ARROW ELECTRONICS INC
Form 10-Q
July 25, 2006

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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 June 30, 2006

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 1-4482

ARROW ELECTRONICS, INC.

(Exact name of registrant as specified in its charter)

New York	**11-1806155**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)
50 Marcus Drive, Melville, New York	**11747**
(Address of principal executive offices)	(Zip Code)

(631) 847-2000

(Registrant s telephone number, including area code)

No Changes

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

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

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 Exchange Act:

Large accelerated filer þ Accelerated filer o Non-accelerated filer 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

There were 122,139,434 shares of Common Stock, $1 par value, outstanding as of July 24, 2006.

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements.

ARROW ELECTRONICS, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
(In thousands except per share data)
(Unaudited)

	Three Months Ended		Six Months Ended	
	June 30, 2006	July 1, 2005	June 30, 2006	July 1, 2005
Sales	$ 3,437,032	$ 2,767,547	$ 6,629,495	$ 5,494,418
Costs and expenses:				
Cost of products sold	2,912,608	2,326,214	5,617,528	4,620,856
Selling, general and administrative expenses	346,828	304,235	672,656	613,078
Depreciation and amortization	11,337	13,493	22,298	26,020
Restructuring charges	3,118	4,847	4,639	8,885
Acquisition indemnification credit	-	-	-	(1,672)
	3,273,891	2,648,789	6,317,121	5,267,167
Operating income	163,141	118,758	312,374	227,251
Equity in earnings of affiliated companies	1,045	562	1,990	1,640
Loss on prepayment of debt	-	1,731	2,605	2,086
Write-down of investment	-	3,019	-	3,019
Interest expense, net	23,993	24,375	47,962	48,475
Income before income taxes and minority interest	140,193	90,195	263,797	175,311
Provision for income taxes	47,084	31,627	88,737	59,371
Income before minority interest	93,109	58,568	175,060	115,940
Minority interest	346	119	718	300
Net income	$ 92,763	$ 58,449	$ 174,342	$ 115,640
Net income per share:				
Basic	$ .76	$ .50	$ 1.44	$ .99
Diluted	$ .76	$ .48	$ 1.42	$ .96
Average number of shares outstanding:				
Basic	121,820	117,009	121,213	116,604
Diluted	122,551	124,241	123,020	124,136

See accompanying notes.

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ARROW ELECTRONICS, INC.
CONSOLIDATED BALANCE SHEETS
(In thousands except par value)

	June 30, 2006 (Unaudited)	December 31, 2005
ASSETS		
Current assets:		
Cash and cash equivalents	$ 329,849	$ 580,661
Accounts receivable, net	2,629,110	2,316,932
Inventories	1,830,840	1,494,982
Prepaid expenses and other assets	155,498	124,899
Total current assets	4,945,297	4,517,474
Property, plant and equipment at cost:		
Land	42,042	41,855
Buildings and improvements	163,097	160,012
Machinery and equipment	457,540	426,239
	662,679	628,106
Less: accumulated depreciation and amortization	(415,058)	(392,641)
Property, plant and equipment, net	247,621	235,465
Investments in affiliated companies	38,730	38,959
Cost in excess of net assets of companies acquired	1,118,242	1,053,266
Other assets	195,521	199,753
Total assets	$ 6,545,411	$ 6,044,917
LIABILITIES AND SHAREHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 1,882,917	$ 1,628,568
Accrued expenses	470,342	434,644
Short-term borrowings, including current portion of long-term debt	320,313	268,666
Total current liabilities	2,673,572	2,331,878

Long-term debt	960,276	1,138,981
Other liabilities	208,177	201,172
Shareholders equity:		
Common stock, par value $1:		
Authorized 160,000 shares in 2006 and 2005		
Issued 122,358 and 120,286 shares in 2006 and 2005, respectively	122,358	120,286
Capital in excess of par value	927,306	861,880
Retained earnings	1,573,757	1,399,415
Foreign currency translation adjustment	99,769	13,308
	2,723,190	2,394,889
Less: Treasury stock (235 and 272 shares in 2006 and 2005, respectively), at cost	(6,282)	(7,278)
Unamortized employee stock awards	-	(2,395)
Other	(13,522)	(12,330)
Total shareholders equity	2,703,386	2,372,886
Total liabilities and shareholders equity	$ 6,545,411	$ 6,044,917

See accompanying notes.

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ARROW ELECTRONICS, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)
(Unaudited)

	Six Months Ended	
	June 30, 2006	**July 1, 2005**
Cash flows from operating activities:		
Net income	$ 174,342	$ 115,640
Adjustments to reconcile net income to net cash provided by (used for) operations:		
Depreciation and amortization	22,298	26,020
Accretion of discount on zero coupon convertible debentures	876	5,395
Amortization of deferred financing costs and discount on notes	1,632	1,885
Amortization of restricted stock and performance awards	4,126	3,010
Amortization of employee stock options	6,156	-
Excess tax benefits from stock-based compensation arrangements	(6,431)	-
Equity in earnings of affiliated companies	(1,990)	(1,640)
Deferred income taxes	(2,595)	705
Restructuring charges	2,814	5,458
Loss on prepayment of debt	1,558	1,247
Minority interest	718	300
Acquisition indemnification credit	-	(1,267)
Write-down of investment	-	3,019
Change in assets and liabilities, net of effects of acquired businesses:		
Accounts receivable	(246,891)	(207,839)
Inventories	(302,379)	79,457
Prepaid expenses and other assets	(23,162)	(6,123)
Accounts payable	219,761	221,484
Accrued expenses	14,253	(30,513)
Other	4,068	(124)
Net cash provided by (used for) operating activities	(130,846)	216,114
Cash flows from investing activities:		
Acquisition of property, plant and equipment	(27,540)	(4,564)
Cash consideration paid for acquired businesses	(19,460)	(2,461)
Purchase of short-term investments	-	(230,456)
Proceeds from sale of short-term investments	-	389,056
Other	3,083	3,711
Net cash provided by (used for) investing activities	(43,917)	155,286
Cash flows from financing activities:		
Change in short-term borrowings	38,536	9,493
Change in long-term debt	(15,724)	(1,936)
Repurchase of senior notes	(4,268)	-

Repurchase of zero coupon convertible debentures	(156,330)	(94,501)
Proceeds from exercise of stock options	53,118	35,563
Excess tax benefits from stock-based compensation arrangements	6,431	-
Net cash used for financing activities	(78,237)	(51,381)
Effect of exchange rate changes on cash	2,188	(9,100)
Net increase (decrease) in cash and cash equivalents	(250,812)	310,919
Cash and cash equivalents at beginning of period	580,661	305,294
Cash and cash equivalents at end of period	$ 329,849	$ 616,213

See accompanying notes.

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ARROW ELECTRONICS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Dollars in thousands except per share data)
(Unaudited)

Note A Basis of Presentation

The accompanying consolidated financial statements of Arrow Electronics, Inc. (the company) were prepared in accordance with accounting principles generally accepted in the United States and reflect all adjustments of a normal recurring nature, which are, in the opinion of management, necessary for a fair presentation of the consolidated financial position and consolidated results of operations at and for the periods presented. The consolidated results of operations for the interim periods are not necessarily indicative of results for the full year.

These consolidated financial statements do not include all the information or notes necessary for a complete presentation and, accordingly, should be read in conjunction with the consolidated financial statements and accompanying notes included in the company s Form 10-Q for the quarterly period ended March 31, 2006, as well as the audited consolidated financial statements and accompanying notes for the year ended December 31, 2005, as filed in the company s Annual Report on Form 10-K.

Reclassification

Certain prior period amounts have been reclassified to conform with current period presentation.

Note B Impact of Recently Issued Accounting Standards

In June 2006, the Financial Accounting Standards Board (FASB) ratified the provisions of Emerging Issues Task Force (EITF) Issue No. 06-2, Accounting for Sabbatical Leave and Other Similar Benefits Pursuant to FASB Statement No. 43, Accounting for Compensated Absences (EITF Issue No. 06-2). EITF Issue No. 06-2 requires that compensation expense associated with a sabbatical leave, or other similar benefit arrangement, be accrued over the requisite service period during which an employee earns the benefit. EITF Issue No. 06-2 is effective for fiscal years beginning after December 15, 2006 and should be recognized as either a change in accounting principle through a cumulative-effect adjustment to retained earnings as of the beginning of the year of adoption or a change in accounting principle through retrospective application to all prior periods. The company is currently evaluating the impact of adopting the provisions of EITF Issue No. 06-2.

In July 2006, the FASB issued Interpretation No. 48, Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109 (FIN 48) which prescribes a recognition threshold and measurement attribute, as well as criteria for subsequently recognizing, derecognizing and measuring uncertain tax positions for financial statement purposes. FIN 48 also requires expanded disclosure with respect to the uncertainty in income tax assets and liabilities. FIN 48 is effective for fiscal years beginning after December 15, 2006 and is required to be recognized as a change in accounting principle through a cumulative-effect adjustment to retained earnings as of the beginning of the year of adoption. The company is currently evaluating the impact of adopting the provisions of FIN 48.

Note C Stock-Based Compensation

Effective January 1, 2006, the company adopted the provisions of FASB Statement No. 123 (revised 2004), Share-Based Payment and the Securities and Exchange Commission Staff Accounting Bulletin No. 107 (collectively, Statement No. 123(R)), which establish accounting for share-based payment (SBP) awards exchanged for employee services and requires companies to expense the estimated fair value of these awards over the requisite employee service period.

Prior to January 1, 2006, the company accounted for SBP awards under Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees which utilized the intrinsic value method and did not require any expense to be recorded in the consolidated financial statements if the exercise price of the award was not less than the market price of the underlying stock on the date of grant. The company elected to adopt, for periods prior to January 1, 2006, the disclosure requirements of FASB Statement No. 123, Accounting for Stock-Based Compensation , as amended by FASB Statement No. 148,

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Accounting for Stock-Based Compensation Transition and Disclosure (collectively, Statement No. 123) which used a fair value based method of accounting for SBP awards.

Statement No. 123(R) requires companies to record compensation expense for stock options measured at fair value, on the date of grant, using an option-pricing model. The fair value of stock options is determined using the Black-Scholes valuation model, which is consistent with the company s valuation techniques previously utilized under Statement No. 123.

The company adopted the modified prospective transition method provided for under Statement No. 123(R) and, accordingly, has not restated prior period amounts. Under this transition method, compensation expense for the three and six months ended June 30, 2006 includes compensation expense for all SBP awards granted prior to, but not yet vested as of, January 1, 2006 based on the grant date fair value estimated in accordance with the original provisions of Statement No. 123. Stock-based compensation expense for all SBP awards granted after January 1, 2006 is based on the grant date fair value estimated in accordance with the provisions of Statement No. 123(R). Stock-based compensation expense includes an estimate for forfeitures and is recognized over the expected term of the award on a straight-line basis. The company evaluated the need to record a cumulative effect adjustment relating to estimated forfeitures for unvested previously issued awards, and the impact was not deemed to be material.

As a result of adopting Statement No. 123(R), the company recorded, as a component of selling, general and administrative expenses, a charge of $3,696 ($2,131 net of related taxes or $.02 per share) and $6,156 ($3,936 net of related taxes or $.03 per share) for the three and six months ended June 30, 2006, respectively, relating to the expensing of stock options.

Statement No. 123(R) requires that the realized tax benefit related to the excess of the deductible amount over the compensation expense recognized be reported as a financing cash flow rather than as an operating cash flow, as required under previous accounting guidance. As a result, the related excess tax benefits for the six months ended June 30, 2006 of $6,431 is classified as a reduction in cash flows from operating activities and as a cash inflow from financing activities. The actual tax benefit realized from SBP awards during the three and six months ended June 30, 2006 was $2,393 and $6,980, respectively. The company is not able to estimate the benefits of such tax deductions for future periods as they depend on, among other things, when employees exercise stock options.

The following table presents the company s pro forma net income and basic and diluted net income per share for the three and six months ended July 1, 2005 had compensation expense been determined in accordance with the fair value method of accounting at the grant dates for awards under the company s various stock-based compensation plans:

	For the Three Months Ended July 1, 2005	For the Six Months Ended July 1, 2005
Net income, as reported	$ 58,449	$ 115,640
Impact of stock-based employee compensation expense determined under the fair value method for all awards, net of related taxes	(2,145)	(4,531)
Pro forma net income	$ 56,304	$ 111,109
Net income per share:		
Basic-as reported	$ .50	$ .99

Basic-pro forma	$	.48	$	.95
Diluted-as reported	$	.48	$	.96
Diluted-pro forma	$	.47	$	.92

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For the three and six months ended June 30, 2006 and July 1, 2005, the fair value of SBP awards was estimated using the Black-Scholes valuation model with the following weighted-average assumptions and fair values:

	For the Three Months Ended		For the Six Months Ended	
	June 30, 2006	July 1, 2005	June 30, 2006	July 1, 2005
Volatility (percent) *	37	46	37	48
Expected term (in years) **	4.3	4.4	4.4	4.5
Risk-free interest rate (percent) ***	5.0	3.3	4.7	3.6
Weighted-average fair value per option granted	$12.30	$11.25	$12.28	$11.79

* Volatility is measured using historical daily price changes of the company s common stock over the expected term of the option.

** The expected term represents the weighted average period the option is expected to be outstanding and is based primarily on the historical exercise behavior of employees.

*** The risk free interest rate is based on the U.S. Treasury zero-coupon yield with a maturity that approximates the expected term of the option.

Stock Options

The following information relates to the stock option activity for the six months ended June 30, 2006:

Options	**Shares**	**Weighted Average Exercise Price**	**Weighted Average Remaining Contractual Life**	**Aggregate Intrinsic Value**
Outstanding at December 31, 2005	7,986,752	$ 26.31		
Granted	113,350	34.44		
Exercised	(2,070,449)	25.41		
Forfeited	(156,695)	26.45		
Outstanding at June 30, 2006	5,872,958	26.78	82 months	$ 36,178
Exercisable at June 30, 2006	2,801,686	24.37	56 months	$ 22,015

The aggregate intrinsic value in the table above represents the total pre-tax intrinsic value (the difference between the company s closing stock price on the last trading day of the second quarter of fiscal 2006 and the exercise price, multiplied by the number of in-the-money options) that would have been received by the option holders had all option holders exercised their options on June 30, 2006. This amount changes based on the fair market value of the company s stock. The total intrinsic value of options exercised for the six months ended June 30, 2006 and July 1, 2005 was $19,145 and $10,035, respectively.

Cash received from option exercises during the six months ended June 30, 2006 was $53,118 and is included within the financing activities section in the accompanying consolidated statements of cash flows.

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Non-Vested Shares

The following information summarizes the changes in non-vested performance shares, restricted stock, restricted stock units, and non-employee director awards for the six months ended June 30, 2006:

	Shares	Weighted Average Grant Date Fair Value
Non-vested shares at December 31, 2005	708,824	$ 23.68
Granted	342,818	33.31
Vested	(113,888)	18.49
Forfeited	(37,785)	25.04
Non-vested shares at June 30, 2006	899,969	27.95

As of June 30, 2006, there was $14,562 of total unrecognized compensation cost related to non-vested shares which is expected to be recognized over a weighted-average period of 2.2 years. The total fair value of shares vested for the six months ended June 30, 2006 and July 1, 2005 was $4,005 and $4,557, respectively.

Share-Repurchase Program

On February 28, 2006, the Board authorized the company to repurchase up to $100,000 of the company s outstanding common stock through a share repurchase program. The purpose of this program is to offset some of the dilutive effect of the issuance of common stock upon the exercise of stock options. Purchases under the stock repurchase program may be made from time to time, as market and business conditions warrant, in accordance with applicable regulations of the Securities and Exchange Commission. As of June 30, 2006, no shares have been repurchased under this plan.

Note D Acquisitions

Reference is made to Note 2 to the audited consolidated financial statements and accompanying notes included in the company s Annual Report on Form 10-K for the year ended December 31, 2005 (Note 2) in which the company has previously disclosed certain purchase price information, as well as the preliminary allocation of the net consideration paid arising out of the company s acquisitions during 2005. The following acquisitions have been accounted for as purchase transactions and, accordingly, results of operations have been included in the company s consolidated results from the dates of acquisition.

2006

In February 2006, the company acquired SKYDATA Corporation (SKYDATA), a value-added distributor of data storage solutions based in Mississauga, Canada. SKYDATA maintains sales offices in Mississauga, Ottawa, and Calgary, as well as Laval, Quebec. Total SKYDATA sales for 2005 were approximately CDN $50,000 (U.S. $43,000). The impact of the SKYDATA acquisition was not deemed to be material to the company s consolidated financial position and consolidated results of operations.

During the first quarter of 2006, the company made a payment of $3,400 which was capitalized as cost in excess of net assets of companies acquired partially offset by the carrying value of the related minority interest to increase its ownership interest in Arrow/Rapac Ltd. to 100%.

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ARROW ELECTRONICS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Dollars in thousands except per share data)
(Unaudited)

2005

On December 30, 2005, the company acquired DNSint.com AG (DNS), a distributor of mid-range computer products in Central, Northern, and Eastern Europe. DNS, which is one of the largest suppliers of Sun Microsystems, Inc. products in Europe, had sales in excess of $400,000 in 2005.

In December 2005, through a series of transactions, the company acquired 70.7% of the common shares of Ultra Source Technology Corp. (Ultra Source). Ultra Source, which is headquartered in Taipei, Taiwan, is one of the leading electronic components distributors in Taiwan with sales offices and distribution centers in Taiwan, Hong Kong, and the People s Republic of China. In 2005, Ultra Source had sales in excess of $500,000.

As discussed in Note 2, the preliminary allocation of the net consideration paid for the DNS and Ultra Source acquisitions (the 2005 acquisitions) is subject to refinement as the company has not yet completed its evaluation of the fair value of the assets acquired and liabilities assumed, including the valuation of any identifiable intangible assets acquired through these transactions.

The following unaudited summary of consolidated operations has been prepared on a pro forma basis as though the 2005 acquisitions occurred on January 1, 2005:

	For the Three Months Ended July 1, 2005	For the Six Months Ended July 1, 2005
Sales	$3,006,347	$5,922,549
Net income	60,659	118,770
Net income per share:		
Basic	$ .52	$ 1.02
Diluted	$ .50	$ .98

The unaudited summary of consolidated operations does not purport to be indicative of the results which would have been obtained if the above acquisitions had occurred as of the beginning of 2005 or of those results which may be obtained in the future.

Note E Investments

Affiliated Companies

The company has a 50% interest in several joint ventures with Marubun Corporation (collectively Marubun/Arrow), and a 50% interest in Altech Industries (Pty.) Ltd. (Altech Industries), a joint venture with Allied Technologies Limited. In connection with the acquisition of Ultra Source, the company has several investments with ownership interests ranging between 33% and 40%. These investments are accounted for using the equity method.

The following presents the company s investment in Marubun/Arrow, the company s investment and long-term note receivable in Altech Industries, and the company s other equity investments at June 30, 2006 and December 31, 2005:

	June 30, 2006	December 31, 2005
Marubun/Arrow	$	