Kimball Electronics, Inc.
Form 10-Q
May 03, 2018

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-Q
(Mark One)
x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended March 31, 2018
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 001-36454
KIMBALL ELECTRONICS, INC.
(Exact name of registrant as specified in its charter)

Indiana	35-2047713
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
1205 Kimball Boulevard, Jasper, Indiana	47546
(Address of principal executive offices)	(Zip Code)

(812) 634-4000
Registrant's telephone number, including area code
Not Applicable
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 x No o

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 x No o

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

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

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. 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 x

The number of shares outstanding of the Registrant’s common stock as of April 23, 2018 was 26,694,649 shares.

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

KIMBALL ELECTRONICS, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(Amounts in Thousands, Except for Share Data)

	(Unaudited) March 31, 2018	June 30, 2017
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 44,244	$ 44,555
Receivables, net of allowances of $410 and $284, respectively	189,502	169,785
Inventories	193,240	144,606
Prepaid expenses and other current assets	25,243	29,219
Total current assets	452,229	388,165
Property and Equipment, net of accumulated depreciation of $198,017 and $180,028, respectively	141,943	137,549
Goodwill	6,191	6,191
Other Intangible Assets, net of accumulated amortization of $27,093 and $26,392, respectively	4,533	4,581
Other Assets	16,159	18,458
Total Assets	$ 621,055	$ 554,944
LIABILITIES AND SHARE OWNERS' EQUITY		
Current Liabilities:		
Borrowings under credit facilities	$ 16,250	$ 10,000
Accounts payable	190,775	154,619
Accrued expenses	32,050	34,630
Total current liabilities	239,075	199,249
Other Liabilities:		
Long-term income taxes payable	11,786	—
Other long-term liabilities	13,076	13,423
Total other liabilities	24,862	13,423
Share Owners' Equity:		
Preferred stock-no par value Shares authorized: 15,000,000 Shares issued: None	—	—
Common stock-no par value Shares authorized: 150,000,000 Shares issued: 29,430,000	—	—
Additional paid-in capital	302,828	302,483
Retained earnings	93,590	82,671
Accumulated other comprehensive loss	(1,229)	(9,084)
Treasury stock, at cost: Shares: 2,735,000 and 2,592,000, respectively	(38,071)	(33,798)
Total Share Owners' Equity	357,118	342,272
Total Liabilities and Share Owners' Equity	$ 621,055	$ 554,944

See Notes to Condensed Consolidated Financial Statements.

KIMBALL ELECTRONICS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(Amounts in Thousands, Except for Per Share Data)

	Three Months Ended March 31		Nine Months Ended March 31	
(Unaudited)	2018	2017	2018	2017
Net Sales	$283,938	$232,930	$795,293	$689,646
Cost of Sales	261,011	214,212	731,914	632,053
Gross Profit	22,927	18,718	63,379	57,593
Selling and Administrative Expenses	11,716	9,179	32,385	26,996
Other General Income	—	—	—	(4,005)
Operating Income	11,211	9,539	30,994	34,602
Other Income (Expense):				
Interest income	14	11	50	48
Interest expense	(140)	(52)	(369)	(151)
Non-operating income (expense), net	2,044	373	3,875	184
Other income (expense), net	1,918	332	3,556	81
Income Before Taxes on Income	13,129	9,871	34,550	34,683
Provision for Income Taxes	2,294	1,754	23,582	8,632
Net Income	$10,835	$8,117	$10,968	$26,051
Earnings Per Share of Common Stock:				
Basic	$0.41	$0.30	$0.41	$0.94
Diluted	$0.40	$0.30	$0.41	$0.94
Average Number of Shares Outstanding:				
Basic	26,714	27,266	26,779	27,565
Diluted	26,846	27,416	27,006	27,655

See Notes to Condensed Consolidated Financial Statements.

KIMBALL ELECTRONICS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(Amounts in Thousands)

	Three Months Ended March 31, 2018			Three Months Ended March 31, 2017		
(Unaudited)	Pre-tax	Tax	Net of Tax	Pre-tax	Tax	Net of Tax
Net income			$10,835			$8,117
Other comprehensive income (loss):						
Foreign currency translation adjustments	$2,699	$—	$2,699	$1,246	$—	$1,246
Tax Reform impact	—	49	49	—	—	—
Postemployment severance actuarial change	134	(49)	85	89	(34)	55
Derivative gain (loss)	1,009	(321)	688	2,476	(749)	1,727
Reclassification to (earnings) loss:						
Derivatives	457	(57)	400	(245)	(8)	(253)
Amortization of actuarial change	(93)	41	(52)	(81)	31	(50)
Other comprehensive income (loss)	$4,206	$(337)	$3,869	$3,485	$(760)	$2,725
Total comprehensive income			$14,704			$10,842

	Nine Months Ended March 31, 2018			Nine Months Ended March 31, 2017		
(Unaudited)	Pre-tax	Tax	Net of Tax	Pre-tax	Tax	Net of Tax
Net income			$10,968			$26,051
Other comprehensive income (loss):						
Foreign currency translation adjustments	$7,561	$—	$7,561	$(3,272)	$—	$(3,272)
Tax Reform impact	—	49	49	—	—	—
Postemployment severance actuarial change	398	(146)	252	401	(151)	250
Derivative gain (loss)	(1,033)	276	(757)	2,210	(421)	1,789
Reclassification to (earnings) loss:						
Derivatives	961	(56)	905	651	(329)	322
Amortization of actuarial change	(258)	103	(155)	(255)	96	(159)
Other comprehensive income (loss)	$7,629	$226	$7,855	$(265)	$(805)	$(1,070)
Total comprehensive income			$18,823			$24,981

See Notes to Condensed Consolidated Financial Statements.

KIMBALL ELECTRONICS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Amounts in Thousands)

	Nine Months Ended March 31	
(Unaudited)	2018	2017
Cash Flows From Operating Activities:		
Net income	$10,968	$26,051
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	19,579	17,501
Gain on sales of assets	(17)	(42)
Deferred income tax and other deferred charges	2,793	(1,221)
Stock-based compensation	3,867	2,715
Bargain purchase gain	—	(925)
Other, net	236	255
Change in operating assets and liabilities:		
Receivables	(18,193)	(13,559)
Inventories	(47,049)	(10,125)
Prepaid expenses and other current assets	3,388	(676)
Accounts payable	36,011	10,929
Accrued expenses and taxes payable	9,305	3,839
Net cash provided by operating activities	20,888	34,742
Cash Flows From Investing Activities:		
Capital expenditures	(21,505)	(25,102)
Proceeds from sales of assets	218	203
Payments for acquisitions, net of cash acquired	—	(2,138)
Purchases of capitalized software	(567)	(911)
Other, net	31	27
Net cash used for investing activities	(21,823)	(27,921)
Cash Flows From Financing Activities:		
Proceeds from credit facilities	—	4,000
Payments on credit facilities	—	(13,000)
Net change in revolving credit facilities	6,250	6,500
Repurchases of common stock	(6,460)	(17,320)
Repurchase of employee shares for tax withholding	(1,508)	(709)
Net cash used for financing activities	(1,718)	(20,529)
Effect of Exchange Rate Change on Cash and Cash Equivalents	2,342	(974)
Net Decrease in Cash and Cash Equivalents	(311)	(14,682)
Cash and Cash Equivalents at Beginning of Period	44,555	54,738
Cash and Cash Equivalents at End of Period	$44,244	$40,056
Supplemental Disclosure of Cash Flow Information		
Cash paid during the period for:		
Income taxes	$12,305	$4,394
Interest expense	$281	$159

See Notes to Condensed Consolidated Financial Statements.

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KIMBALL ELECTRONICS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)
Note 1. Business Description and Summary of Significant Accounting Policies
Business Description:
Kimball Electronics, Inc. (also referred to herein as “Kimball Electronics,” the “Company,” “we,” “us,” or “our”) is a global contract electronic manufacturing services (“EMS”) company that specializes in producing durable electronics for the automotive, medical, industrial, and public safety end markets. We offer a package of value that begins with our core competency of producing “durable electronics” and includes our set of robust processes and procedures that help us ensure that we deliver the highest levels of quality, reliability, and service throughout the entire life cycle of our customers’ products. We have been producing safety critical electronic assemblies for our automotive customers for over 30 years. We are well recognized by customers and industry trade publications for our excellent quality, reliability, and innovative service.
Basis of Presentation:
The Condensed Consolidated Financial Statements presented herein reflect the consolidated financial position as of March 31, 2018 and June 30, 2017, results of operations for the three and nine months ended March 31, 2018 and 2017, and cash flows for the nine months ended March 31, 2018 and 2017. The financial data presented herein is unaudited and should be read in conjunction with the annual Consolidated Financial Statements as of and for the year ended June 30, 2017 and related notes thereto included in our Annual Report on Form 10-K. As such, certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America (“U.S. GAAP”) have been condensed or omitted, although we believe that the disclosures are adequate to make the information presented not misleading. Intercompany transactions and balances have been eliminated. Management believes the financial statements include all adjustments (consisting only of normal recurring adjustments) considered necessary to present fairly the financial statements for the interim periods. The results of operations for the interim periods shown in this report are not necessarily indicative of results for any future interim period or for the entire fiscal year.
Notes Receivable and Trade Accounts Receivable:
Notes receivable and trade accounts receivable are recorded per the terms of the agreement or sale, and accrued interest is recognized when earned. We determine on a case-by-case basis the cessation of accruing interest, the resumption of accruing interest, the method of recording payments received on nonaccrual receivables, and the delinquency status for our limited number of notes receivable.
In the ordinary course of business, customers periodically negotiate extended payment terms on trade accounts receivable. Customary terms require payment within 30 to 45 days, with any terms beyond 45 days being considered extended payment terms. We may utilize accounts receivable factoring arrangements with third-party financial institutions in order to extend terms for the customer without negatively impacting our cash flow. These arrangements in all cases do not contain recourse provisions which would obligate us in the event of our customers’ failure to pay. Receivables are considered sold when they are transferred beyond the reach of Kimball Electronics and its creditors, the purchaser has the right to pledge or exchange the receivables, and we have surrendered control over the transferred receivables. In the nine months ended March 31, 2018 and 2017, we sold, without recourse, $120.1 million and $107.8 million of accounts receivable, respectively. Factoring fees were not material.
The Company’s China operation, in limited circumstances, may receive banker’s acceptance drafts from customers as payment for their trade accounts receivable. The banker’s acceptance drafts are non-interest bearing and primarily mature within six months from the origination date. The Company has the ability to sell the drafts at a discount or transfer the drafts in settlement of current accounts payable prior to the scheduled maturity date. These drafts, which totaled $5.4 million at March 31, 2018 and $5.3 million at June 30, 2017, are reflected in Receivables on the Condensed Consolidated Balance Sheets until the banker’s drafts are sold at a discount, transferred in settlement of current accounts payable, or cash is received at maturity. Banker’s acceptance drafts sold at a discount or transferred in settlement of current accounts payable during the nine months ended March 31, 2018 and 2017 were $4.0 million and $6.8 million, respectively. See Note 4 - Commitments and Contingent Liabilities of Notes to Condensed Consolidated

Financial Statements for more information on banker’s acceptance drafts.

Other General Income:

Other General Income in the nine months ended March 31, 2017 included $4.0 million of pre-tax income resulting from a payment received related to a class action lawsuit in which Kimball Electronics was a class member. The lawsuit alleged that certain suppliers to the EMS industry conspired over a number of years to raise and fix the prices of electronic components, resulting in overcharges to purchasers of those components. No Other General Income was recorded in the nine months ended March 31, 2018.

Non-operating Income (Expense), net:

Non-operating income (expense), net includes the impact of such items as foreign currency rate movements and related derivative gain or loss, fair value adjustments on supplemental employee retirement plan (“SERP”) investments, bank charges, and other miscellaneous non-operating income and expense items that are not directly related to operations. The bargain purchase gain on acquisition relates to the acquisition of Aircom Manufacturing, Inc. during the nine months ended March 31, 2017 and resulted from the estimated fair values of the assets acquired and liabilities recorded being greater than the consideration paid. For more information on the bargain purchase gain, refer to our Annual Report on Form 10-K for the year ended June 30, 2017. The gain on SERP investments is offset by a change in the SERP liability that is recognized in Selling and Administrative Expenses.

Components of Non-operating income (expense), net:

	Three Months Ended March 31		Nine Months Ended March 31	
(Amounts in Thousands)	2018	2017	2018	2017
Foreign currency/derivative gain (loss)	$2,093	$37	$3,487	$(1,433)
Gain on supplemental employee retirement plan investments	21	423	606	682
Bargain purchase gain on acquisition	—	—	—	925
Other	(70)	(87)	(218)	10
Non-operating income (expense), net	$2,044	$373	$3,875	$184

Income Taxes:

In determining the quarterly provision for income taxes, we use an estimated annual effective tax rate which is based on expected annual income, statutory tax rates, and available tax planning opportunities in the various jurisdictions in which we operate. Unusual or infrequently occurring items are separately recognized in the quarter in which they occur.

The U.S. Tax Cuts and Jobs Act (“Tax Reform”) was enacted into law on December 22, 2017. Tax Reform makes broad and complex changes to the U.S. tax code, for which complete guidance may have not yet been issued. Tax Reform will affect our current fiscal year ending June 30, 2018, including, but not limited to, (i) reducing the U.S. corporate statutory tax rate, (ii) requiring a one-time transition tax on certain unremitted earnings of foreign subsidiaries that is payable over an eight-year period, (iii) eliminating U.S. federal income taxes on dividends from foreign subsidiaries, and (iv) bonus depreciation that will allow for full expensing of qualifying property. Tax Reform reduces the U.S. corporate statutory tax rate from 35% to 21%. For our fiscal year ending June 30, 2018, we have a blended corporate tax rate of 28.1%, which is based on the applicable tax rates before and after Tax Reform and the number of days in the year.

The Company has made reasonable estimates of certain effects and, therefore, recorded provisional adjustments including the revaluation of its net deferred tax assets at the new applicable rates and the one-time deemed repatriation tax on accumulated unremitted foreign earnings. Approximately $3.7 million of additional tax expense was recorded for the nine months ended March 31, 2018 for the revaluation of the net deferred tax assets, which includes a $0.1 million benefit associated with a measurement period adjustment recorded during the three-month period ended March 31, 2018. The Company recorded during the nine months ended March 31, 2018 approximately $12.8 million of tax expense for the deemed repatriation tax, of which $11.8 million of the tax payable was recorded in Long-term income taxes payable on the Condensed Consolidated Balance Sheet. The one-time deemed repatriation tax is based on 15.5% of the accumulated unremitted foreign earnings held in foreign cash and other liquid assets and 8.0% of the residual accumulated unremitted foreign earnings. Both the revaluation of the net deferred tax assets and the deemed repatriation tax were treated as discrete items and were recognized in Provision for Income Taxes on the Condensed Consolidated Statements of Income for the nine months ended March 31, 2018. The measurement period adjustment to the revaluation of the net deferred tax assets was treated as a discrete item and the benefit was recognized in Provision for

Income Taxes on the Condensed Consolidated Statements of Income for the three months ended March 31, 2018. The Company considers these provisional recorded amounts to be reasonable estimates as of March 31, 2018, and these amounts could be affected by additional information and other analysis related to Tax Reform. As a result, these amounts could be adjusted during the measurement period ending December 2018.

Tax Reform also subjects U.S. corporations to tax on Global Intangible Low-Taxed Income ("GILTI"), which imposes tax on foreign earnings in excess of a deemed return on tangible assets. Due to the complexity of the new GILTI tax rules, the Company is continuing to evaluate this provision for which no provisional amounts have been recorded in the Company's Condensed Consolidated Financial Statements. An accounting policy election can be made to either record deferred taxes related to GILTI or to record the related taxes in the period in which they occur. The Company has not yet elected an accounting policy related to GILTI and will only do so after completion of further evaluation and analysis. The provisions related to GILTI are subject to adjustment during the measurement period ending December 2018.

The Company entered into a Tax Matters Agreement with Kimball International, Inc. (our "former Parent") that governs the Company's rights and obligations after the spin-off from former Parent on October 31, 2014 with respect to tax liabilities and benefits, tax attributes, tax contests, and other tax sharing regarding income taxes, other tax matters, and related tax returns. The Company will continue to have joint and several liabilities with former Parent with the IRS and certain U.S. state tax authorities for U.S. federal income and state taxes for the taxable periods in which the Company was a part of former Parent's consolidated group. The tax matters agreement specifies the portion, if any, of this liability for which the Company bears responsibility, and former Parent has agreed to indemnify the Company against any amounts for which the Company is not responsible. As of both March 31, 2018 and June 30, 2017, the Company has a receivable from Kimball International recorded for $0.6 million, of which $0.5 million is a long-term receivable, and was recorded in Other Assets on the Condensed Consolidated Balance Sheets, relating to benefits from domestic research and development tax credits.

"Emerging Growth Company" Reporting Requirements:

The Company qualifies as an "emerging growth company" as defined in the Jumpstart Our Business Startups Act (the "JOBS Act"). For as long as a company is deemed to be an "emerging growth company," it may take advantage of specified reduced reporting and other regulatory requirements that are generally unavailable to other public companies. Among other things, we are not required to provide an auditor attestation report on the assessment of the internal control over financial reporting under Section 404(b) of the Sarbanes-Oxley Act of 2002 (the "Sarbanes-Oxley Act").

Section 107 of the JOBS Act also provides that an "emerging growth company" can delay the adoption of certain accounting standards until those standards would otherwise apply to private companies. We have elected to take advantage of this extended transition period. Our financial statements may therefore not be comparable to those of companies that comply with such new or revised accounting standards.

We would cease to be an "emerging growth company" upon the earliest of:

- the last day of the fiscal year following the fifth anniversary of the date of the first sale of our common stock pursuant to an effective registration statement filed under the Securities Act, or June 30, 2020;
- the last day of the fiscal year in which our total annual gross revenues exceed $1.07 billion;
- the date on which we have, during the previous three-year period, issued more than $1 billion in non-convertible debt securities; or
- the date on which we become a "large accelerated filer," as defined in Rule 12b-2 under the Securities and Exchange Act of 1934, as amended (the "Exchange Act"), which would occur if the market value of our common stock held by non-affiliates exceeds $700 million as of the last day of our most recently completed second fiscal quarter.

We continue to monitor our status as an "emerging growth company" and are currently preparing, and expect to be ready, to comply with the additional reporting and regulatory requirements that will be applicable to us when we cease to qualify as an "emerging growth company."

New Accounting Standards:
In February 2018, the Financial Accounting Standards Board ("FASB") issued guidance on accounting for the reclassification of certain tax effects from accumulated other comprehensive income. The objective of this guidance is to allow a reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects resulting from Tax Reform. For all companies, the guidance is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Early adoption is permitted in any interim or annual period. If a company elects to reclassify the stranded tax effects, the guidance offers two acceptable adoption methods: (i) at the beginning of the period, annual or interim, of adoption; or (ii) retrospectively to each period or periods in which the tax effects of Tax Reform related to items remaining in accumulated other comprehensive income are recognized. The Company elected to early adopt this guidance at the beginning of its third quarter of fiscal year 2018 and reclassified its stranded tax effects from accumulated other comprehensive income to retained earnings as of January 1, 2018. The components of the Company's accumulated other comprehensive income that had stranded tax effects as a result of the change in the federal corporate tax rate due to Tax Reform were derivative gain (loss) and post employment benefits net actuarial gain. Upon adoption of this guidance, a net cumulative-effect adjustment of, in thousands, $49 was recorded to the Company's retained earnings as of January 1, 2018. This cumulative-effect adjustment decreased Retained earnings and decreased Accumulated other comprehensive loss on the Condensed Consolidated Balance Sheet. There was no impact to net income nor earnings per share of common stock as a result of the adoption of this guidance.
In August 2017, the FASB issued guidance on accounting for derivatives and hedging activities. The objective of this guidance is to better align a company's risk management activities and financial reporting for hedging relationships, simplify the hedge accounting requirements, and improve the disclosures of hedging arrangements. For public companies, the guidance is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. For as long as we remain an "emerging growth company" the new guidance will be effective for our fiscal year 2020 annual financial statements and for interim statements beginning in fiscal year 2021. Early adoption is permitted. We are currently evaluating the impact of the adoption of this guidance on our consolidated financial statements.
In March 2016, the FASB issued guidance on accounting for share-based payment transactions. The objective of this guidance is to simplify certain aspects of the accounting for share-based payment transactions, including the treatment of excess income tax benefits and deficiencies, allowing an election to account for forfeitures as they occur, and classification of excess tax benefits on the statement of cash flows. For public companies, the guidance is effective for fiscal years beginning after December 15, 2016, including interim periods within those fiscal years. Early adoption is permitted in any interim or annual period. The Company adopted this guidance effective July 1, 2017. There was no impact on the Company's financial statements upon the initial adoption as there were no tax benefits that were not previously recognized because the related tax deduction had not reduced taxes payable, and therefore no cumulative-effect adjustment to the Company's beginning retained earnings was required. The Company has elected to reverse the compensation cost of any forfeited awards when they occur and will classify the cash flows related to excess tax benefits for share-based payment arrangements as cash flows from operating activities on a prospective basis. The new guidance requires prospective application of the tax effects of differences recognized on or after the effective date between the deduction for an award for tax purposes and the compensation costs of that award recognized for financial reporting purposes. As a result, during the nine months ended March 31, 2018, the Company recorded a discrete income tax adjustment related to the excess tax benefit on performance shares granted of $0.6 million in Provision for Income Taxes on the Condensed Consolidated Statements of Income, or $0.02 per diluted share. Due to including the income tax effects from excess tax benefits in the provision for income taxes, the effects of the excess tax benefits are no longer included in the calculation of diluted shares outstanding, which generally will result in an increase in the number of diluted shares outstanding. The Company adopted this change in the method of calculating diluted shares outstanding on a prospective basis.
In February 2016, the FASB issued guidance on leases. The new guidance requires lessees to recognize assets and liabilities on the balance sheet for the rights and obligations created by those leases with terms of more than 12 months. Under the current guidance, only capital leases are recognized on the balance sheet. The new guidance

requires additional qualitative and quantitative disclosures. For public companies, the guidance is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. For as long as we remain an “emerging growth company” the new guidance will be effective for our fiscal year 2020 annual financial statements and for interim statements beginning in fiscal year 2021. Early application is permitted. We are currently evaluating the impact of the adoption of this guidance on our consolidated financial statements.

In November 2015, the FASB issued guidance on the balance sheet classification of deferred taxes. Under the current guidance, deferred tax liabilities and assets must be separated into current and noncurrent amounts in a classified statement of financial position. The new guidance requires deferred tax liabilities and assets be classified as noncurrent in a classified statement of financial position. The new guidance does not change the requirement that deferred tax liabilities and assets of a tax-paying component of an entity to be offset and presented as a single amount. For public companies, the guidance is effective for financial statements issued for annual periods beginning after December 15, 2016, including interim periods within those annual periods. For as long as we remain an "emerging growth company" the guidance is effective for our fiscal year 2019 annual financial statements and interim periods within our fiscal year 2020 financial statements, with earlier application permitted as of the beginning of an interim or annual reporting period. The guidance offers two acceptable adoption methods: (i) retrospective adoption to all periods presented; or (ii) prospective adoption to all deferred tax liabilities and assets. We do not expect the adoption of this standard to have a material effect on our financial position, results of operations, or cash flows.

In July 2015, the FASB issued guidance on Simplifying the Measurement of Inventory. The guidance amends the subsequent measurement of inventory from the lower of cost or market to the lower of cost and net realizable value. Under the current guidance, market value could be replacement cost, net realizable value, or net realizable value less an approximately normal profit margin. Within the scope of the new guidance, an entity should measure inventory at the lower of cost and net realizable value. Net realizable value is the estimated selling prices in the ordinary course of business, less reasonably predictable costs of completion, disposal, and transportation. For public companies, the guidance is effective for fiscal years beginning after December 15, 2016, including interim periods within those fiscal years. For as long as we remain an "emerging growth company" the guidance is effective for our fiscal year 2018 annual financial statements and for interim statements beginning in fiscal year 2019. Early application is permitted as of the beginning of an interim or annual reporting period. We do not expect the adoption of this standard to have a material effect on our financial position, results of operations, or cash flows.

In May 2014, the FASB issued guidance on the recognition of revenue from contracts with customers. The core principle of the guidance is that a company should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration which the company expects to receive in exchange for those goods or services. To achieve this core principle, the guidance provides a five-step analysis of transactions to determine when and how revenue is recognized. The guidance addresses several areas including transfer of control, contracts with multiple performance obligations, and costs to obtain and fulfill contracts. The guidance also requires additional disclosure about the nature, amount, timing, and uncertainty of revenue and cash flows arising from customer contracts, including significant judgments and changes in judgments and assets recognized from costs incurred to obtain or fulfill a contract. In August 2015, the FASB issued additional guidance deferring the effective date for one year while allowing entities the option to adopt one year early. For public companies, the guidance is effective for annual reporting periods beginning after December 15, 2017, including interim periods within that annual reporting period. For as long as we remain an "emerging growth company" the guidance will be effective for our fiscal year 2020 annual financial statements and for interim periods beginning in fiscal year 2021. The Company continues to evaluate the impact the adoption of this new standard will have on its consolidated financial statements; however, it anticipates, for the majority of its contracts for manufacturing services, it will change from a point-in-time recognition method upon transfer of title to an over-time model based on the progress of completing customer orders. We believe the adoption of the standard will have a material effect on the Company's consolidated financial statements primarily from the recognition of contract assets for unbilled receivables and a corresponding reduction in inventories. Under the guidance there are two acceptable adoption methods: (i) full retrospective adoption to each prior reporting period presented with the option to elect certain practical expedients; or (ii) modified retrospective adoption with the cumulative effect of initially applying the guidance recognized at the date of initial application and providing certain additional disclosures. We presently expect to adopt this new guidance utilizing the modified retrospective approach.

Note 2. Inventories

Inventories are valued using the lower of first-in, first-out ("FIFO") cost or market value. Inventory components were as follows:

(Amounts in Thousands)	March 31, 2018	June 30, 2017
Finished products	$28,021	$18,916

Work-in-process	16,572	15,480
Raw materials	148,647	110,210
Total inventory	$193,240	$144,606

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Note 3. Accumulated Other Comprehensive Income (Loss)

During the nine months ended March 31, 2018 and 2017, the changes in the balances of each component of Accumulated Other Comprehensive Income (Loss), net of tax, were as follows:

Accumulated Other Comprehensive Income (Loss)

(Amounts in Thousands)	Foreign Currency Translation Adjustments	Derivative Gain (Loss)	Post Employment Benefits Net Actuarial Gain	Accumulated Other Comprehensive Income (Loss)
Balance at June 30, 2017	$ (6,876)	$ (2,788)	$ 580	$ (9,084)
Tax Reform impact [1]	—	(81)	130	49
Other comprehensive income (loss) before reclassifications	7,561	(757)	252	7,056
Reclassification to (earnings) loss	—	905	(155)	750
Net current-period other comprehensive income (loss)	7,561	67	227	7,855
Balance at March 31, 2018	$ 685	$ (2,721)	$ 807	$ (1,229)
Balance at June 30, 2016	$ (9,653)	$ (3,137)	$ 600	$ (12,190)
Other comprehensive income (loss) before reclassifications	(3,272)	1,789	250	(1,233)
Reclassification to (earnings) loss	—	322	(159)	163
Net current-period other comprehensive income (loss)	(3,272)	2,111	91	(1,070)
Balance at March 31, 2017	$ (12,925)	$ (1,026)	$ 691	$ (13,260)

(1) In the third quarter of fiscal year 2018, the Company adopted a new accounting standard on accounting for the reclassification of certain tax effects from accumulated other comprehensive income related to Tax Reform. See Note 1 – Business Description and Summary of Significant Accounting Policies of Notes to Condensed Consolidated Financial Statements for further information on the adoption of new accounting standards and Tax Reform.

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The following reclassifications were made from Accumulated Other Comprehensive Income (Loss) to the Condensed Consolidated Statements of Income:

Reclassifications from Accumulated Other Comprehensive Income (Loss)	Three Months Ended March 31		Nine Months Ended March 31		Affected Line Item in the Condensed Consolidated Statements of Income
(Amounts in Thousands)	2018	2017	2018	2017	
Derivative gain (loss) [1]	$(457)	$245	$(961)	$(645)	Cost of Sales
	—	—	—	(6)	Non-operating income (expense), net
	57	8	56	329	Provision for Income Taxes
	$(400)	$253	$(905)	$(322)	Net of Tax
Postemployment Benefits:					
Amortization of actuarial gain [2]	$53	$46	$145	$147	Cost of Sales
	40	35	113	108	Selling and Administrative Expenses
	(41)	(31)	(103)	(96)	Provision for Income Taxes
	$52	$50	$155	$159	Net of Tax
Total reclassifications for the period	$(348)	$303	$(750)	$(163)	Net of Tax

Amounts in parentheses indicate reductions to income.

(1) See Note 6 - Derivative Instruments of Notes to Condensed Consolidated Financial Statements for further information on derivative instruments.

(2) See Note 8 - Postemployment Benefits of Notes to Condensed Consolidated Financial Statements for further information on postemployment benefit plans.

Note 4. Commitments and Contingent Liabilities

Standby letters of credit may be issued to third-party suppliers and insurance institutions and can only be drawn upon in the event of the Company’s failure to pay its obligations to a beneficiary. As of March 31, 2018, we had a maximum financial exposure from unused standby letters of credit totaling $0.4 million. We don’t expect circumstances to arise that would require us to perform under any of these arrangements and believe that the resolution of any claims that might arise in the future, either individually or in the aggregate, would not materially affect our condensed consolidated financial statements. Accordingly, no liability has been recorded as of March 31, 2018 with respect to the standby letters of credit. The Company also may enter into commercial letters of credit to facilitate payments to vendors and from customers.

The Company’s China operation, in limited circumstances, receives banker’s acceptance drafts from customers as settlement for their trade accounts receivable. We in turn may transfer the acceptance drafts to a supplier of ours in settlement of current accounts payable. These drafts contain certain recourse provisions afforded to the transferee under laws of The People’s Republic of China. If a transferee were to exercise its available recourse rights, our China operation would be required to satisfy the obligation with the transferee and the draft would revert back to our China operation. At March 31, 2018, the drafts transferred and outstanding totaled $1.3 million. No transferee has exercised their recourse rights against us. For additional information on banker’s acceptance drafts, see Note 1 – Business Description and Summary of Significant Accounting Policies of Notes to Condensed Consolidated Financial Statements.

We maintain a provision for limited warranty repair or replacement of products manufactured and sold, which has been established in specific manufacturing contract agreements. We estimate product warranty liability at the time of sale based on historical repair or replacement cost trends in conjunction with the length of the warranty offered. Management refines the warranty liability periodically based on changes in historical cost trends and in certain cases where specific warranty issues become known.

Changes in the product warranty accrual for the nine months ended March 31, 2018 and 2017 were as follows:

	Nine Months Ended March 31	
(Amounts in Thousands)	2018	2017
Product warranty liability at the beginning of the period	$593	$605
Additions to warranty accrual (including changes in estimates)	396	398
Settlements made (in cash or in kind)	(135)	(353)
Product warranty liability at the end of the period	$854	$650

Note 5. Fair Value

The Company categorizes assets and liabilities measured at fair value into three levels based upon the assumptions (inputs) used to price the assets or liabilities. Level 1 provides the most reliable measure of fair value, whereas level 3 generally requires significant management judgment. The three levels are defined as follows:

- Level 1: Unadjusted quoted prices in active markets for identical assets and liabilities.
- Level 2: Observable inputs other than those included in level 1. For example, quoted prices for similar assets or liabilities in active markets or quoted prices for identical assets or liabilities in inactive markets.
- Level 3: Unobservable inputs reflecting management's own assumptions about the inputs used in pricing the asset or liability.

Our policy is to recognize transfers between these levels as of the end of each quarterly reporting period. There were no transfers between these levels during the nine months ended March 31, 2018. There were also no changes in the inputs or valuation techniques used to measure fair values during the nine months ended March 31, 2018. For more information on inputs and fair valuation techniques used, refer to our Annual Report on Form 10-K for the year ended June 30, 2017.

Recurring Fair Value Measurements:
As of March 31, 2018 and June 30, 2017, the fair values of financial assets and liabilities that are measured at fair value on a recurring basis using the market approach are categorized as follows:

	March 31, 2018		
(Amounts in Thousands)	Level 1	Level 2	Total
Assets			
Cash equivalents	$1,095	$—	$1,095
Derivatives: foreign exchange contracts	—	1,201	1,201
Trading securities: mutual funds held in nonqualified SERP	8,581	—	8,581
Total assets at fair value	$9,676	$1,201	