MODINE MANUFACTURING CO
Form 10-Q
February 01, 2019

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D. C. 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 December 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 1-1373

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

WISCONSIN	39-0482000
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

1500 DeKoven Avenue, Racine, Wisconsin	53403
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code (262) 636 1200

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 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 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 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 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 Smaller reporting company

Emerging growth company

If an emerging growth company, indicate by checkmark if the registrant has not elected 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

The number of shares outstanding of the registrant's common stock, $0.625 par value, was 50,628,421 at January 25, 2019.

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements.

MODINE MANUFACTURING COMPANY
CONSOLIDATED STATEMENTS OF OPERATIONS
For the three and nine months ended December 31, 2018 and 2017
(In millions, except per share amounts)
(Unaudited)

	Three months ended December 31,		Nine months ended December 31,	
	2018	2017	2018	2017
Net sales	$ 541.0	$ 512.7	$ 1,656.0	$ 1,536.5
Cost of sales	449.3	427.3	1,382.1	1,276.5
Gross profit	91.7	85.4	273.9	260.0
Selling, general and administrative expenses	57.2	60.8	179.9	182.2
Restructuring expenses	0.5	9.4	0.7	11.5
Impairment charges	0.4	1.3	0.4	1.3
Loss on sale of assets	-	-	1.7	-
Operating income	33.6	13.9	91.2	65.0
Interest expense	(6.2)	(6.3)	(18.9)	(19.5)
Other expense – net	(0.5)	(0.3)	(2.1)	(2.3)
Earnings before income taxes	26.9	7.3	70.2	43.2
(Provision) benefit for income taxes	(8.6)	(35.2)	9.3	(37.4)
Net earnings (loss)	18.3	(27.9)	79.5	5.8
Net earnings attributable to noncontrolling interest	(0.3)	(0.4)	(1.0)	(1.2)
Net earnings (loss) attributable to Modine	$ 18.0	$ (28.3)	$ 78.5	$ 4.6
Net earnings (loss) per share attributable to Modine shareholders:				
Basic	$ 0.36	$ (0.57)	$ 1.55	$ 0.09
Diluted	$ 0.35	$ (0.57)	$ 1.53	$ 0.09
Weighted-average shares outstanding:				
Basic	50.5	50.0	50.4	49.8
Diluted	51.2	50.0	51.2	50.6

The notes to condensed consolidated financial statements are an integral part of these statements.

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MODINE MANUFACTURING COMPANY
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
For the three and nine months ended December 31, 2018 and 2017
(In millions)
(Unaudited)

	Three months ended December 31,		Nine months ended December 31,	
	2018	2017	2018	2017
Net earnings (loss)	$ 18.3	$ (27.9)	$ 79.5	$ 5.8
Other comprehensive income (loss):				
Foreign currency translation	(2.1)	5.0	(32.6)	32.8
Defined benefit plans, net of income taxes of $0.3, $0.4, $0.9 and $1.3 million	1.0	0.9	3.0	2.6
Cash flow hedges, net of income taxes of ($0.2), $0.2, ($0.3) and $0.2 million	(0.9)	0.4	(1.0)	0.4
Total other comprehensive income (loss)	(2.0)	6.3	(30.6)	35.8
Comprehensive income (loss)	16.3	(21.6)	48.9	41.6
Comprehensive income attributable to noncontrolling interest	(0.3)	(0.8)	(0.5)	(1.6)
Comprehensive income (loss) attributable to Modine	$ 16.0	$ (22.4)	$ 48.4	$ 40.0

The notes to condensed consolidated financial statements are an integral part of these statements.

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MODINE MANUFACTURING COMPANY
CONSOLIDATED BALANCE SHEETS
December 31, 2018 and March 31, 2018
(In millions, except per share amounts)
(Unaudited)

	December 31, 2018	March 31, 2018
ASSETS		
Cash and cash equivalents	$ 30.7	$ 39.3
Trade accounts receivable – net	301.5	342.4
Inventories	211.0	191.3
Other current assets	71.7	70.1
Total current assets	614.9	643.1
Property, plant and equipment – net	489.1	504.3
Intangible assets – net	119.5	129.9
Goodwill	169.0	173.8
Deferred income taxes	96.5	96.9
Other noncurrent assets	23.7	25.4
Total assets	$ 1,512.7	$ 1,573.4
LIABILITIES AND SHAREHOLDERS' EQUITY		
Short-term debt	$ 67.5	$ 53.2
Long-term debt – current portion	45.7	39.9
Accounts payable	245.7	277.9
Accrued compensation and employee benefits	73.7	97.3
Other current liabilities	41.9	47.2
Total current liabilities	474.5	515.5
Long-term debt	354.2	386.3
Deferred income taxes	9.1	9.9
Pensions	99.1	109.6
Other noncurrent liabilities	35.1	53.6
Total liabilities	972.0	1,074.9
Commitments and contingencies (see Note 16)		
Shareholders' equity:		
Preferred stock, $0.025 par value, authorized 16.0 million shares, issued - none	-	-
Common stock, $0.625 par value, authorized 80.0 million shares, issued 52.7 million and 52.3 million shares	32.9	32.7
Additional paid-in capital	236.7	229.9
Retained earnings	465.8	394.9
Accumulated other comprehensive loss	(170.4)	(140.3)
Treasury stock, at cost, 2.1 million and 1.8 million shares	(31.4)	(27.1)
Total Modine shareholders' equity	533.6	490.1
Noncontrolling interest	7.1	8.4
Total equity	540.7	498.5
Total liabilities and equity	$ 1,512.7	$ 1,573.4

The notes to condensed consolidated financial statements are an integral part of these statements.

MODINE MANUFACTURING COMPANY
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
For the nine months ended December 31, 2018 and 2017
(In millions)
(Unaudited)

	Nine months ended December 31, 2018	2017
Cash flows from operating activities:		
Net earnings	$ 79.5	$ 5.8
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation and amortization	57.6	56.8
Loss on sale of assets	1.7	-
Impairment charges	0.4	1.3
Stock-based compensation expense	6.8	7.6
Deferred income taxes	(2.9)	10.1
Other – net	2.4	6.6
Changes in operating assets and liabilities:		
Trade accounts receivable	23.8	22.3
Inventories	(31.2)	(10.5)
Accounts payable	(11.8)	2.2
Other assets and liabilities	(58.9)	3.8
Net cash provided by operating activities	67.4	106.0
Cash flows from investing activities:		
Expenditures for property, plant and equipment	(58.7)	(55.0)
Other – net	1.0	(0.8)
Net cash used for investing activities	(57.7)	(55.8)
Cash flows from financing activities:		
Borrowings of debt	189.2	121.5
Repayments of debt	(199.3)	(162.5)
Dividend paid to noncontrolling interest	(1.8)	(0.9)
Other – net	(4.4)	2.7
Net cash used for financing activities	(16.3)	(39.2)
Effect of exchange rate changes on cash	(2.3)	3.0
Net (decrease) increase in cash, cash equivalents and restricted cash	(8.9)	14.0
Cash, cash equivalents and restricted cash – beginning of period	40.3	34.8
Cash, cash equivalents and restricted cash – end of period	$ 31.4	$ 48.8

The notes to condensed consolidated financial statements are an integral part of these statements.

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MODINE MANUFACTURING COMPANY
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(In millions, except per share amounts)
(unaudited)

Note 1: General

The accompanying condensed consolidated financial statements were prepared in conformity with generally accepted accounting principles ("GAAP") in the United States applied on a basis consistent with those principles used in the preparation of the annual consolidated financial statements of Modine Manufacturing Company ("Modine" or the "Company") for the fiscal year ended March 31, 2018, except in regard to the new accounting guidance adopted, as described below. The financial statements include all normal recurring adjustments that are, in the opinion of management, necessary for a fair statement of results for the interim periods. Results for the first nine months of fiscal 2019 are not necessarily indicative of the results to be expected for the full year. These financial statements should be read in conjunction with the consolidated financial statements and related notes in Modine's Annual Report on Form 10-K for the year ended March 31, 2018.

Sale of AIAC Air Conditioning South Africa (Pty) Ltd.

During the second quarter of fiscal 2019, the Company completed the sale of its AIAC Air Conditioning South Africa (Pty) Ltd. business, which was reported within the Building HVAC Systems segment, for a selling price of $0.5 million. As a result of this transaction, the Company recorded a loss of $1.7 million, which included the write-off of accumulated foreign currency translation losses of $0.8 million. The Company reported this loss on sale of assets as a separate line within the consolidated statements of operations. Annual net sales attributable to this disposed business were less than $2.0 million.

New Accounting Guidance

Revenue Recognition

In May 2014, the Financial Accounting Standards Board ("FASB") issued new guidance that outlines a comprehensive model for entities to use in accounting for revenue arising from contracts with customers. The core principle of the new guidance is that companies are to recognize revenue to depict the transfer of goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The new guidance also includes a cohesive set of disclosure requirements intended to provide users of financial statements with comprehensive information about revenue arising from contracts with customers. The Company adopted this new guidance for fiscal 2019 using the modified-retrospective transition method.

The Company assessed customer contracts and evaluated contractual provisions in light of the new guidance. Through its evaluation process, the Company identified a limited number of customer contracts that provide an enforceable right to payment for customized products, which require revenue recognition prior to the product being shipped to the customer. As a result of its adoption of the new guidance, the Company recorded an increase of $0.7 million to retained earnings as of April 1, 2018, along with related balance sheet reclassifications. The increase to retained earnings reflects $3.0 million of net sales that, had the new guidance been in effect, the Company would have recognized as of March 31, 2018. See Note 2 for additional information regarding revenue recognition.

Income Taxes: Intra-Entity Transfers of Assets Other Than Inventory

In October 2016, the FASB issued new guidance related to income tax accounting for intercompany asset transfers. This new guidance requires companies to recognize the income tax effects of intercompany asset transfers other than inventory at the transaction date. The income tax effects of these transfers were previously deferred. The Company adopted this new guidance for fiscal 2019 using the modified-retrospective transition method. Upon adoption, the Company recorded a decrease to retained earnings of $8.3 million as of April 1, 2018.

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(In millions, except per share amounts)
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Statement of Cash Flows: Restricted Cash
In November 2016, the FASB issued new guidance that requires restricted cash to be included with cash and cash equivalents when reconciling the beginning and ending balances presented within the statement of cash flows. The Company adopted this new guidance for fiscal 2019 using the retrospective transition method. As a result, all prior period information has been recast to be comparable to the new presentation requirements. See Note 10 for information regarding the Company's restricted cash.

Leases
In February 2016, the FASB issued new comprehensive lease accounting guidance that supersedes existing lease accounting guidance and requires balance sheet recognition for most leases. This guidance is effective for the Company's first quarter of fiscal 2020. The Company will apply a modified-retrospective transition method, under which it expects to elect not to adjust comparative periods. Upon adoption of this new guidance, the Company will recognize right-of-use assets and corresponding lease liabilities on its balance sheet. The Company has completed an initial assessment of its lease portfolio and is in the process of collecting data, testing a new lease accounting software solution, and implementing new processes and internal controls to adopt the new guidance. The Company is currently evaluating the impact this guidance will have on its consolidated financial statements.

Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income
In February 2018, the FASB issued new guidance related to the accounting for certain stranded income tax effects in accumulated other comprehensive income (loss) resulting from tax reform legislation that was enacted in the U.S. in December 2017. This guidance permits companies to reclassify stranded income tax effects to retained earnings and is effective for the Company's first quarter of fiscal 2020. The Company is currently evaluating the impact this guidance will have on its consolidated financial statements.

The cumulative effects on the Company's consolidated balance sheet, as of April 1, 2018, resulting from the adoption of new accounting guidance were as follows:

		Adjustments Due to New Accounting Guidance		
	Balance as of March 31, 2018	Revenue Recognition	Intra-entity Transfers of Assets	Balance as of April 1, 2018
ASSETS				
Inventories	$ 191.3	$ (2.0)	$ -	$ 189.3
Other current assets	70.1	3.0	(8.3)	64.8
Deferred income taxes	96.9	(0.2)	-	96.7
LIABILITIES AND SHAREHOLDERS' EQUITY				
Deferred income taxes	$ 9.9	$ 0.1	$ -	$ 10.0
Retained earnings	394.9	0.7	(8.3)	387.3

Note 2: Revenue Recognition

Effective April 1, 2018, the Company adopted new revenue recognition accounting guidance using the modified-retrospective transition method and, as a result, recorded a cumulative-effect adjustment to increase retained earnings by $0.7 million. The Company's condensed consolidated financial statements for the three and nine months ended December 31, 2018 reflect the adoption of this new guidance; however, the comparable prior-year periods have not been restated. See Note 1 for additional information regarding the adjustments to the Company's consolidated balance sheet as of April 1, 2018.

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Significant Accounting Policy
The Company generates revenue from selling innovative thermal management products and solutions to diversified global markets and customers. The Company recognizes revenue based upon consideration specified in a contract and as it satisfies performance obligations by transferring control over its products to its customers, which may be at a point in time or over time. The majority of the Company's revenue is recognized at a point in time, based upon shipment terms.

The Company records an allowance for doubtful accounts for estimated uncollectible receivables and accrues for estimated warranty costs at the time of sale. These estimates are based upon historical experience, current business trends, and current economic conditions.

The Company accounts for shipping and handling activities as fulfilment costs rather than separate performance obligations, and records shipping and handling costs in cost of sales and related amounts billed to customers in net sales.

The Company establishes payment terms with its customers based upon industry and regional practices, which typically do not exceed 90 days. As the Company expects to receive payment from its customers within one year from the time of sale, it disregards the effects of the time value of money in its determination of the transaction price.

The Company has not disclosed the value of unsatisfied performance obligations because the original expected performance period is one year or less for the large majority of its customer contracts.

Nature of Goods and Services and Significant Judgments
The following is a description of the Company's principal revenue-generating activities:

Vehicular Thermal Solutions ("VTS")
The VTS segment principally generates revenue from providing engineered heat transfer systems and components for use in on- and off-highway original equipment. This segment provides powertrain and engine cooling products, including, but not limited to, radiators, charge air coolers, condensers, oil coolers, EGR coolers, and fuel coolers, to original equipment manufacturers ("OEMs") in the automotive, commercial vehicle, and off-highway markets in the Americas, Europe, and Asia regions. In addition, the VTS segment designs customer-owned tooling for OEMs and also serves Brazil's automotive and commercial vehicle aftermarkets.

While the VTS segment provides customized production and service parts to customers under multi-year programs, these programs typically do not contain contractually-guaranteed volumes to be purchased by the customer. As a result, individual purchase orders typically represent the quantities ordered by the customer. With the exception of a small number of VTS customers, the terms within the customer agreement, purchase order, or customer-owned tooling contract do not provide the Company with an enforceable right to payment for performance completed to date. As a result, the VTS segment recognizes revenue primarily at the time control is transferred to the customer based upon shipping terms, which is generally upon shipment.

In regard to VTS customers with contractual cancellation terms that provide an enforceable right to payment for performance completed to date, the Company recognizes revenue over time based upon its estimated progress towards satisfaction of the performance obligations. The VTS segment measures progress by evaluating the production status of ordered products not yet shipped to the customer.

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For certain customer programs, the Company agrees to provide annual price reductions based upon contract terms. For these scheduled price reductions, the Company evaluates whether the provisions represent a material right to the customer, and if so, defers associated revenue as a result.

At times, the Company makes up-front incentive payments to certain customers related to future sales under multi-year programs. The Company capitalizes these incentive payments, which it expects to recover through future sales, and amortizes the assets as a reduction to revenue when the related products are sold to customers.

Commercial and Industrial Solutions ("CIS")
The CIS segment principally generates revenue from providing thermal management products, including customized coils and coolers, to the heating, ventilating, air conditioning, and refrigeration ("HVAC&R") markets in North America, Europe, and Asia. In addition, the segment applies corrosion protection solutions, which are referred to as coatings, to heat-transfer equipment.

For the sale of coils and coolers, individual customer purchase orders generally represent the Company's contract with its customers. With the exception of a small number of customers, the applicable customer contracts do not provide the Company with an enforceable right to payment for performance completed to date. As a result, the CIS segment recognizes revenue for its sale of coils and coolers primarily at the time control is transferred to the customer based upon shipping terms, which is generally upon shipment.

For both sales to customers whose contract cancellation terms provide an enforceable right to payment and sales from the coatings businesses, in which the customers control the heat-transfer equipment being enhanced by the coating application, the CIS segment recognizes revenue over time based upon its estimated progress towards satisfaction of the performance obligations. The segment measures progress by evaluating the production status towards completion of ordered products or services not yet shipped to its customers.

Building HVAC Systems ("BHVAC")
The BHVAC segment principally generates revenue from providing a variety of heating, ventilating, and air conditioning products, primarily for commercial buildings and related applications in North America and the U.K., as well as mainland Europe and the Middle East.

Heating products are manufactured in the U.S. and are generally sold to independent distributors, who in turn market the heating products to end customers. Because these products are sold to many different customers without contractual or practical limitations, the BHVAC segment recognizes revenue at the time control is transferred to the customer based upon shipping terms, which is generally upon shipment.

Ventilation and air conditioning products are highly-specified to a customer's needs; however, the underlying sales contracts do not provide the Company with an enforceable right to payment for performance completed to date. As a result, the BHVAC segment recognizes revenue for these products at the time control is transferred to the customer based upon shipping terms, which is generally upon shipment.

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MODINE MANUFACTURING COMPANY
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(In millions, except per share amounts)
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Disaggregation of Revenue
The table below presents revenue to external customers for each of the Company's business segments by primary end market, by geographic location and based upon the timing of revenue recognition.

	Three months ended December 31, 2018			
	VTS	CIS	BHVAC	Segment Total
Primary end market:				
Automotive	$ 130.4	$ -	$ -	$ 130.4
Commercial vehicle	92.0	-	-	92.0
Off-highway	74.2	-	-	74.2
Commercial HVAC	-	72.2	53.2	125.4
Commercial refrigeration	-	42.4	-	42.4
Data center cooling	-	40.2	11.0	51.2
Industrial cooling	-	11.8	-	11.8
Other	26.7	0.4	-	27.1
Net sales	$ 323.3	$ 167.0	$ 64.2	$ 554.5
Geographic location:				
Americas	$ 150.7	$ 96.0	$ 40.9	$ 287.6
Europe	124.9	59.8	23.3	208.0
Asia	47.7	11.2	-	58.9
Net sales	$ 323.3	$ 167.0	$ 64.2	$ 554.5
Timing of revenue recognition:				
Products transferred at a point in time	$ 309.4	$ 128.7	$ 64.2	$ 502.3
Products transferred over time	13.9	38.3	-	52.2
Net sales	$ 323.3	$ 167.0	$ 64.2	$ 554.5

(In millions, except per share amounts)

	Nine months ended December 31, 2018			
	VTS	CIS	BHVAC	Segment Total
Primary end market:				
Automotive	$ 411.9	$ -	$ -	$ 411.9
Commercial vehicle	287.5	-	-	287.5
Off-highway	234.9	-	-	234.9
Commercial HVAC	-	237.4	130.6	368.0
Commercial refrigeration	-	140.1	-	140.1
Data center cooling	-	110.3	29.3	139.6
Industrial cooling	-	36.4	-	36.4
Other	77.4	4.9	-	82.3
Net sales	$ 1,011.7	$ 529.1	$ 159.9	$ 1,700.7
Geographic location:				
Americas	$ 460.8	$ 304.0	$ 98.0	$ 862.8
Europe	400.6	187.0	61.9	649.5
Asia	150.3	38.1	-	188.4
Net sales	$ 1,011.7	$ 529.1	$ 159.9	$ 1,700.7
Timing of revenue recognition:				
Products transferred at a point in time	$ 974.7	$ 426.2	$ 159.9	$ 1,560.8
Products transferred over time	37.0	102.9	-	139.9
Net sales	$ 1,011.7	$ 529.1	$ 159.9	$ 1,700.7

Contract Balances

Contract assets and contract liabilities from contracts with customers were as follows:

	December 31, 2018	March 31, 2018
Contract assets	$ 25.5	$ 13.5
Contract liabilities	5.6	6.8

Contract assets, included within other current assets in the consolidated balance sheet, primarily consist of capitalized costs related to customer-owned tooling contracts, wherein the customer has guaranteed reimbursement, and assets recorded for revenue recognized over time, which represent the Company's rights to consideration for work completed but not yet billed. The $12.0 million increase in contract assets during the first nine months of fiscal 2019 was primarily related to contract assets totaling $8.2 million as of December 31, 2018 for revenue recognized over time, which were recorded as a result of the Company's adoption of the new revenue recognition accounting guidance, and customer-owned tooling contracts, under which more costs were capitalized than reimbursed.

Contract liabilities, included within other current liabilities in the consolidated balance sheet, consist of payments received in advance of satisfying performance obligations under customer contracts, including contracts for customer-owned tooling. The $1.2 million decrease in contract liabilities during fiscal 2019 was primarily due to the Company's satisfaction of performance obligations under customer contracts for which payment had been received in advance.

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MODINE MANUFACTURING COMPANY
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(In millions, except per share amounts)
(unaudited)

Impacts of Adopting New Accounting Guidance

The impacts from the adoption of the new revenue recognition guidance to the Company's consolidated statements of operations for the three and nine months ended December 31, 2018 and its consolidated balance sheet as of December 31, 2018 were as follows:

	Three months ended December 31, 2018		
	As Reported	Impact of New Accounting Guidance	Results Without Impact of New Accounting Guidance
Net sales	$ 541.0	$ (5.6)	$ 535.4
Net earnings attributable to Modine	18.0	(2.1)	15.9
Net earnings per share attributable to Modine shareholders:			
Basic	$ 0.36	$ (0.04)	$ 0.32
Diluted	0.35	(0.04)	0.31

	Nine months ended December 31, 2018		
	As Reported	Impact of New Accounting Guidance	Results Without Impact of New Accounting Guidance
Net sales	$ 1,656.0	$ (5.2)	$ 1,650.8
Net earnings attributable to Modine	78.5	(2.0)	76.5
Net earnings per share attributable to Modine shareholders:			
Basic	$ 1.55	$ (0.04)	$ 1.51
Diluted			