capital Inc. Our U.S. and Euro Credit Agreements contain various covenants which, absent prepayment in full of the indebtedness and other obligations, or the receipt of waivers, limit our ability to conduct certain specified business transactions, buy or sell assets out of the ordinary course of business, engage in sale and leaseback transactions, pay dividends and take certain other actions.

We currently are in compliance with all covenants and conditions under our credit agreements. Since we believe that we will continue to comply with these covenants and conditions, we believe that we have adequate availability of funds to meet our cash requirements. See Note 9 to the Consolidated Financial Statements included in the Company's 2006 Annual Report on Form 10-K for a detailed description of debt.

**ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

*Market Risks*

EnerSys' cash flows and earnings are subject to fluctuations resulting from changes in interest rates, raw material costs and foreign currency exchange rates. We manage our exposure to these market risks through internally established policies and procedures and, when deemed appropriate, through the use of derivative financial instruments. EnerSys' policy does not allow speculation in derivative instruments for profit or execution of derivative instrument contracts for which there are no underlying exposures. We do not use financial instruments for trading purposes and are not a party to any leveraged derivatives. We monitor our underlying market risk exposures on an ongoing basis and believe that we can modify or adapt our hedging strategies as needed.

*Interest Rate Risks*

We are exposed to changes in variable U.S. interest rates on borrowings under our credit agreements. On a selective basis, from time to time, we enter into interest rate swap agreements to reduce the negative impact that increases in interest rates could have on our outstanding variable rate debt. Such agreements effectively convert \$203.0 million of our variable-rate debt to a fixed-rate basis, utilizing the three-month London Interbank Offered Rate, or LIBOR, as a floating rate reference. Fluctuations in LIBOR and fixed rates affect both our net financial investment position and the amount of cash to be paid or received by us under these agreements. The following commentary provides details for the \$203.0 million interest rate swap agreements:

In February 2001, we entered into interest rate swap agreements to fix the interest rate on \$60.0 million of our floating rate debt through February 22, 2006, at 5.59% per year. In April and May 2004, we amended these agreements to extend the maturity to February 22, 2008, and reduce the fixed rate to 5.16% per year beginning May 24, 2004.

**Table of Contents**

In April 2004, we entered into interest rate swap agreements to fix interest rates on an additional \$60.0 million of floating rate debt through May 5, 2008. The fixed rates per year began May 5, 2004, and are 2.85% during the first year, 3.15% the second year, 3.95% the third year and 4.75% in the fourth year, which averages 3.68% for the four-year period.

In August 2004, we entered into an interest rate swap agreement to fix interest rates on an additional \$8.0 million of floating rate debt through May 5, 2008. The fixed rates per year began November 5, 2004, and are 2.85% during the first year, 3.15% the second year, 3.95% the third year and 4.20% in the fourth year, which averages 3.64% for the three and one-half year period.

In October 2005, we entered into interest rate swap agreements to fix interest rates on an additional \$75.0 million of floating rate debt through December 22, 2010. The fixed rates per year plus an applicable credit spread began December 22, 2005, and are 4.25% during the first year, 4.525% the second year, 4.80% the third year, 5.075% the fourth year, and 5.47% in the fifth year, which averages 4.82% for the five-year period.

A 100 basis point increase in interest rates would increase interest expense by approximately \$2 million on the variable rate portions of our debt.

*Commodity Cost Risks - Lead Contracts*

We have a significant risk in our exposure to certain raw materials. Our largest single raw material cost is lead, for which the cost remains volatile. In order to hedge against increases in our lead cost, we have entered into contracts with financial institutions to fix the price of lead. Each such contract is for a period not extending beyond one year. We had the following contracts at the dates shown below:

Date	\$ s Under Contract (in millions)	# Pounds Purchased (in millions)	Average Cost/Pound	Approximate % of Lead Requirements <sup>(1)</sup>
December 31, 2006	\$ 36.4	53.3	\$ 0.68	12%
March 31, 2006	17.4	32.8	0.53	7%
January 1, 2006	8.6	21.9	0.39	6%

(1) Based on an approximate annual lead requirements for the period then ended.

We estimate that a 10% increase in our cost of lead over our estimated cost in fiscal 2007 would increase our annual total cost of goods sold by approximately \$30 million or 3%.

*Foreign Currency Exchange Rate Risks*

We manufacture and assemble our products primarily in China, France, Germany, Italy, Mexico, Poland, Spain, the United Kingdom, and the United States. Over half of our sales and expenses are translated in foreign currencies. Our sales revenue, production costs, profit margins and competitive position are affected by the strength of the currencies in countries where we manufacture or purchase goods relative to the strength of the currencies in countries where our products are sold. Additionally, as we report our financial statements in the U.S. dollar, our financial results are affected by the strength of the currencies in countries where we have operations relative to the strength of the U.S. dollar. The principal foreign currencies in which we conduct business are the euro, British pound, Polish zloty, Mexican peso, Canadian dollar and Chinese renminbi.

We quantify and monitor our global foreign currency exposures. On a selective basis we will enter into foreign currency forward contracts and option contracts to reduce our impact from the volatility of currency movements. Based primarily on statistical currency correlations on our exposures in fiscal 2006, we are highly confident that the pretax effect on annual earnings of changes in the principal currencies in which we conduct our business would not be in excess of approximately \$6 million in more than one year out of twenty years.

**Table of Contents**

Our largest exposure is from the purchase and conversion of U.S. dollar based lead costs into local currencies in Europe, China and Mexico. Additionally, we have currency exposures from intercompany trade transactions. To hedge these exposures we have entered into forward contracts with financial institutions to fix the value at which we will buy or sell certain currencies. Each contract is for a period not extending beyond one year. As of December 31, 2006, and March 31, 2006, we had entered into a total of \$39.4 million and \$34.3 million, respectively, as follows:

Transactions Hedged	December 31, 2006		March 31, 2006	
	\$US Equivalent (in millions)	Average Rate Hedged	\$US Equivalent (in millions)	Average Rate Hedged
Sell euros for U.S. dollars	\$ 25.7	1.28	\$ 20.6	1.22
Sell UK pounds sterling for U.S. dollars	4.6	1.87	5.9	1.76
Buy Polish zloty for euros	6.6	3.88	3.0	4.14
Sell Canadian dollars for U.S. dollars	2.5	1.11	4.8	1.18
<b>Total</b>	<b>\$ 39.4</b>		<b>\$ 34.3</b>	

Foreign exchange translation adjustments are recorded on the Condensed Consolidated Statements of Comprehensive Income.

Based on changes in the timing and amount of interest rate and foreign currency exchange rate movements and our actual exposures and hedges, actual gains and losses in the future may differ from our historical results.

**ITEM 4. CONTROLS AND PROCEDURES**

(a) Disclosure Controls and Procedures. The Company's management, with the participation of the Company's Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of the Company's disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act")) as of the end of the period covered by this report. Based on such evaluation, the Company's Chief Executive Officer and Chief Financial Officer have concluded that, as of the end of such period, the Company's disclosure controls and procedures are effective.

(b) Internal Control Over Financial Reporting. There have not been any changes in the Company's internal control over financial reporting (as such term is defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the fiscal quarter to which this report relates that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

**Table of Contents**

**PART II OTHER INFORMATION**

**Item 1. Legal Proceedings**  
**Exide Litigation**

When we acquired Yuasa's North and South American industrial battery business in 2000, we acquired the worldwide right to use the *Exide* trademark on industrial batteries. Yuasa had acquired an exclusive, perpetual, worldwide and transferable license to use the *Exide* name on industrial batteries in 1991 when it bought Exide Technologies' industrial battery business.

On April 15, 2002, Exide Technologies filed for protection under Chapter 11 of the U.S. Bankruptcy Code in the United States Bankruptcy Court for the District of Delaware. During the course of its Chapter 11 proceedings, Exide Technologies sought to reject certain agreements related to the 1991 sale of Exide Technologies' industrial battery business to Yuasa, including the trademark license referred to above. We opposed Exide Technologies' attempt to reject these agreements. On April 3, 2006, the Court found in favor of Exide Technologies. On June 30, 2006, the Court entered a supplemental order pursuant to which (a) EnerSys was granted until October 3, 2007, to discontinue the use of the *Exide* trademark on industrial batteries; (b) Exide Technologies was required to refrain from using the *Exide* trademark on industrial batteries until April 3, 2008; and (c) EnerSys' motion for a stay pending appeal of the court order granting Exide Technologies' motion to reject the agreements was denied. On July 11, 2006, we appealed the court's decision.

**Other Litigation**

In the first fiscal quarter of 2007, we settled a litigation matter. As a result of this settlement, we recorded litigation settlement income, net of related legal fees and expenses, of \$2.8 million. Additionally, in the second fiscal quarter of 2007, we settled a legal dispute. As a result of this settlement, we recorded litigation settlement income, net of related legal fees and expenses, of \$1.0 million.

From time to time, we are involved in litigation incidental to the conduct of our business. We do not expect that any of this litigation, individually or in the aggregate, will have a material adverse effect on our financial condition, results of operations or cash flow.

**Item 1a. Risk Factors**

In addition to the other information set forth in this report on Form 10-Q, you should carefully consider the factors discussed in Part I, Item 1A. Risk Factors in our Annual Report on Form 10-K for the year ended March 31, 2006, which could materially affect our business, financial condition or future results.

**Table of Contents****Item 2. Unregistered Sales of Equity Securities and Use of Proceeds  
Purchases of Equity Securities by the Issuer and Affiliated Purchasers**

The following table summarizes the number of common shares we purchased from participants in our equity incentive plans. As provided by such plans, vested options outstanding may be exercised through surrender to the Company of option shares or vested options outstanding under the Plan to satisfy the applicable aggregate exercise price (and any withholding tax) required to be paid upon such exercise.

**Purchases of Equity Securities**

Period	(a) Total number of shares (or units) purchased	(b) Average price paid per share (or unit)	(c) Total number of shares (or units) purchased as part of publicly announced plans or programs	(d)
				Maximum number (or approximate dollar value) of shares (or units) that may be purchased under the plans or programs
Month 1				
October 1				
October 29, 2006	467,117	\$ 18.21		
Month 2				
October 30				
November 26, 2006	52,023	\$ 17.38		
Month 3				
November 27				
December 31, 2006				
Total	519,140	\$ 18.13		



**Table of Contents**

**Item 6. Exhibits**

<b>Exhibit Number</b>	<b>Description of Exhibit</b>
1.1	Underwriting Agreement, dated December 7, 2006, between EnerSys, Lehman Brothers Inc. and certain selling stockholders named therein (incorporated by reference to Exhibit 10.1 to EnerSys Form 8-K dated December 7, 2006).
10.1	Amendment, dated January 10, 2007, to the Euro 25,000,000 Credit Facility, dated June 15, 2005, among EnerSys S.p.A., Banca Intesa S.p.A., Sanpaolo IMI S.p.A., et al. (incorporated by reference to Exhibit 10.1 to EnerSys Form 8-K dated January 16, 2007).
10.2	EnerSys Amended and Restated 2006 Equity Incentive Plan (filed herewith).
31.1	Certification of the Chief Executive Officer pursuant to Rule 13a-14(a)/15d-14(a) Under the Securities Exchange Act of 1934 (filed herewith).
31.2	Certification of the Chief Financial Officer pursuant to Rule 13a-14(a)/15d-14(a) Under the Securities Exchange Act of 1934 (filed herewith).
32.1	Certification of the Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (furnished herewith).

**Table of Contents**

**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

ENERSYS (Registrant)

By /s/ Michael T. Phillion  
Michael T. Phillion  
Executive Vice President-Finance and  
Chief Financial Officer  
(Authorized Officer and Principal Financial Officer)

Date: February 7, 2007

**Table of Contents**

EnerSys

**EXHIBIT INDEX**

<b>Exhibit Number</b>	<b>Description of Exhibit</b>
1.1	Underwriting Agreement, dated December 7, 2006, between EnerSys, Lehman Brothers Inc. and certain selling stockholders named therein (incorporated by reference to Exhibit 10.1 to EnerSys Form 8-K dated December 7, 2006).
10.1	Amendment, dated January 10, 2007, to the Euro 25,000,000 Credit Facility, dated June 15, 2005, among EnerSys S.p.A., Banca Intesa S.p.A., Sanpaolo IMI S.p.A., et al. (incorporated by reference to Exhibit 10.1 to EnerSys Form 8-K dated January 16, 2007).
10.2	EnerSys Amended and Restated 2006 Equity Incentive Plan (filed herewith).
31.1	Certification of the Chief Executive Officer pursuant to Rule 13a-14(a)/15d-14(a) Under the Securities Exchange Act of 1934 (filed herewith).
31.2	Certification of the Chief Financial Officer pursuant to Rule 13a-14(a)/15d-14(a) Under the Securities Exchange Act of 1934 (filed herewith).
32.1	Certification of the Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (furnished herewith).