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RAVEN INDUSTRIES INC

Form 10-Q

August 23, 2018

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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 July 31, 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: 001-07982

RAVEN INDUSTRIES, INC.

(Exact name of registrant as specified in its charter)

South Dakota

46-0246171

(State or other jurisdiction of incorporation or organization) (I.R.S. Employer Identification No.)

205 East 6th Street, P.O. Box 5107, Sioux Falls, SD 57117-5107

(Address of principal executive offices)

(605) 336-2750

(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 No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of

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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, a 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

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

As of August 17, 2018 there were 35,902,427 shares of common stock, \$1 par value, of Raven Industries, Inc. outstanding. There were no other classes of stock outstanding.

**RAVEN INDUSTRIES, INC.
INDEX**

PAGE

PART I - FINANCIAL INFORMATION

<u>Item 1. Financial Statements:</u>	
<u>Consolidated Balance Sheets (unaudited)</u>	<u>3</u>
<u>Consolidated Statements of Income and Comprehensive Income (unaudited)</u>	<u>4</u>
<u>Consolidated Statements of Shareholders' Equity (unaudited)</u>	<u>5</u>
<u>Consolidated Statements of Cash Flows (unaudited)</u>	<u>6</u>
<u>Notes to Consolidated Financial Statements (unaudited)</u>	<u>7</u>
<u>Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>19</u>
<u>Item 3. Quantitative and Qualitative Disclosures about Market Risks</u>	<u>28</u>
<u>Item 4. Controls and Procedures</u>	<u>29</u>

PART II - OTHER INFORMATION

<u>Item 1. Legal Proceedings</u>	<u>29</u>
<u>Item 1A. Risk Factors</u>	<u>29</u>
<u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u>	<u>29</u>
<u>Item 3. Defaults Upon Senior Securities</u>	<u>29</u>
<u>Item 4. Mine Safety Disclosures</u>	<u>30</u>
<u>Item 5. Other Information</u>	<u>30</u>
<u>Item 6. Exhibits</u>	<u>30</u>
<u>Signatures</u>	<u>31</u>

PART I — FINANCIAL INFORMATION**ITEM 1. FINANCIAL STATEMENTS****RAVEN INDUSTRIES, INC.
CONSOLIDATED BALANCE SHEETS
(unaudited)***(dollars and shares in thousands, except per-share data)*

	July 31, 2018	January 31, 2018
ASSETS		
Current assets		
Cash and cash equivalents	\$65,439	\$ 40,535
Accounts receivable, net	61,348	58,532
Inventories	55,993	55,351
Other current assets	5,372	5,861
Total current assets	188,152	160,279
Property, plant and equipment, net	106,716	106,280
Goodwill	46,438	46,710
Amortizable intangible assets, net	11,772	10,584
Other assets	2,837	2,950
TOTAL ASSETS	\$355,915	\$ 326,803
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities		
Accounts payable	\$14,882	\$ 13,106
Accrued liabilities	21,875	21,946
Other current liabilities	733	1,890
Total current liabilities	37,490	36,942
Other liabilities	16,315	13,795
Commitments and contingencies (see Note 11)	—	—
Shareholders' equity		
Common stock, \$1 par value, authorized shares 100,000; issued 67,229 and 67,124, respectively	67,229	67,124
Paid-in capital	59,489	59,143
Retained earnings	279,438	252,772
Accumulated other comprehensive income (loss)	(3,702)	(2,573)
Treasury stock at cost, 31,332 and 31,332 shares, respectively	(100,402)	(100,402)
Total Raven Industries, Inc. shareholders' equity	302,052	276,064
Noncontrolling interest	58	2
Total equity	302,110	276,066
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	\$355,915	\$ 326,803

The accompanying notes are an integral part of the unaudited consolidated financial statements.

RAVEN INDUSTRIES, INC.
CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME
(unaudited)

	Three Months Ended		Six Months Ended	
	July 31, 2018	July 31, 2017	July 31, 2018	July 31, 2017
<i>(dollars in thousands, except per-share data)</i>				
Net sales	\$102,684	\$86,610	\$213,813	\$180,145
Cost of sales	68,076	60,097	139,207	121,676
Gross profit	34,608	26,513	74,606	58,469
Research and development expenses	6,151	4,256	11,436	8,236
Selling, general, and administrative expenses	11,828	10,557	25,010	20,055
Long-lived asset impairment loss	—	—	—	259
Operating income	16,629	11,700	38,160	29,919
Other (expense) income, net	(139)	(63)	5,540	(293)
Income before income taxes	16,490	11,637	43,700	29,626
Income tax expense	2,769	3,403	7,832	9,044
Net income	13,721	8,234	35,868	20,582
Net income (loss) attributable to the noncontrolling interest	44	(1)	56	(1)
Net income attributable to Raven Industries, Inc.	\$13,677	\$8,235	\$35,812	\$20,583
Net income per common share:				
Basic	\$0.38	\$0.23	\$1.00	\$0.57
Diluted	\$0.38	\$0.23	\$0.98	\$0.56
Cash dividends paid per common share	\$0.13	\$0.13	\$0.26	\$0.26
Comprehensive income (loss):				
Net income	\$13,721	\$8,234	\$35,868	\$20,582
Other comprehensive income (loss):				
Foreign currency translation	(357)	810	(837)	822
Postretirement benefits, net of income tax benefit of \$2, \$3, \$4 and \$7 respectively	(6)	(7)	(12)	(13)
Other comprehensive income (loss), net of tax	(363)	803	(849)	809
Comprehensive income	13,358	9,037	35,019	21,391
Comprehensive income (loss) attributable to noncontrolling interest	44	(1)	56	(1)
Comprehensive income attributable to Raven Industries, Inc.	\$13,314	\$9,038	\$34,963	\$21,392

The accompanying notes are an integral part of the unaudited consolidated financial statements.

#4

RAVEN INDUSTRIES, INC.
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY
(unaudited)

(dollars in thousands, except per-share amounts)	\$1 Par Common Stock	Paid-in Capital	Treasury Stock		Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Raven Industries, Inc. Equity	Non- controlling Interest	Total Equity
	Stock		Shares	Cost					
Balance January 31, 2017	\$ 67,060	\$ 55,795	30,984	\$ (90,402)	\$ 230,649	\$ (3,676)	\$ 259,426	\$ 5	\$ 259,431
Net income	—	—	—	—	20,583	—	20,583	(1)	20,582
Other comprehensive income (loss):									
Cumulative foreign currency translation adjustment	—	—	—	—	—	822	822	—	822
Postretirement benefits reclassified from accumulated other comprehensive income (loss) after tax benefit of \$7	—	—	—	—	—	(13)	(13)	—	(13)
Cash dividends (\$0.26 per share)	—	109	—	—	(9,493)	—	(9,384)	—	(9,384)
Shares issued on stock options exercised, net of shares withheld for employee taxes	12	(160)	—	—	—	—	(148)	—	(148)
Shares issued on vesting of stock units, net of shares withheld for employee taxes	11	(162)	—	—	—	—	(151)	—	(151)
Director shares issued	4	(4)	—	—	—	—	—	—	—
Share-based compensation	—	1,932	—	—	—	—	1,932	—	1,932
Balance July 31, 2017	\$ 67,087	\$ 57,510	30,984	\$ (90,402)	\$ 241,739	\$ (2,867)	\$ 273,067	\$ 4	\$ 273,071
Balance January 31, 2018	\$ 67,124	\$ 59,143	31,332	\$ (100,402)	\$ 252,772	\$ (2,573)	\$ 276,064	\$ 2	\$ 276,066
Net income	—	—	—	—	35,812	—	35,812	56	35,868
Other comprehensive income (loss):									
Cumulative foreign currency translation adjustment	—	—	—	—	—	(837)	(837)	—	(837)
Postretirement benefits reclassified from accumulated other comprehensive income (loss) after tax benefit of \$4	—	—	—	—	—	(12)	(12)	—	(12)
Reclassification due to ASU 2018-02 adoption	—	—	—	—	280	(280)	—	—	—
Cash dividends (\$0.26 per share)	—	100	—	—	(9,426)	—	(9,326)	—	(9,326)
Shares issued on stock options exercised, net of shares withheld for employee taxes	42	(721)	—	—	—	—	(679)	—	(679)
Shares issued on vesting of stock units, net of shares withheld for employee taxes	63	(1,314)	—	—	—	—	(1,251)	—	(1,251)
Share-based compensation	—	2,281	—	—	—	—	2,281	—	2,281
Balance July 31, 2018	\$ 67,229	\$ 59,489	31,332	\$ (100,402)	\$ 279,438	\$ (3,702)	\$ 302,052	\$ 58	\$ 302,110

The accompanying notes are an integral part of the unaudited consolidated financial statements.

RAVEN INDUSTRIES, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(unaudited)

	Six Months Ended	
	July 31,	July 31,
	2018	2017
<i>(dollars in thousands)</i>		
OPERATING ACTIVITIES:		
Net income	\$35,868	\$20,582
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	7,401	7,184
Change in fair value of acquisition-related contingent consideration	403	145
Long-lived asset impairment loss	—	259
Loss from equity investment	—	154
Gain from sale of equity method investment	(5,785)	—
Deferred income taxes	(439)	(942)
Share-based compensation expense	2,281	1,932
Other operating activities, net	(1,987)	174
Change in operating assets and liabilities:		
Accounts receivable	(2,982)	(3,279)
Inventories	(792)	(8,466)
Other assets	74	(1,257)
Operating liabilities	4,610	3,375
Net cash provided by operating activities	38,652	19,861
INVESTING ACTIVITIES:		
Capital expenditures	(6,853)	(5,223)
Proceeds from sale or maturity of investments	6,668	250
Purchases of investments	(164)	(255)
Proceeds (disbursements) from sale of assets, settlement of liabilities	832	(344)
Other investing activities	(1,971)	(17)
Net cash used in investing activities	(1,488)	(5,589)
FINANCING ACTIVITIES:		
Dividends paid	(9,326)	(9,384)
Payments of acquisition-related contingent liability	(499)	(320)
Restricted stock units vested and issued	(679)	(151)
Employee stock option exercises	(1,251)	(148)
Other financing activities	(102)	—
Net cash used in financing activities	(11,857)	(10,003)
Effect of exchange rate changes on cash	(403)	280
Net increase in cash and cash equivalents	24,904	4,549
Cash and cash equivalents at beginning of year	40,535	50,648
Cash and cash equivalents at end of period	\$65,439	\$55,197

The accompanying notes are an integral part of the unaudited consolidated financial statements.

(dollars in thousands, except per-share amounts)

RAVEN INDUSTRIES, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

(dollars in thousands, except per-share amounts)

(1) BASIS OF PRESENTATION AND PRINCIPLES OF CONSOLIDATION

Raven Industries, Inc. (the Company or Raven) is a diversified technology company providing a variety of products to customers within the agricultural, aerospace/defense, construction, geomembrane, industrial, and stratospheric balloon markets. The Company is comprised of three unique operating units, or divisions, classified into reportable segments: Applied Technology, Engineered Films, and AeroStar.

The accompanying interim unaudited consolidated financial statements, which includes the accounts of Raven and its wholly-owned or controlled subsidiaries, net of intercompany balances and transactions, has been prepared by the Company in accordance with generally accepted accounting principles in the United States (GAAP) for interim financial information and the instructions to Form 10-Q and Article 10 of Regulation S-X of the Securities and Exchange Commission (SEC). Accordingly, these financial statements do not include all of the information and notes required by GAAP for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring adjustments) considered necessary to fairly present this financial information have been included. These financial statements should be read in conjunction with the audited consolidated financial statements and the accompanying notes included in the Company's Annual Report on Form 10-K for the fiscal year ended January 31, 2018.

Financial results for the interim three- and six-month periods ended July 31, 2018 are not necessarily indicative of the results that may be expected for the year ending January 31, 2019. The January 31, 2018 consolidated balance sheet was derived from audited financial statements, but does not include all disclosures required in an annual report on Form 10-K. Preparing financial statements in conformity with GAAP requires management to make certain estimates and assumptions. These affect the reported amounts of assets and liabilities as of the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Noncontrolling interests represent capital contributions, income and loss attributable to the owners of less than wholly-owned consolidated entities. The Company owns a 75% interest in an entity consolidated under the AeroStar business segment. Given the Company's controlling financial interest, the accounts of the business venture have been consolidated with the accounts of the Company, and a noncontrolling interest has been recorded for the noncontrolling investor interest in the net assets and operations of the business venture.

(2) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

There have been no material changes to the Company's significant accounting policies as described in the Company's Annual Report on Form 10-K for the fiscal year ended January 31, 2018 other than described in the Accounting Standards Adopted section below.

Accounting Pronouncements

Accounting Standards Adopted

In the fiscal 2019 first quarter, the Company early adopted Financial Accounting Standards Board (FASB) Accounting Standards Update (ASU) No. 2018-02, "Income Statement - Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income" (ASU 2018-02) issued in February 2018. The amendments in this guidance allow for a reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects resulting from the Tax Cuts and Jobs Act (TCJA).

Consequently, the amendments eliminate the stranded tax effects resulting from the TCJA and are intended to improve the usefulness of information reported. The Company elected to apply the amendments in the period of adoption. The Company recorded a \$280 reclassification entry for the stranded tax effects in Accumulated Other Comprehensive Income related to Raven's post-retirement plan further disclosed in the Company's Annual Report in the Form 10-K filed March 23, 2018. The impact of the reclassification is reported as "Reclassification due to ASU 2018-02 adoption" in the Consolidated Statements of Shareholders' Equity.

In the fiscal 2019 first quarter when it became effective, the Company adopted FASB ASU No. 2017-09, "Compensation - Stock Compensation (Topic 718): Scope of Modification Accounting" (ASU 2017-09) on a prospective basis. The guidance amends the scope of modification accounting for share-based payment arrangements. The ASU provides guidance on the types of changes to the terms or conditions of share-based payment awards to which an entity would be required to apply modification accounting under Topic 718. Specifically, an entity would not apply modification accounting if the fair value, vesting conditions, and classification of the awards as equity instruments or liability instruments are the same immediately before and after the modification

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(dollars in thousands, except per-share amounts)

to the award. The Company did not modify any of its outstanding awards during the six-month period ended July 31, 2018; therefore, the adoption of this guidance had no impact on its consolidated financial statements, results of operations, or disclosures.

In the fiscal 2019 first quarter when it became effective, the Company adopted, the FASB ASU No. 2017-07, "Compensation - Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Postretirement Benefit Cost" (ASU 2017-07). The guidance clarifies where the cost components of the net benefit cost should be reported in the income statement and it allows only the service cost to be capitalized. The adoption of this guidance resulted in \$7 and \$14 of the net periodic benefit cost being reported as a charge to operating income and \$71 and \$142 reported as a charge to non-operating income (expense) for the three- and six-months ended July 31, 2018, respectively. The classification of this charge on the Consolidated Statements of Income and Comprehensive Income is described in Note 8 *Employee Retirement Benefits* in the Notes to the Consolidated Financial Statements. The net periodic benefit cost for the prior fiscal year was not material.

In the fiscal 2019 first quarter when it became effective, the Company adopted FASB ASU 2016-16, "Income Taxes (Topic 740) Intra-Entity Transfers of Assets Other Than Inventory" (ASU 2016-16). Previous GAAP prohibits the recognition of current and deferred income taxes for an intra-entity asset transfer until the asset has been sold to an outside party. This prohibition on recognition is an exception to the principle of comprehensive recognition of current and deferred income taxes in GAAP. This new guidance eliminates the exception for an intra-entity transfer of an asset other than inventory. The Company did not have any intra-entity transfers of assets impacted by this guidance, as such the adoption of this guidance had no impact on its consolidated financial statements, results of operations, or disclosures.

In the fiscal 2019 first quarter when it became effective, the Company adopted FASB ASU 2016-15, "Statement of Cash Flows (Topic 230) Classification of Certain Cash Receipts and Cash Payments" (ASU 2016-15). The specific classification issues clarified in the guidance either were not applicable to the Company or are consistent with how the Company previously classified them, therefore the adoption of this guidance had no impact on its consolidated financial statements, results of operations, or disclosures.

In the fiscal 2019 first quarter when it became effective, the Company adopted FASB ASU No. 2016-01, "Financial Instruments—Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities" (ASU 2016-01). The updated accounting guidance requires equity securities to be measured at fair value with changes in the fair value recognized through net income. An entity's equity investments that are accounted for under the equity method of accounting or result in consolidation of an investee are not included within the scope of this update. The impacted financial instruments held at the time of adoption were not material, as such, the adoption of this guidance and the subsequent changes to Subtopic 825-10 in ASU 2018-03 "Technical Corrections and Improvements to Financial Instruments—Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities," did not have a material impact on the Company's consolidated financial statements, results of operations, or disclosures.

In the fiscal 2019 first quarter, the Company adopted ASU No. 2014-09, "Revenue from Contracts with Customers (Topic 606)" (ASU 2014-09). ASU 2014-09 provides a comprehensive new recognition model that requires recognition of revenue when a company transfers promised goods or services to customers in an amount that reflects the consideration which a company expects to receive in exchange for those goods or services. This guidance supersedes the revenue recognition requirements in FASB ASC Topic 605, "Revenue Recognition," and most industry-specific guidance. ASU 2014-09 defines a five-step process to achieve this core principle. It also requires additional disclosure about the nature, amount, timing, and uncertainty of revenue and cash flows arising from customer contracts. The Company adopted ASU 2014-09 on a modified retrospective basis. The comparative

historical information has not been adjusted and continues to be reported under ASC Topic 605 as previously presented. The adoption of ASU 2014-09 did not have a material impact on the Company's consolidated financial statements or results of operations as of the adoption date and for the three- or six months ended July 31, 2018 as a significant majority of our sales revenue is recognized when products are shipped from our manufacturing facilities. As part of our adoption of ASU 2014-09 we have elected the following practical expedients: modified retrospective basis was applied for all contracts that were not completed as of February 1, 2018; shipping and handling costs associated with outbound freight after control over a product has transferred to a customer are considered fulfillment costs included within cost of sales; and taxes that are collected by the Company from a customer, which are assessed by governmental authorities that are both imposed upon and concurrent with a specific revenue-producing transaction, are excluded from revenues. Additional disclosures related to the revenues arising from contracts with customers as required by Topic 606 are included in Note 5 *Revenue*.

New Accounting Standards Not Yet Adopted

In February 2016 the FASB issued ASU No. 2016-02, "Leases (Topic 842)" (ASU 2016-02). The primary difference between previous GAAP and ASU 2016-02 is the recognition of lease assets and lease liabilities by lessees for those leases classified as operating leases under previous GAAP. The guidance requires a lessee to recognize a lease liability (to make lease payments) and a right-of-use asset (representing its right to use the underlying asset for the lease term) on the balance sheet with terms greater than 12 months. ASU 2016-02 is effective for fiscal years beginning after December 15, 2018. In July 2018 the FASB amended Topic 842 to provide entities additional guidance on transition to adopt using either a modified retrospective approach for leases

(dollars in thousands, except per-share amounts)

that exist upon adoption and in the comparative periods presented, or an optional approach to initially apply the new lease guidance upon the adoption date without adjusting the comparative periods presented. The Company is currently evaluating the method and impact the adoption will have on its consolidated financial statements, results of operations, and disclosures.

(3) SELECTED BALANCE SHEET INFORMATION

Following are the components of selected items from the Consolidated Balance Sheets:

	July 31, 2018	January 31, 2018
Accounts receivable, net:		
Trade accounts	\$59,138	\$ 57,063
Unbilled receivables	3,167	2,447
Allowance for doubtful accounts	(957)	(978)
	\$61,348	\$ 58,532
Inventories:		
Finished goods	\$6,709	\$ 8,054
In process	1,406	961
Materials	47,878	46,336
	\$55,993	\$ 55,351
Other current assets:		
Insurance policy benefit	\$714	\$ 759
Income tax receivable	16	1,397
Receivable from sale of investment	1,055	—
Prepaid expenses and other	3,587	3,705