

ESCO TECHNOLOGIES INC
Form 10-Q
August 08, 2018

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(MARK ONE)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2018

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE TRANSITION PERIOD FROM _____ TO _____

COMMISSION FILE NUMBER 1-10596

ESCO TECHNOLOGIES INC.

(Exact name of registrant as specified in its charter)

MISSOURI
(State or other jurisdiction of
incorporation or organization)

43-1554045
(I.R.S. Employer
Identification No.)

9900A CLAYTON ROAD

ST. LOUIS, MISSOURI 63124-1186
(Address of principal executive offices) (Zip Code)

(314) 213-7200

(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 No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (Section 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes No

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

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

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Class	Shares outstanding at July 31, 2018
Common stock, \$.01 par value per share	25,910,828

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

ESCO TECHNOLOGIES INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

(Dollars in thousands, except per share amounts)

	Three Months Ended	
	June 30,	
	2018	2017
Net sales	\$ 192,223	171,189
Costs and expenses:		
Cost of sales	122,805	108,856
Selling, general and administrative expenses	39,910	38,453
Amortization of intangible assets	4,605	4,085
Interest expense, net	2,243	1,213
Other (income) expenses, net	(656)	1,160
Total costs and expenses	168,907	153,767
Earnings before income taxes	23,316	17,422
Income tax expense	4,297	4,777
Net earnings	\$ 19,019	12,645
Earnings per share:		
Basic - Net earnings	\$ 0.73	0.49
Diluted - Net earnings	\$ 0.73	0.49

See accompanying notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

(Dollars in thousands, except per share amounts)

	Nine Months Ended	
	June 30,	
	2018	2017
Net sales	\$ 540,496	478,735
Costs and expenses:		
Cost of sales	346,911	307,149
Selling, general and administrative expenses	122,813	107,104
Amortization of intangible assets	13,615	11,548
Interest expense, net	6,464	2,752
Other expenses (income), net	992	(184)
Total costs and expenses	490,795	428,369
Earnings before income taxes	49,701	50,366
Income tax (benefit) expense	(13,983)	15,837
Net earnings	\$ 63,684	34,529
Earnings per share:		
Basic - Net earnings	\$ 2.46	1.34
Diluted - Net earnings	\$ 2.45	1.33

See accompanying notes to consolidated financial statements.

ESCO TECHNOLOGIES INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(Unaudited)

(Dollars in thousands)

	Three Months Ended		Nine Months Ended	
	June 30,		June 30,	
	2018	2017	2018	2017
Net earnings	\$ 19,019	12,645	63,684	34,529
Other comprehensive income (loss), net of tax:				
Foreign currency translation adjustments	(6,865)	4,796	(2,740)	2,981
Net unrealized (loss) gain on derivative instruments	(62)	81	93	(23)
Total other comprehensive (loss) income, net of tax	(6,927)	4,877	(2,647)	2,958
Comprehensive income	\$ 12,092	17,522	61,037	37,487

See accompanying notes to consolidated financial statements.

ESCO TECHNOLOGIES INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(Unaudited)

(Dollars in thousands)

	June 30, 2018	September 30, 2017
ASSETS		
Current assets:		
Cash and cash equivalents	\$43,259	45,516
Accounts receivable, net	164,100	160,580
Costs and estimated earnings on long-term contracts, less progress billings of \$43,769 and \$64,099, respectively	39,180	47,286
Inventories	145,596	124,515
Other current assets	17,861	14,895
Total current assets	409,996	392,792
Property, plant and equipment, net of accumulated depreciation of \$113,831 and \$99,650, respectively	134,704	132,748
Intangible assets, net of accumulated amortization of \$87,494 and \$73,879, respectively	345,874	351,134
Goodwill	381,420	377,879
Other assets	6,977	5,891
Total assets	\$1,278,971	1,260,444
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Current maturities of long-term debt	\$20,000	20,000
Accounts payable	49,830	54,789
Advance payments on long-term contracts, less costs incurred of \$54,295 and \$59,772, respectively	29,841	22,451
Accrued salaries	26,597	32,259
Current portion of deferred revenue	37,082	28,583
Accrued other expenses	36,672	36,887
Total current liabilities	200,022	194,969
Pension obligations	21,976	30,223
Deferred tax liabilities	63,292	86,378
Other liabilities	24,427	21,956
Long-term debt	242,000	255,000
Total liabilities	551,717	588,526
Shareholders' equity:		
Preferred stock, par value \$.01 per share, authorized 10,000,000 shares	—	—
	305	305

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Common stock, par value \$.01 per share, authorized 50,000,000 shares, issued 30,534,786 and 30,468,824 shares, respectively		
Additional paid-in capital	290,106	289,785
Retained earnings	574,192	516,718
Accumulated other comprehensive loss, net of tax	(29,955)	(27,308)
	834,648	779,500
Less treasury stock, at cost: 4,623,958 and 4,635,622 common shares, respectively	(107,394)	(107,582)
Total shareholders' equity	727,254	671,918
Total liabilities and shareholders' equity	\$ 1,278,971	1,260,444

See accompanying notes to consolidated financial statements.

ESCO TECHNOLOGIES INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

(Dollars in thousands)

	Nine Months Ended	
	June 30,	
	2018	2017
Cash flows from operating activities:		
Net earnings	\$63,684	34,529
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation and amortization	28,350	23,023
Stock compensation expense	3,864	4,130
Changes in assets and liabilities	(18,239)	(24,977)
Effect of deferred taxes	(23,086)	(577)
Change in deferred revenue and costs, net	8,785	4,863
Pension contributions	(9,414)	(2,317)
Other	-	(5,202)
Net cash provided by operating activities	53,944	33,472
Cash flows from investing activities:		
Acquisition of businesses, net of cash acquired	(11,445)	(162,268)
Additions to capitalized software	(7,118)	(6,213)
Capital expenditures	(15,539)	(23,055)
Proceeds from sale of land	-	1,184
Proceeds from life insurance	-	2,307
Net cash used by investing activities	(34,102)	(188,045)
Cash flows from financing activities:		
Proceeds from long-term debt	53,000	213,000
Principal payments on long-term debt	(66,000)	(58,000)
Dividends paid	(6,205)	(6,190)
Other	(2,886)	(21)
Net cash (used) provided by financing activities	(22,091)	148,789
Effect of exchange rate changes on cash and cash equivalents	(8)	480
Net decrease in cash and cash equivalents	(2,257)	(5,304)
Cash and cash equivalents, beginning of period	45,516	53,825
Cash and cash equivalents, end of period	\$43,259	48,521
Supplemental cash flow information:		
Interest paid	\$6,333	2,404
Income taxes paid (including state and foreign)	4,343	20,421

See accompanying notes to consolidated financial statements.

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ESCO TECHNOLOGIES INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. BASIS OF PRESENTATION

The accompanying consolidated financial statements, in the opinion of management, include all adjustments, consisting of normal recurring accruals, necessary for a fair presentation of the results for the interim periods presented. The consolidated financial statements are presented in accordance with the requirements of Form 10-Q and consequently do not include all the disclosures required for annual financial statements by accounting principles generally accepted in the United States of America (GAAP). For further information, refer to the consolidated financial statements and related notes included in the Company's Annual Report on Form 10-K for the fiscal year ended September 30, 2017.

The Company's results for the three and nine-month periods ended June 30, 2018 are not necessarily indicative of the results for the entire 2018 fiscal year. References to the third quarters of 2018 and 2017 represent the fiscal quarters ended June 30, 2018 and 2017, respectively.

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities. Actual results could differ from those estimates.

2. ACQUISITION

On March 14, 2018, the Company acquired the assets of Manta Test Systems Inc. (Manta), a North American utility solutions provider located in Mississauga, Ontario, Canada, for a purchase price of \$9.5 million in cash. Manta has annualized sales of approximately \$8 million. Since the date of acquisition, the operating results for Manta have been included as a product line of Doble Engineering Company within the Company's USG segment. Based on the preliminary purchase price allocation, the Company recorded approximately \$0.4 million of accounts receivable, \$1.1 million of inventory, \$0.2 million of property, plant and equipment, \$0.4 million of accounts payable and accrued expenses, \$3.5 million of goodwill, \$1.2 million of tradenames and \$3.5 million of amortizable intangible assets consisting of customer relationships with a weighted average life of 13 years.

3. EARNINGS PER SHARE (EPS)

Basic EPS is calculated using the weighted average number of common shares outstanding during the period. Diluted EPS is calculated using the weighted average number of common shares outstanding during the period plus shares issuable upon the assumed exercise of dilutive common share options and vesting of performance-accelerated restricted shares (restricted shares) by using the treasury stock method. The number of shares used in the calculation of earnings per share for each period presented is as follows (in thousands):

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	Three Months Ended June 30,		Nine Months Ended June 30,	
	2018	2017	2018	2017
Weighted Average Shares Outstanding - Basic	25,900	25,815	25,862	25,756
Dilutive Options and Restricted Shares	150	210	180	219
Adjusted Shares - Diluted	26,050	26,025	26,042	25,975

4. SHARE-BASED COMPENSATION

The Company provides compensation benefits to certain key employees under several share-based plans providing for performance-accelerated restricted shares (restricted shares), and to non-employee directors under a non-employee directors compensation plan.

Performance-Accelerated Restricted Share Awards

Compensation expense related to the restricted share awards was \$0.9 million and \$3.1 million for the three and nine-month periods ended June 30, 2018, respectively, and \$1.0 million and \$3.3 million for the corresponding periods of 2017. There were 316,544 non-vested shares outstanding as of June 30, 2018.

Non-Employee Directors Plan

Compensation expense related to the non-employee director grants was \$0.3 million and \$0.8 million for the three and nine-month periods ended June 30, 2018, respectively, and \$0.3 million and \$0.8 million for the corresponding periods of 2017.

The total share-based compensation cost that has been recognized in the results of operations and included within selling, general and administrative expenses (SG&A) was \$1.2 million and \$3.9 million for the three-and nine-month periods ended June 30, 2018, respectively, and \$1.3 million and \$4.1 million for the three and nine-month periods ended June 30, 2017. The total income tax benefit recognized in results of operations for share-based compensation arrangements was \$0.2 million and \$0.9 million for the three and nine-month periods ended June 30, 2018, respectively, and \$1.2 million and \$2.2 million for the three and nine-month periods ended June 30, 2017, respectively. As of June 30, 2018, there was \$8.9 million of total unrecognized compensation cost related to share-based compensation arrangements. That cost is expected to be recognized over a remaining weighted-average period of 2.1 years.

5. INVENTORIES

Inventories consist of the following:

(In thousands)	June 30, 2018	September 30, 2017
Finished goods	\$30,960	28,127
Work in process	57,155	43,750
Raw materials	57,481	52,638
Total inventories	\$145,596	124,515

6. GOODWILL AND OTHER INTANGIBLE ASSETS

Included on the Company's Consolidated Balance Sheets at June 30, 2018 and September 30, 2017 are the following intangible assets gross carrying amounts and accumulated amortization:

(Dollars in thousands)	June 30 2018	September 30, 2017
Goodwill	\$381,420	377,879
Intangible assets with determinable lives:		
Patents		
Gross carrying amount	\$973	928
Less: accumulated amortization	773	750
Net	\$200	178
Capitalized software		
Gross carrying amount	\$68,876	63,007
Less: accumulated amortization	39,757	34,382
Net	\$29,119	28,625
Customer relationships		
Gross carrying amount	\$185,055	181,891
Less: accumulated amortization	45,066	37,364
Net	\$139,989	144,527
Other		
Gross carrying amount	\$5,316	5,373
Less: accumulated amortization	1,899	1,383
Net	\$3,417	3,990
Intangible assets with indefinite lives:		
Trade names	\$173,149	173,813

The changes in the carrying amount of goodwill attributable to each business segment for the nine months ended June 30, 2018 is as follows:

(Dollars in millions)	USG	Test	Filtration	Packaging	Total
Balance as of September 30, 2017	250.2	34.1	73.7	19.9	377.9
Acquisition activity	3.8	-	-	-	3.8
Foreign currency translation	(0.1)	-	-	(0.2)	(0.3)
Balance as of June 30, 2018	\$253.9	34.1	73.7	19.7	381.4

7. BUSINESS SEGMENT INFORMATION

The Company is organized based on the products and services that it offers, and classifies its business operations in four reportable segments for financial reporting purposes: Filtration/Fluid Flow (Filtration), RF Shielding and Test (Test), Utility Solutions Group (USG) and Technical Packaging. The Filtration segment's operations consist of PTI Technologies Inc. (PTI), VACCO Industries (VACCO), Crissair, Inc. (Crissair), Westland Technologies Inc. (Westland), Mayday Manufacturing Co. and its affiliate Hi-Tech Metals, Inc. (collectively referred to as Mayday). The companies within this segment primarily design and manufacture specialty filtration products, including hydraulic filter elements used in commercial aerospace applications, unique filter mechanisms used in micro-propulsion devices for satellites and custom designed filters for manned and unmanned aircraft; manufacture elastomeric-based signature reduction solutions for the U.S. Navy; and manufacture landing gear components for the aerospace and defense industry. The Test segment's operations consist primarily of ETS-Lindgren Inc. (ETS-Lindgren). ETS-Lindgren is an industry leader in providing its customers with the ability to identify, measure and contain magnetic, electromagnetic and acoustic energy. The USG segment's operations consist primarily of Doble Engineering Company (Doble), Morgan Schaffer Inc. (Morgan Schaffer), and NRG Systems, Inc. (NRG). Doble provides high-end, intelligent diagnostic test solutions for the electric power delivery industry and is a leading supplier of partial discharge testing instruments used to assess the integrity of high voltage power delivery equipment. Morgan Schaffer provides an integrated offering of dissolved gas analysis, oil testing, and data management solutions for the electric power industry. NRG designs and manufactures decision support tools for the renewable energy industry, primarily wind. The Technical Packaging segment's operations consist of Thermoform Engineered Quality LLC (TEQ) and Plastique Limited and Plastique Sp. z o.o. (together, Plastique). The companies within this segment provide innovative solutions to the medical and commercial markets for thermoformed packages and specialty products using a wide variety of thin gauge plastics and pulp.

Management evaluates and measures the performance of its reportable segments based on “Net Sales” and “EBIT”, which are detailed in the table below. EBIT is defined as earnings before interest and taxes.

	Three Months		Nine Months	
	Ended June 30,		Ended June 30,	
(In thousands)	2018	2017	2018	2017
<u>NET SALES</u>				