PALL CORP
Form 10-Q
March 28, 2008

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

þ **Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the quarterly period ended January 31, 2008

or

o **Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the transition period from to

Commission File Number: 001- 04311
PALL CORPORATION
(Exact name of registrant as specified in its charter)

New York	**11-1541330**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
2200 Northern Boulevard, East Hills, NY	**11548**
(Address of principal executive offices)	(Zip Code)

(516) 484-5400
(Registrant s telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes o No þ

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

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

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

The number of shares of the registrant s common stock outstanding as of March 21, 2008 was 122,872,069.

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Special Note

Along with this report, Pall Corporation (the Company) is filing its delayed fiscal year 2007 annual report on Form 10-K (2007 Form 10-K) as well as its delayed quarterly report for the first quarter of fiscal year 2008 on Form 10-Q. These reports were delayed pending the completion of an inquiry conducted by the Company s audit committee into the Company s understatement of its United States (U.S.) federal income tax payments and its provision for income taxes. The audit committee completed its inquiry in January 2008. On August 1, 2007, the audit committee, on the recommendation of management, concluded that the Company s previously issued financial statements for each of the eight fiscal years in the period ended July 31, 2006 (including the interim periods within those years), and for each of the fiscal quarters ended October 31, 2006, January 31, 2007 and April 30, 2007, should no longer be relied upon. Accordingly, the Company has restated its previously issued financial statements for those periods in its 2007 Form 10-K. The Company has not amended its previously filed Annual Reports on Form 10-K or Quarterly Reports on Form 10-Q for the periods affected by this restatement.

The adjustments made as a result of the restatement are discussed in Note 2, Audit Committee Inquiry and Restatement, to the accompanying condensed consolidated financial statements included in Part I Item 1 Financial Statements (Unaudited). For additional discussion of the inquiry and the restatement adjustments, see Part I Item 2 Management s Discussion and Analysis of Financial Condition and Results of Operations Audit Committee Inquiry and Restatement and Note 2 to the accompanying condensed consolidated financial statements. For a description of the material weakness identified by management in internal control over financial reporting with respect to the Company s accounting for income taxes and management s remediation of the material weakness, see Part I Item 4 Controls and Procedures of this Form 10-Q.

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS.

PALL CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands, except per share data)
(Unaudited)

	Jan. 31, 2008	July 31, 2007
ASSETS		
Current assets:		
Cash and cash equivalents	$ 410,265	$ 443,036
Accounts receivable	576,204	551,393
Inventories	506,365	471,467
Prepaid expenses	47,142	34,135
Other current assets	86,801	106,346
Total current assets	1,626,777	1,606,377
Property, plant and equipment, net	628,071	607,900
Goodwill	263,653	260,205
Intangible assets	48,750	47,933
Other non-current assets	311,445	186,431
Total assets	$ 2,878,696	$ 2,708,846
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Notes payable	$ 63,231	$ 39,949
Accounts payable and other current liabilities	481,855	499,075
Income taxes payable	39,251	291,395
Current portion of long-term debt	1,783	1,771
Total current liabilities	586,120	832,190
Long-term debt, net of current portion	692,430	591,591
Income taxes payable non-current	220,221	
Deferred taxes and other non-current liabilities	229,835	224,464
Total liabilities	1,728,606	1,648,245
Stockholders equity:		
Common stock, par value $.10 per share	12,796	12,796
Capital in excess of par value	168,540	159,620
Retained earnings	1,019,471	974,945
Treasury stock, at cost	(154,850)	(164,454)
Stock option loans	(462)	(679)
Accumulated other comprehensive income (loss):		
Foreign currency translation	168,406	142,691
Minimum pension liability	(67,036)	(67,036)

Unrealized investment gains	3,891	2,801
Unrealized losses on derivatives	(666)	(83)
	104,595	78,373
Total stockholders equity	1,150,090	1,060,601
Total liabilities and stockholders equity	$ 2,878,696	$ 2,708,846

See accompanying notes to condensed consolidated financial statements.

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PALL CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF EARNINGS
(In thousands, except per share data)
(Unaudited)

	Three Months Ended		Six Months Ended	
	Jan. 31, 2008	**Jan. 31, 2007 (As Restated)**	**Jan. 31, 2008**	**Jan. 31, 2007 (As Restated)**
Net sales	$ 625,747	$ 544,930	$ 1,186,754	$ 1,044,218
Cost of sales	337,471	288,460	637,162	564,076
Gross profit	288,276	256,470	549,592	480,142
Selling, general and administrative expenses	178,845	168,203	349,832	325,578
Research and development	18,092	15,277	34,987	29,511
Restructuring and other charges/(gains), net	13,859	(3,648)	22,628	13,440
Interest expense, net	8,063	9,759	15,784	20,455
Earnings before income taxes	69,417	66,879	126,361	91,158
Provision for income taxes	21,429	22,532	42,271	30,810
Net earnings	$ 47,988	$ 44,347	$ 84,090	$ 60,348
Earnings per share:				
Basic	$ 0.39	$ 0.36	$ 0.68	$ 0.49
Diluted	$ 0.39	$ 0.36	$ 0.68	$ 0.49
Dividends declared per share	$ 0.12	$ 0.12	$ 0.36	$ 0.23
Average shares outstanding:				
Basic	123,372	123,185	123,256	122,988
Diluted	124,572	124,504	124,449	124,392

See accompanying notes to condensed consolidated financial statements.

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PALL CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)
(Unaudited)

	Six Months Ended	
	Jan. 31, 2008	**Jan. 31, 2007**
Operating activities:		
Net cash (used)/provided by operating activities	$ (74,905)	$ 148,875
Investing activities:		
Capital expenditures	(52,681)	(32,210)
Proceeds from sale of retirement benefit assets	11,666	14,864
Purchases of retirement benefit assets	(13,714)	(14,018)
Disposals of long lived assets	4,605	43,968
Acquisitions of businesses, net of disposals and cash acquired		(406)
Other	(2,741)	(2,252)
Net cash (used)/provided by investing activities	(52,865)	9,946
Financing activities:		
Notes payable	21,538	(8,080)
Dividends paid	(29,425)	(26,885)
Net proceeds from stock plans	7,462	24,840
Purchase of treasury stock		(11,800)
Long-term borrowings	119,424	618
Repayments of long-term debt	(39,509)	(113,819)
Excess tax benefits from stock-based compensation arrangements	760	2,919
Net cash provided/(used) by financing activities	80,250	(132,207)
Cash flow for period	(47,520)	26,614
Cash and cash equivalents at beginning of year	443,036	317,657
Effect of exchange rate changes on cash and cash equivalents	14,749	1,415
Cash and cash equivalents at end of period	$ 410,265	$ 345,686
Supplemental disclosures:		
Interest paid	$ 24,342	$ 18,242
Income taxes paid (net of refunds)	187,232	13,064

See accompanying notes to condensed consolidated financial statements.

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PALL CORPORATION AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(In thousands, except per share data)
(Unaudited)

NOTE 1 BASIS OF PRESENTATION

The condensed consolidated financial information included herein is unaudited. Such information reflects all adjustments of a normal recurring nature, which are, in the opinion of Company management, necessary to present fairly the Company s consolidated financial position, results of operations and cash flows as of the dates and for the periods presented herein. These condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes set forth in the Company s Annual Report on Form 10-K for the fiscal year ended July 31, 2007 (2007 Form 10-K).

NOTE 2 AUDIT COMMITTEE INQUIRY AND RESTATEMENT

As discussed in the 2007 Form 10-K, an inquiry was conducted by the Company s audit committee into the Company s understatement of its United States (U.S.) federal income tax payments and its provision for income taxes. The audit committee completed its inquiry in January 2008. On August 1, 2007, the audit committee, on the recommendation of management, concluded that the Company s previously issued financial statements for each of the eight fiscal years in the period ended July 31, 2006 (including the interim periods within those years), and for each of the fiscal quarters ended October 31, 2006, January 31, 2007 and April 30, 2007, should no longer be relied upon. Accordingly, the Company has restated its previously issued financial statements for those periods in its 2007 Form 10-K. The Company has not amended its previously filed Annual Reports on Form 10-K or Quarterly Reports on Form 10-Q for the periods affected by this restatement. The financial information presented below for fiscal year 2007 has been restated as set forth in the 2007 Form 10-K.

This matter resulted in the Company s failure or inability to comply with certain representations, warranties and covenants in its debt and other financing-related agreements, including the Company s obligation to provide certain information (principally the Company s periodic Securities and Exchange Commission (SEC) reports) to those lenders or counterparties. The Company entered into amendments and/or waivers to address these matters with the lenders or counterparties, as applicable, under its $500,000 unsecured senior revolving credit facility, Yen 9 billion variable-rate loan due June 20, 2010 and certain other debt and financing-related agreements, as well as an amendment of the indenture relating to the $280,000 6% senior notes due August 1, 2012. Under the terms of those amendments and covenant waivers, the Company was obligated to return to compliance with its reporting obligations under the federal securities laws by March 31, 2008. As of the date hereof, the Company is in compliance with its filing obligations under the foregoing agreements, as amended.

The following tables present the effects of the adjustments made to the Company s previously reported statements of earnings for the three and six months ended January 31, 2007 for the restatement of the Company s provision for income taxes and interest expense, net.

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PALL CORPORATION AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(In thousands, except per share data)
(Unaudited)

	Three Months Ended January 31, 2007		
	As previously reported	Adjustments	As restated
Net sales	$ 544,930	$	$ 544,930
Cost of sales	288,460		288,460
Gross profit	256,470		256,470
Selling, general and administrative expenses	168,203		168,203
Research and development	15,277		15,277
Restructuring and other charges/(gains), net	(3,648)		(3,648)
Interest expense, net	4,848	4,911	9,759
Earnings before income taxes	71,790	(4,911)	66,879
Provision for income taxes	15,987	6,545	22,532
Net earnings	$ 55,803	$ (11,456)	$ 44,347
Earnings per share:			
Basic	$ 0.45		$ 0.36
Diluted	$ 0.45		$ 0.36
Average shares outstanding:			
Basic	123,185		123,185
Diluted	124,504		124,504

	Six Months Ended January 31, 2007		
	As previously reported	Adjustments	As restated
Net sales	$ 1,044,218	$	$ 1,044,218
Cost of sales	564,076		564,076
Gross profit	480,142		480,142
Selling, general and administrative expenses	325,578		325,578
Research and development	29,511		29,511
Restructuring and other charges, net	13,440		13,440
Interest expense, net	10,634	9,821	20,455
Earnings before income taxes	100,979	(9,821)	91,158

Provision for income taxes	20,742	10,068	30,810
Net earnings	$ 80,237	$ (19,889)	$ 60,348
Earnings per share:			
Basic	$ 0.65		$ 0.49
Diluted	$ 0.64		$ 0.49
Average shares outstanding:			
Basic	122,988		122,988
Diluted	124,392		124,392

PALL CORPORATION AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(In thousands, except per share data)
(Unaudited)

NOTE 3 ADOPTION OF NEW ACCOUNTING PRONOUNCEMENTS

In June 2006, the Financial Accounting Standards Board (FASB) issued Financial Interpretation No. 48, Accounting for Uncertainty in Income Taxes (FIN No. 48). FIN No. 48 establishes a recognition threshold and measurement process for recording income tax positions in an enterprise s financial statements in accordance with SFAS No. 109, Accounting for Income Taxes. FIN No. 48 prescribes a two-step evaluation process for income tax positions. The first step is recognition and, if the recognition threshold is met, a second step, measurement, is applied. For recognition, an enterprise judgmentally determines whether it is more-likely-than-not that an income tax position will be sustained upon examination, including resolution of related appeals or litigation processes, based on the technical merits of the position. If the income tax position meets the more-likely-than-not recognition threshold it is measured and the appropriate amount is recognized in the financial statements as the largest amount of income tax benefit that is greater than 50% likely of being realized. If an income tax position does not meet the more-likely-than-not recognition threshold, no benefit for that position is recognized in the financial statements. Income tax positions that meet the more-likely-than-not recognition threshold at the effective date of FIN No. 48 may be recognized or, continue to be recognized, upon adoption of FIN No. 48.

Effective August 1, 2007, the Company adopted FIN No. 48 and in accordance with FIN No. 48, the Company recognized a cumulative-effect adjustment of $5,600, reducing its liability for unrecognized income tax benefits and interest and increasing the August 1, 2007 balance of Retained Earnings.

At August 1, 2007, the Company had $210,000 in gross tax reserves for unrecognized income tax benefits. The Company s uncertain income tax positions, if recognized, would reduce income tax expense by approximately $135,000 thus favorably affecting the Company s effective tax rate.

In addition, consistent with the provisions of FIN No. 48, the Company reclassified $210,000 of income tax liabilities from current to non-current liabilities because payment of cash is not anticipated within one year of the balance sheet date. These non-current income tax liabilities are recorded in Income taxes payable non-current in the condensed consolidated balance sheet.

The Company and its subsidiaries are currently subject to examination by various taxing authorities. While it is possible that one or more of these examinations may be resolved within the next twelve months, the Company does not anticipate a significant impact to the unrecognized income tax benefits.

The Company recognizes accrued interest expense related to unrecognized income tax benefits in interest expense and the balance at the end of a reporting period is recorded in accrued interest payable on the Company s condensed consolidated balance sheet. Penalties are accrued as part of income tax expense and the unpaid balance at the end of a reporting period are recorded as part of the current or non-current reserve for uncertain income tax positions. At August 1, 2007, the Company had accrued $64,000 for the potential payment of interest and penalties. At January 31, 2008, the accrued balance for the potential payment of interest and penalties was $70,000.

As of August 1, 2007, the Company is subject to U.S. federal and state and local income tax examinations for the fiscal tax years ended in 1996 through 2007, and to non-U.S. income tax examinations for the fiscal tax years ended in 2000 through 2007.

The balance of the Company s gross uncertain income tax positions at the end of the second quarter is $220,000.

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PALL CORPORATION AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(In thousands, except per share data)
(Unaudited)

NOTE 4 BALANCE SHEET DETAILS

The following tables provide details of selected balance sheet items:

	Jan. 31, 2008	July 31, 2007
Accounts receivable:		
Billed	$ 523,967	$ 510,991
Unbilled	65,135	52,212
Total	589,102	563,203
Less: Allowances for doubtful accounts	(12,898)	(11,810)
	$ 576,204	$ 551,393

Unbilled receivables principally relate to long-term contracts recorded under the percentage-of-completion method of accounting.

	Jan. 31, 2008	July 31, 2007
Inventories:		
Raw materials and components	$ 149,342	$ 136,248
Work-in-process	84,298	73,725
Finished goods	272,725	261,494
	$ 506,365	$ 471,467

	Jan. 31, 2008	July 31, 2007
Property, plant and equipment:		
Property, plant and equipment	$ 1,434,992	$ 1,370,287
Less: Accumulated depreciation and amortization	(806,921)	(762,387)
	$ 628,071	$ 607,900

NOTE 5 GOODWILL AND INTANGIBLE ASSETS

The following table presents goodwill, net of accumulated amortization recorded prior to adopting SFAS No. 142, Goodwill and Other Intangible Assets (SFAS No. 142), allocated by reportable segment, in accordance with SFAS No. 142.

	Jan. 31, 2008	July 31, 2007
Life Sciences	$ 71,375	$ 69,433
Industrial	192,278	190,772
	$ 263,653	$ 260,205

The change in the carrying amount of goodwill is primarily attributable to changes in foreign exchange rates used to translate the goodwill contained in the financial statements of foreign subsidiaries using the rates at each respective balance sheet date.

Intangible assets, net, consist of the following:

	Jan. 31, 2008		
	Gross	**Accumulated Amortization**	**Net**
Patents and unpatented technology	$ 84,358	$ 40,767	$ 43,591
Trademarks	4,855	2,887	1,968
Other	5,061	1,870	3,191
	$ 94,274	$ 45,524	$ 48,750

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PALL CORPORATION AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(In thousands, except per share data)
(Unaudited)

	July 31, 2007		
	Gross	Accumulated Amortization	Net
Patents and unpatented technology	$ 82,561	$ 37,369	$ 45,192
Trademarks	4,818	2,671	2,147
Other	2,275	1,681	594
	$ 89,654	$ 41,721	$ 47,933

Amortization expense for intangible assets for the three and six months ended January 31, 2008 was $1,988 and $4,093, respectively. Amortization expense for intangible assets for the three and six months ended January 31, 2007 was $2,041 and $4,063, respectively. Amortization expense is estimated to be approximately $3,614 for the remainder of fiscal year 2008, $7,046 in fiscal year 2009, $6,804 in fiscal year 2010, $6,591 in fiscal year 2011, $6,348 in fiscal year 2012 and $3,640 in fiscal year 2013.

NOTE 6 TREASURY STOCK

On October 14, 2004, the Company s board of directors authorized the expenditure of up to $200,000 for the repurchase of shares of the Company s common stock. On November 15, 2006, the board of directors authorized an additional expenditure of $250,000 to repurchase shares. The Company s shares may be purchased over time, as market and business conditions warrant. There is no time restriction on this authorization. During the six months ended January 31, 2008, the Company did not purchase shares in open-market transactions. At January 31, 2008, approximately $348,232 remained available to be expended under the current stock repurchase programs. Repurchased shares are held in treasury for use in connection with the Company s stock-based compensation plans and for general corporate purposes.

During the six months ended January 31, 2008, 326 shares were issued under the Company s stock-based compensation plans. At January 31, 2008, the Company held 5,086 treasury shares.

NOTE 7 CONTINGENCIES AND COMMITMENTS

With respect to the matters described below under the headings Federal Securities Class Actions, Shareholder Derivative Lawsuits and Other Proceedings, no liabilities or insurance recoveries have been reflected in the condensed consolidated financial statements as of January 31, 2008 as these amounts are not currently estimable.

Federal Securities Class Actions:

Four putative class action lawsuits have been filed against the Company and certain members of its management team alleging violations of the federal securities laws relating to the Company s understatement of certain of its U.S. income tax payments and of its provision for income taxes in certain prior periods described in Note 2, Audit Committee Inquiry and Restatement. These lawsuits were filed between August 14, 2007 and October 11, 2007 in the United States District Court for the Eastern District of New York. The plaintiffs principally allege that the defendants violated the federal securities laws by issuing materially false and misleading public statements about the Company s financial results, financial statements, income tax liability, effective tax rate and internal controls. The plaintiffs seek unspecified compensatory damages, costs and expenses. On October 15, 2007, various plaintiffs and groups of plaintiffs filed motions seeking to consolidate the cases and to be appointed lead plaintiff. These motions have not been decided.

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PALL CORPORATION AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(In thousands, except per share data)
(Unaudited)

Shareholder Derivative Lawsuits:

On October 5, 2007, two plaintiffs filed identical derivative lawsuits in New York Supreme Court, Nassau County relating to the tax matter described above. These actions purport to bring claims on behalf of the Company based on allegations that certain current and former directors and officers of the Company breached their fiduciary duties by failing to evaluate and otherwise inform themselves about the Company s internal controls and financial reporting systems and procedures. In addition, plaintiffs allege that certain officers of the Company were unjustly enriched as a result of the Company s inaccurate financial results over fiscal years 1999-2006. The complaints seek unspecified compensatory damages on behalf of Pall Corporation, disgorgement of defendants salaries, bonuses, stock grants and stock options, equitable relief and costs and expenses. The Company, acting in its capacity as nominal defendant, moved to dismiss the complaints on December 17, 2007 for failure to make a demand upon the Company s board of directors prior to filing the lawsuits, which motion is pending.

Another shareholder derivative lawsuit relating to the tax matter described above was filed in the United States District Court for the Eastern District of New York on January 10, 2008. This action purports to bring claims on behalf of the Company based on allegations that certain of the current directors of the Company breached their fiduciary duties and were unjustly enriched in connection with the tax matter. The complaint seeks unspecified compensatory damages on behalf of Pall Corporation, disgorgement of defendants profits, benefits and other compensation, equitable and non-monetary relief, and costs and expenses. The Company, acting in its capacity as nominal defendant, moved to dismiss the complaint on March 10, 2008, for lack of subject matter jurisdiction over the complaint, which motion is pending.

Other Proceedings:

The SEC and U.S. Attorney s Office for the Eastern District of New York are conducting investigations in connection with the tax matter described above. The Company is cooperating with these investigations.

Environmental Matters:

The Company s condensed consolidated balance sheet at January 31, 2008 includes liabilities for environmental matters of approximately $16,670, which relates primarily to the previously reported environmental proceedings involving a Company subsidiary, Gelman Sciences Inc., pertaining to groundwater contamination. In the opinion of management, the Company is in substantial compliance with applicable environmental laws and its current accruals for environmental remediation are adequate. However, as regulatory standards under environmental laws are becoming increasingly stringent, there can be no assurance that future developments, additional information and experience gained will not cause the Company to incur material environmental liabilities or costs beyond those accrued in its c