

BRADY CORP
Form 10-Q
February 19, 2016
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the Quarterly Period Ended January 31, 2016

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 1-14959

BRADY CORPORATION
(Exact name of registrant as specified in its charter)

Wisconsin 39-0178960
(State or other jurisdiction of (I.R.S. Employer
incorporation or organization) Identification No.)

6555 West Good Hope Road, Milwaukee, Wisconsin 53223
(Address of principal executive offices) (Zip Code)
(414) 358-6600
(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 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 Smaller reporting company

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

APPLICABLE ONLY TO CORPORATE ISSUERS

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

As of February 18, 2016, there were 46,697,146 outstanding shares of Class A Nonvoting Common Stock and 3,538,628 shares of Class B Voting Common Stock. The Class B Voting Common Stock, all of which is held by

affiliates of the Registrant, is the only voting stock.

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

BRADY CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS

(Dollars in Thousands)

	January 31, 2016 (Unaudited)	July 31, 2015
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 120,198	\$ 114,492
Accounts receivable—net	150,615	157,386
Inventories:		
Finished products	62,127	66,700
Work-in-process	15,445	16,958
Raw materials and supplies	21,681	20,849
Total inventories	99,253	104,507
Prepaid expenses and other current assets	35,843	32,197
Total current assets	405,909	408,582
Other assets:		
Goodwill	427,460	433,199
Other intangible assets	63,630	68,888
Deferred income taxes	16,333	22,310
Other	16,497	18,704
Property, plant and equipment:		
Cost:		
Land	5,012	5,284
Buildings and improvements	92,672	94,423
Machinery and equipment	258,044	270,086
Construction in progress	2,577	2,164
	358,305	371,957
Less accumulated depreciation	256,849	260,743
Property, plant and equipment—net	101,456	111,214
Total	\$ 1,031,285	\$ 1,062,897
LIABILITIES AND STOCKHOLDERS' INVESTMENT		
Current liabilities:		
Notes payable	\$ 4,974	\$ 10,411
Accounts payable	66,189	73,020
Wages and amounts withheld from employees	33,767	30,282
Taxes, other than income taxes	6,682	7,250
Accrued income taxes	5,091	7,576
Other current liabilities	40,429	38,194
Current maturities on long-term debt	—	42,514
Total current liabilities	157,132	209,247
Long-term obligations, less current maturities	247,689	200,774
Other liabilities	63,976	65,188
Total liabilities	468,797	475,209
Stockholders' investment:		

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Class A nonvoting common stock—Issued 51,261,487 and 51,261,487 shares, respectively and outstanding 46,705,559 and 47,781,184 shares, respectively	513	513
Class B voting common stock—Issued and outstanding, 3,538,628 shares	35	35
Additional paid-in capital	314,905	314,403
Earnings retained in the business	427,637	414,069
Treasury stock—4,555,928 and 3,480,303 shares, respectively of Class A nonvoting common stock, at cost	(114,547)	(93,234)
Accumulated other comprehensive loss	(62,355)	(45,034)
Other	(3,700)	(3,064)
Total stockholders' investment	562,488	587,688
Total	\$1,031,285	\$1,062,897

See Notes to Condensed Consolidated Financial Statements.

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BRADY CORPORATION AND SUBSIDIARIES
 CONDENSED CONSOLIDATED STATEMENTS OF EARNINGS
 (Dollars in Thousands, Except Per Share Amounts)

	Three months ended January 31, (Unaudited)		Six months ended January 31, (Unaudited)	
	2016	2015	2016	2015
Net sales	\$268,630	\$282,628	\$551,703	\$592,868
Cost of products sold	135,738	144,425	279,462	304,503
Gross margin	132,892	138,203	272,241	288,365
Operating expenses:				
Research and development	9,097	8,948	17,666	18,579
Selling, general and administrative	100,206	107,565	200,884	216,846
Restructuring charges	—	4,879	—	9,157
Total operating expenses	109,303	121,392	218,550	244,582
Operating income	23,589	16,811	53,691	43,783
Other (expense) income:				
Investment and other (expense) income	(992	) 211	(1,751	) 535
Interest expense	(2,130	) (3,000	) (4,281	) (5,891
Earnings from continuing operations before income taxes	20,467	14,022	47,659	38,427
Income tax expense	5,177	2,438	13,666	11,344
Earnings from continuing operations	\$15,290	\$11,584	\$33,993	\$27,083
Loss from discontinued operations, net of income taxes	—	—	—	(1,915
Net earnings	\$15,290	\$11,584	\$33,993	\$25,168
Earnings from continuing operations per Class A Nonvoting Common Share:				
Basic	\$0.30	\$0.23	\$0.67	\$0.53
Diluted	\$0.30	\$0.23	\$0.67	\$0.53
Earnings from continuing operations per Class B Voting Common Share:				
Basic	\$0.30	\$0.23	\$0.65	\$0.51
Diluted	\$0.30	\$0.23	\$0.65	\$0.51
Loss from discontinued operations per Class A Nonvoting Common Share:				
Basic	\$—	\$—	\$—	\$(0.04
Diluted	\$—	\$—	\$—	\$(0.04
Loss from discontinued operations per Class B Voting Common Share:				
Basic	\$—	\$—	\$—	\$(0.03
Diluted	\$—	\$—	\$—	\$(0.04
Net earnings per Class A Nonvoting Common Share:				
Basic	\$0.30	\$0.23	\$0.67	\$0.49
Diluted	\$0.30	\$0.23	\$0.67	\$0.49
Dividends	\$0.20	\$0.20	\$0.41	\$0.40
Net earnings per Class B Voting Common Share:				
Basic	\$0.30	\$0.23	\$0.65	\$0.48
Diluted	\$0.30	\$0.23	\$0.65	\$0.47
Dividends	\$0.20	\$0.20	\$0.39	\$0.38

Weighted average common shares outstanding (in thousands):

Basic	50,527	51,272	50,778	51,262
Diluted	50,647	51,348	50,868	51,330

See Notes to Condensed Consolidated Financial Statements.

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BRADY CORPORATION AND SUBSIDIARIES
 CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
 (Dollars in Thousands)

	Three months ended January 31, (Unaudited)		Six months ended January 31, (Unaudited)	
	2016	2015	2016	2015
Net earnings	\$15,290	\$11,584	\$33,993	\$25,168
Other comprehensive loss:				
Foreign currency translation adjustments:				
Net loss recognized in other comprehensive loss	(7,463)	(46,816)	(13,946)	(71,120)
Reclassification adjustment for gains included in net earnings	—	—	—	(34,697)
	(7,463)	(46,816)	(13,946)	(105,817)
Net investment hedge translation adjustments	2,671	12,276	3,542	20,427
Long-term intercompany loan translation adjustments:				
Net (loss) gain recognized in other comprehensive loss	(2,396)	2,232	(3,820)	882
Reclassification adjustment for gains included in net earnings	—	—	—	(393)
	(2,396)	2,232	(3,820)	489
Cash flow hedges:				
Net (loss) gain recognized in other comprehensive loss	(302)	1,239	(562)	1,841
Reclassification adjustment for losses (gains) included in net earnings	115	(116)	(342)	(95)
	(187)	1,123	(904)	1,746
Pension and other post-retirement benefits:				
Actuarial gain amortization	(161)	(214)	(323)	(428)
Prior service credit amortization	(414)	(81)	(1,035)	(162)
	(575)	(295)	(1,358)	(590)
Other comprehensive loss, before tax	(7,950)	(31,480)	(16,486)	(83,745)
Income tax expense related to items of other comprehensive loss	(979)	(4,654)	(835)	(7,980)
Other comprehensive loss, net of tax	(8,929)	(36,134)	(17,321)	(91,725)
Comprehensive income (loss)	\$6,361	\$(24,550)	\$16,672	\$(66,557)
See Notes to Condensed Consolidated Financial Statements.				

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BRADY CORPORATION AND SUBSIDIARIES
 CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
 (Dollars in Thousands)

	Six months ended January 31, (Unaudited)	
	2016	2015
Operating activities:		
Net earnings	\$33,993	\$25,168
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	17,502	20,066
Non-cash portion of stock-based compensation expense	4,569	2,471
Non-cash portion of restructuring charges	—	896
Loss on sale of business, net	—	426
Deferred income taxes	3,338	(781)
Changes in operating assets and liabilities (net of effects of business acquisitions/divestitures):		
Accounts receivable	3,204	10,918
Inventories	3,403	(10,840)
Prepaid expenses and other assets	(3,811)	(3,053)
Accounts payable and other liabilities	(1,618)	(15,423)
Income taxes	(2,326)	(5,918)
Net cash provided by operating activities	58,254	23,930
Investing activities:		
Purchases of property, plant and equipment	(3,928)	(17,808)
Sale of business, net of cash retained	—	6,111
Other	2,521	4,173
Net cash used in investing activities	(1,407)	(7,524)
Financing activities:		
Payment of dividends	(20,425)	(20,449)
Proceeds from issuance of common stock	53	847
Purchases of treasury stock	(23,397)	—
(Repayments) proceeds from borrowing on credit facilities	(437)	29,428
Debt issuance costs	(803)	—
Income tax on equity-based compensation, and other	(1,299)	(3,830)
Net cash (used in) provided by financing activities	(46,308)	5,996
Effect of exchange rate changes on cash	(4,833)	(10,937)
Net increase in cash and cash equivalents	5,706	11,465
Cash and cash equivalents, beginning of period	114,492	81,834
Cash and cash equivalents, end of period	\$120,198	\$93,299

See Notes to Condensed Consolidated Financial Statements

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BRADY CORPORATION AND SUBSIDIARIES
 NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
 Six Months Ended January 31, 2016

(Unaudited)

(In thousands, except share and per share amounts)

NOTE A — Basis of Presentation

The condensed consolidated financial statements included herein have been prepared by Brady Corporation and subsidiaries (the "Company," "Brady," "we," or "our") without audit, pursuant to the rules and regulations of the Securities and Exchange Commission. In the opinion of the Company, the foregoing statements contain all adjustments, consisting only of normal recurring adjustments necessary to present fairly the financial position of the Company as of January 31, 2016 and July 31, 2015, its results of operations and comprehensive income (loss) for the three and six months ended January 31, 2016 and 2015, and cash flows for the six months ended January 31, 2016 and 2015. The consolidated balance sheet as of July 31, 2015 has been derived from the audited consolidated financial statements of that date. The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America ("GAAP") requires management to make estimates and assumptions that affect the reported amounts therein. Due to the inherent uncertainty involved in making estimates, actual results in future periods may differ from the estimates.

Certain information and footnote disclosures normally included in financial statements prepared in accordance with GAAP have been omitted pursuant to rules and regulations of the Securities and Exchange Commission. Accordingly, the condensed consolidated financial statements do not include all of the information and footnotes required by GAAP for complete financial statement presentation. It is suggested that these condensed consolidated financial statements be read in conjunction with the consolidated financial statements and the notes thereto included in the Company's latest annual report on Form 10-K for the year ended July 31, 2015.

The results of operations of the Company's Die-Cut business have been reported as discontinued operations within the condensed consolidated statements of earnings for the six months ended January 31, 2015. A portion of the Die-Cut business was divested in fiscal 2014 and the remainder was divested in the first quarter of fiscal 2015. In accordance with the authoritative literature, the Company has elected to not separately disclose the cash flows or other comprehensive income related to discontinued operations. Refer to Note I, "Discontinued Operations" for further discussion regarding the business.

NOTE B — Goodwill and Other Intangible Assets

Changes in the carrying amount of goodwill for the six months ended January 31, 2016, were as follows:

	IDS	WPS	Total
Balance as of July 31, 2015	\$382,786	\$50,413	\$433,199
Translation adjustments	(2,772	) (2,967	) \$(5,739
Balance as of January 31, 2016	\$380,014	\$47,446	\$427,460

Goodwill at January 31, 2016 and July 31, 2015 included \$118,637 and \$209,392 of accumulated impairment losses within the Identification Solutions ("IDS") and Workplace Safety ("WPS") segments, respectively, for a total of \$328,029. There were no impairment charges recorded during the six months ended January 31, 2016.

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Other intangible assets include patents, trademarks, customer relationships, non-compete agreements and other intangible assets with finite lives being amortized in accordance with the accounting guidance for other intangible assets. The Company also has unamortized indefinite-lived trademarks that are classified as other intangible assets. The net book value of these assets was as follows:

	January 31, 2016				July 31, 2015			
	Weighted Average Amortization Period (Years)	Gross Carrying Amount	Accumulated Amortization	Net Book Value	Weighted Average Amortization Period (Years)	Gross Carrying Amount	Accumulated Amortization	Net Book Value
Amortized other intangible assets:								
Patents	5	\$12,147	\$(10,851)	\$1,296	5	\$12,073	\$(10,641)	\$1,432
Trademarks and other	5	14,270	(13,668)	602	5	14,375	(12,471)	1,904
Customer relationships	7	135,283	(96,784)	38,499	7	136,693	(94,537)	42,156
Non-compete agreements and other	4	8,922	(8,903)	19	4	9,076	(9,032)	44
Unamortized other intangible assets:								
Trademarks	N/A	23,214	—	23,214	N/A	23,352	—	23,352
Total		\$193,836	\$(130,206)	\$63,630		\$195,569	\$(126,681)	\$68,888

The decrease in the gross carrying amount of other intangible assets as of January 31, 2016 compared to July 31, 2015 was due to the effect of currency fluctuations during the six month period.

The gross carrying amount of goodwill and other intangible assets in the condensed consolidated balance sheet at January 31, 2016 differs from the value assigned to them in the original allocation of purchase price due to impairments and the effect of currency fluctuations between the date of acquisition and January 31, 2016.

Amortization expense on intangible assets was \$2,595 and \$2,982 for the three months ended January 31, 2016 and 2015, respectively, and \$5,228 and \$6,351 for the six months ended January 31, 2016 and 2015, respectively. The amortization over each of the next five fiscal years is projected to be \$8,794, \$7,117, \$6,442, \$6,166 and \$5,640 for the fiscal years ending July 31, 2016, 2017, 2018, 2019 and 2020, respectively.

NOTE C — Other Comprehensive Loss

Other comprehensive loss consists of foreign currency translation adjustments, unrealized gains and losses from cash flow hedges and net investment hedges, and the unamortized gain on post-retirement plans, net of their related tax effects.

The following table illustrates the changes in the balances of each component of accumulated other comprehensive loss, net of tax, for the six months ended January 31, 2016:

	Unrealized (loss) gain on cash flow hedges	Unamortized gain on post-retirement plans	Foreign currency translation adjustments	Accumulated other comprehensive loss
Beginning balance, July 31, 2015	\$9	\$ 3,438	\$(48,481)	\$(45,034)
Other comprehensive loss before reclassification	(141)	—	(15,613)	(15,754)
Amounts reclassified from accumulated other comprehensive loss	(209)	(1,358)	—	(1,567)
Ending balance, January 31, 2016	\$(341)	\$ 2,080	\$(64,094)	\$(62,355)

The increase in accumulated other comprehensive loss as of January 31, 2016 compared to July 31, 2015 was primarily due to the appreciation of the U.S. dollar against other currencies during the six month period. The foreign currency translation adjustments column in the table above includes the impact of foreign currency translation, foreign currency translation on intercompany notes, and the settlements of net investment hedges, net of tax. Of the total \$1,567 in amounts reclassified from accumulated other comprehensive loss, the \$209 gain on cash flow hedges was reclassified into cost of products sold, and the \$1,358 gain on post-retirement plans was reclassified into selling, general and administrative expenses ("SG&A") on the condensed consolidated statement of earnings for the six months ended January 31, 2016.

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The changes in accumulated other comprehensive income (loss) by component, net of tax, for the six months ended January 31, 2015 were as follows:

	Unrealized gain (loss) on cash flow hedges	Unamortized gain on post-retirement plans	Foreign currency translation adjustments	Accumulated other comprehensive income (loss)
Beginning balance, July 31, 2014	\$(12)	\$ 4,854	\$59,314	\$ 64,156
Other comprehensive income (loss) before reclassification	1,218	—	(57,598)	(56,380)
Amounts reclassified from accumulated other comprehensive income (loss)	(58)	(590)	(34,697)	(35,345)
Ending balance, January 31, 2015	\$1,148	\$ 4,264	\$(32,981)	\$ (27,569)

The decrease in accumulated other comprehensive income (loss) as of January 31, 2015 compared to July 31, 2014 was primarily due the appreciation of the U.S. dollar against other currencies during the six month period. The decrease was also attributable to the accumulated foreign currency translation gains in the China Die-Cut businesses, which were reclassified into net earnings upon the completion of the second phase of the Die-Cut divestiture during the three months ended October 31, 2014. The foreign currency translation adjustments column in the table above includes the impact of foreign currency translation, foreign currency translation on intercompany notes, and the settlements of net investment hedges, net of tax. Of the total \$35,345 in amounts reclassified from accumulated other comprehensive income, the \$34,697 gain was reclassified to the net loss on the sale of the Die-Cut business, the \$58 gain on cash flow hedges was reclassified into cost of products sold, and the \$590 gain on post-retirement plans was reclassified into SG&A on the condensed consolidated statement of earnings for the six months ended January 31, 2015.

The following table illustrates the income tax expense on the components of other comprehensive loss for the three and six months ended January 31, 2016 and 2015:

	Three months ended January 31,		Six months ended January 31,	
	2016	2015	2016	2015
Income tax expense related to items of other comprehensive loss:				
Net investment hedge translation adjustments	\$(1,042)	\$(4,788)	\$(1,381)	\$(7,967)
Long-term intercompany loan settlements	—	501	—	550
Cash flow hedges	56	(394)	554	(597)
Other income tax adjustments and currency translation	7	27	(8)	34
Income tax expense related to items of other comprehensive loss	\$(979)	\$(4,654)	\$(835)	\$(7,980)

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NOTE D — Net Earnings per Common Share

Reconciliations of the numerator and denominator of the basic and diluted per share computations for the Company's Class A and Class B common stock are summarized as follows:

	Three months ended January 31,		Six months ended January 31,	
	2016	2015	2016	2015
Numerator: (in thousands)				
Earnings from continuing operations	\$ 15,290	\$ 11,584	\$ 33,993	\$ 27,083
Less:				
Preferential dividends	—	—	(783	) (794
Preferential dividends on dilutive stock options	—	—	(1	) (1
Numerator for basic and diluted earnings from continuing operations per Class B Voting Common Share	\$ 15,290	\$ 11,584	\$ 33,209	\$ 26,288
Denominator: (in thousands)				
Denominator for basic earnings from continuing operations per share for both Class A and Class B	50,527	51,272	50,778	51,262
Plus: Effect of dilutive stock options	120	76	90	68
Denominator for diluted earnings from continuing operations per share for both Class A and Class B	50,647	51,348	50,868	51,330
Earnings from continuing operations per Class A Nonvoting Common Share:				
Basic	\$0.30	\$0.23	\$0.67	\$0.53
Diluted	\$0.30	\$0.23	\$0.67	\$0.53
Earnings from continuing operations per Class B Voting Common Share:				
Basic	\$0.30	\$0.23	\$0.65	\$0.51
Diluted	\$0.30	\$0.23	\$0.65	