TENNANT CO
Form 10-Q
October 29, 2014
Table of Contents

UNITED STATES OF AMERICA
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

[ü]	QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
	For the quarterly period ended September 30, 2014
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 1-16191

TENNANT COMPANY
(Exact name of registrant as specified in its charter)

Minnesota	41-0572550
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

701 North Lilac Drive
P.O. Box 1452
Minneapolis, Minnesota 55440
(Address of principal executive offices)
(Zip Code)
(763) 540-1200
(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	ü	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 (§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	ü	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 definition of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act.

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

As of October 15, 2014, there were 18,400,228 shares of Common Stock outstanding.

TABLE OF CONTENTS

Table of Contents

PART I – FINANCIAL INFORMATION
Item 1. Financial Statements
TENNANT COMPANY
CONDENSED CONSOLIDATED STATEMENTS OF EARNINGS
(Unaudited)

(In thousands, except shares and per share data)	Three Months Ended September 30		Nine Months Ended September 30	
	2014	2013	2014	2013
Net Sales	$202,643	$188,541	$605,706	$556,871
Cost of Sales	115,480	106,679	346,363	314,745
Gross Profit	87,163	81,862	259,343	242,126
Operating Expense:				
Research and Development Expense	6,844	7,970	21,976	23,309
Selling and Administrative Expense	63,215	57,663	187,885	174,083
Total Operating Expense	70,059	65,633	209,861	197,392
Profit from Operations	17,104	16,229	49,482	44,734
Other Income (Expense):				
Interest Income	84	67	254	295
Interest Expense	(396)	(440)	(1,301)	(1,318)
Net Foreign Currency Transaction Losses	(276)	(303)	(156)	(1,046)
Other Expense, Net	(162)	(157)	(282)	(238)
Total Other Expense, Net	(750)	(833)	(1,485)	(2,307)
Profit Before Income Taxes	16,354	15,396	47,997	42,427
Income Tax Expense	4,562	4,779	14,887	12,497
Net Earnings	$11,792	$10,617	$33,110	$29,930
Earnings per Share:				
Basic	$0.65	$0.58	$1.82	$1.64
Diluted	$0.63	$0.56	$1.77	$1.59
Weighted Average Shares Outstanding:				
Basic	18,120,729	18,267,828	18,201,291	18,288,083
Diluted	18,635,287	18,811,638	18,727,818	18,823,745
Cash Dividend Declared per Common Share	$0.20	$0.18	$0.58	$0.54

See accompanying Notes to the Condensed Consolidated Financial Statements.

Table of Contents

TENNANT COMPANY
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(Unaudited)

(In thousands)	Three Months Ended September 30		Nine Months Ended September 30	
	2014	2013	2014	2013
Net Earnings	$11,792	$10,617	$33,110	$29,930
Other Comprehensive Income (Loss):				
Foreign currency translation adjustments	(6,963)	2,696	(5,112)	(1,221)
Pension and retiree medical benefits	46	4	138	921
Income Taxes:				
Foreign currency translation adjustments	(6)	(1)	7	(8)
Pension and retiree medical benefits	(17)	89	(51)	86
Total Other Comprehensive Income (Loss), net of tax	(6,940)	2,788	(5,018)	(222)
Comprehensive Income	$4,852	$13,405	$28,092	$29,708

See accompanying Notes to the Condensed Consolidated Financial Statements.

Table of Contents

TENNANT COMPANY
CONDENSED CONSOLIDATED BALANCE SHEETS
(Unaudited)

(In thousands, except shares and per share data)	September 30, 2014	December 31, 2013
ASSETS		
Current Assets:		
Cash and Cash Equivalents	$79,784	$80,984
Restricted Cash	395	393
Accounts Receivable, less Allowances of $5,008 and $4,526, respectively	141,771	140,182
Inventories	83,964	66,906
Prepaid Expenses	13,473	11,426
Deferred Income Taxes, Current Portion	8,200	13,723
Other Current Assets	1,658	1,682
Total Current Assets	329,245	315,296
Property, Plant and Equipment	311,704	300,906
Accumulated Depreciation	(226,513)	(217,430)
Property, Plant and Equipment, Net	85,191	83,476
Deferred Income Taxes, Long-Term Portion	6,072	2,423
Goodwill	18,725	18,929
Intangible Assets, Net	16,680	19,028
Other Assets	15,337	17,154
Total Assets	$471,250	$456,306
LIABILITIES AND SHAREHOLDERS’ EQUITY		
Current Liabilities:		
Short-Term Borrowings and Current Portion of Long-Term Debt	$3,717	$3,803
Accounts Payable	57,896	53,079
Employee Compensation and Benefits	33,549	29,756
Income Taxes Payable	1,140	812
Other Current Liabilities	43,209	44,076
Total Current Liabilities	139,511	131,526
Long-Term Liabilities:		
Long-Term Debt	24,450	28,000
Employee-Related Benefits	24,407	25,173
Deferred Income Taxes, Long-Term Portion	4,553	2,870
Other Liabilities	4,961	4,891
Total Long-Term Liabilities	58,371	60,934
Total Liabilities	197,882	192,460
Commitments and Contingencies (Note 11)		
Shareholders' Equity:		
Preferred Stock, $0.02 par value; 1,000,000 shares authorized; no shares issued or outstanding	—	—
Common Stock, $0.375 par value; 60,000,000 shares authorized; 18,408,026 and 18,491,524 shares issued and outstanding, respectively	6,903	6,934
Additional Paid-In Capital	24,271	31,956
Retained Earnings	272,183	249,927
Accumulated Other Comprehensive Loss	(29,989)	(24,971)
Total Shareholders’ Equity	273,368	263,846
Total Liabilities and Shareholders’ Equity	$471,250	$456,306

See accompanying Notes to the Condensed Consolidated Financial Statements.

Table of Contents

TENNANT COMPANY
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

(In thousands)	Nine Months Ended September 30 2014	2013
OPERATING ACTIVITIES		
Net Earnings	$33,110	$29,930
Adjustments to reconcile Net Earnings to Net Cash Provided by Operating Activities:		
Depreciation	13,186	13,178
Amortization	1,812	1,914
Deferred Income Taxes	3,136	(4)
Share-Based Compensation Expense	5,261	5,106
Allowance for Doubtful Accounts and Returns	1,248	1,153
Other, Net	(45)	155
Changes in Operating Assets and Liabilities:		
Receivables	(6,077)	(6,551)
Inventories	(21,720)	(11,798)
Accounts Payable	5,879	2,826
Employee Compensation and Benefits	1,755	(2,620)
Other Current Liabilities	216	1,716
Income Taxes	137	940
Other Assets and Liabilities	(1,073)	863
Net Cash Provided by Operating Activities	36,825	36,808
INVESTING ACTIVITIES		
Purchases of Property, Plant and Equipment	(13,476)	(11,380)
Proceeds from Disposals of Property, Plant and Equipment	235	97
Acquisition of Business, Net of Cash Acquired	—	(750)
Proceeds from Sale of Business	1,418	3,520
Increase in Restricted Cash	(12)	(224)
Net Cash Used for Investing Activities	(11,835)	(8,737)
FINANCING ACTIVITIES		
Payments of Short-Term Debt	(1,500)	—
Short-Term Debt Borrowings	—	1,500
Payment of Long-Term Debt	(2,015)	(938)
Purchases of Common Stock	(13,609)	(16,626)
Proceeds from Issuance of Common Stock	1,650	5,994
Excess Tax Benefit on Stock Plans	1,620	2,944
Dividends Paid	(10,854)	(9,918)
Net Cash Used for Financing Activities	(24,708)	(17,044)
Effect of Exchange Rate Changes on Cash and Cash Equivalents	(1,482)	342
Net Increase (Decrease) in Cash and Cash Equivalents	(1,200)	11,369
Cash and Cash Equivalents at Beginning of Period	80,984	53,940
Cash and Cash Equivalents at End of Period	$79,784	$65,309
Supplemental Disclosure of Cash Flow Information:		
Cash Paid for Income Taxes	$8,274	$8,093
Cash Paid for Interest	$1,107	$1,189
Supplemental Non-cash Investing and Financing Activities:		

Capital Expenditures in Accounts Payable	$1,001	$873

See accompanying Notes to the Condensed Consolidated Financial Statements.

Table of Contents

TENNANT COMPANY
NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)
(In thousands, except shares and per share data)

1. Basis of Presentation

The accompanying unaudited Condensed Consolidated Financial Statements have been prepared in accordance with the Securities and Exchange Commission ("SEC") requirements for interim reporting, which allows certain footnotes and other financial information normally required by accounting principles generally accepted in the United States of America to be condensed or omitted. In our opinion, the Condensed Consolidated Financial Statements contain all adjustments (consisting of only normal recurring adjustments) necessary for the fair presentation of our financial position and results of operations.

These statements should be read in conjunction with the Consolidated Financial Statements and Notes included in our annual report on Form 10-K for the year ended December 31, 2013. The results of operations for interim periods are not necessarily indicative of the results to be expected for the full year.

2. Newly Adopted Accounting Pronouncements

Presentation of Unrecognized Tax Benefits

In July 2013, the Financial Accounting Standards Board ("FASB") issued amendments to guidance on the financial statement presentation of an unrecognized tax benefit when a net operating loss carryforward, a similar tax loss or a tax credit carryforward exists. The amendments require entities to present an unrecognized tax benefit netted against certain deferred tax assets when specific requirements are met. The amendments are effective for fiscal years, and interim periods within those years, beginning after December 15, 2013. Adoption of this guidance did not have a material impact on our results of operations or financial position.

3. Management Actions

Q4 2013 Action - During the fourth quarter of 2013, we implemented a restructuring action to right size the cost structure in our European operations, primarily as a result of the strategic decision to adjust our Direct versus Distribution selling efforts, to enhance our go-to-market approach which is anticipated to improve profitability and increase customer satisfaction. The pre-tax charge of $1,577 recognized in the fourth quarter consisted primarily of severance and was included within Selling and Administrative Expense in the Condensed Consolidated Statements of Earnings. We believe the anticipated savings will offset the pre-tax charge in approximately 1.5 years. The charge impacted our Europe, Middle East, Africa (EMEA) operating segment, which has no goodwill balance. We do not expect additional costs will be incurred related to this restructuring action.

A reconciliation of the beginning and ending liability balances is as follows:

	Severance and Related Costs
Q4 2013 restructuring action	$1,577
December 31, 2013 balance	$1,577
2014 utilization:	
Cash payments	(1,188)
Foreign currency adjustments	(47)
Change in estimate	(25)
September 30, 2014 balance	$317

7

Table of Contents

Q1 2013 Action - During the first quarter of 2013, we implemented a restructuring action to right size the cost structure of our European operations, primarily focused on reducing the size of our sales and service organization, in response to the challenging economic situation. The pre-tax charge of $1,440 recognized in the first quarter consisted primarily of severance and was included within Selling and Administrative Expense in the Condensed Consolidated Statements of Earnings. We believe the anticipated savings will offset the pre-tax charge in approximately one year. The charge impacted our Europe, Middle East, Africa (EMEA) operating segment, which has no goodwill balance. We do not expect additional costs will be incurred related to this restructuring action.

A reconciliation of the beginning and ending liability balances is as follows:

	Severance and Related Costs
Q1 2013 restructuring action	$1,440
Cash payments	(1,110)
Foreign currency adjustments	17
December 31, 2013 balance	$347
2014 utilization:	
Cash payments	(120)
Foreign currency adjustments	(23)
September 30, 2014 balance	$204

4. Acquisitions and Divestitures

Acquisitions

On May 31, 2011, we acquired Water Star, Inc. (“Water Star”), a Newbury, Ohio firm specializing in electrochemistry, for $4,456. The total purchase price of $4,456 was comprised of $2,956 paid at closing and two $750 installment payments which were paid in cash on May 31, 2012 and 2013. This acquisition is consistent with our strategy to expand our intellectual property in support of our long-term vision to deliver sustainable, breakthrough innovations.

Divestitures

On July 31, 2012, we entered into a Share Purchase Agreement (“SPA”) with M&F Management and Financing GmbH (“M&F”) for the sale of ownership of our subsidiary, Tennant CEE GmbH, and our minority interest in a joint venture, OOO Tennant. In exchange for the ownership of these entities, we received €815, or $1,014, in cash, as of the date of sale and financed the remaining €5,351, for a total purchase price of €6,166. A total of €2,126, or $2,826, was received in equal quarterly payments during 2013 and the first anniversary payment of €1,075, or $1,435, was received on July 31, 2013. The second anniversary payment of €1,075, or $1,418, was received on July 31, 2014. The remaining €1,075, or $1,357, as of September 30, 2014, will be received on the third anniversary date of the divestiture, which is July 31, 2015. As a result of this divestiture, we recorded a pre-tax gain of $784 during the third quarter of 2012 in our Profit from Operations in the Condensed Consolidated Statements of Earnings.

M&F is now a master distributor of Tennant products in the Central Eastern Europe, Middle East and Africa markets. In addition, as further discussed in Note 17, at the time of the transaction, M&F was a related party of ours. We have identified M&F as a variable interest entity (“VIE”) and have performed a qualitative assessment that considered M&F's purpose and design, our involvement and the risks and benefits and determined that we are not the primary beneficiary of this VIE. The only financing we have provided to M&F was related to the SPA as noted above and there are no arrangements that would require us to provide significant financial support in the future.

Table of Contents

5. Inventories

Inventories are valued at the lower of cost or market. Inventories at September 30, 2014 and December 31, 2013 consisted of the following:

	September 30, 2014	December 31, 2013
Inventories carried at LIFO:		
Finished goods	$46,860	$36,238
Raw materials, production parts and work-in-process	20,624	13,922
LIFO reserve	(27,463)	(27,463)
Total LIFO inventories	40,021	22,697
Inventories carried at FIFO:		
Finished goods	30,577	31,489
Raw materials, production parts and work-in-process	13,366	12,720
Total FIFO inventories	43,943	44,209
Total inventories	$83,964	$66,906

The LIFO reserve approximates the difference between LIFO carrying cost and FIFO.

6. Goodwill and Intangible Assets

The changes in the carrying value of Goodwill for the nine months ended September 30, 2014 were as follows:

	Goodwill	Accumulated Impairment Losses	Total
Balance as of December 31, 2013	$68,906	$(49,977)	$18,929
Foreign currency fluctuations	(1,780)	1,576	(204)
Balance as of September 30, 2014	$67,126	$(48,401)	$18,725

The balances of acquired Intangible Assets, excluding Goodwill, as of September 30, 2014 and December 31, 2013, were as follows:

	Customer Lists	Trade Name	Technology	Total
Balance as of September 30, 2014				
Original cost	$22,933	$4,481	$7,049	$34,463
Accumulated amortization	(12,297)	(2,074)	(3,412)	(17,783)
Carrying value	$10,636	$2,407	$3,637	$16,680
Weighted-average original life (in years)	15	14	13	