

BRADY CORP
Form 10-Q
May 24, 2018
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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 April 30, 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 1-14959

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, 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 Emerging growth company
Non-accelerated filer Smaller reporting 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

APPLICABLE ONLY TO CORPORATE ISSUERS

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

As of May 21, 2018, there were 48,200,663 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, Unaudited)

	April 30, 2018	July 31, 2017
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 130,903	\$ 133,944
Accounts receivable—net	161,319	149,638
Inventories:		
Finished products	72,809	69,760
Work-in-process	20,126	18,117
Raw materials and supplies	22,598	19,147
Total inventories	115,533	107,024
Prepaid expenses and other current assets	17,295	17,208
Total current assets	425,050	407,814
Other assets:		
Goodwill	435,426	437,697
Other intangible assets	48,036	53,076
Deferred income taxes	8,688	35,456
Other	17,758	18,077
Property, plant and equipment:		
Cost:		
Land	7,332	7,470
Buildings and improvements	98,005	98,228
Machinery and equipment	268,736	261,192
Construction in progress	6,557	4,109
	380,630	370,999
Less accumulated depreciation	282,181	272,896
Property, plant and equipment—net	98,449	98,103
Total	\$ 1,033,407	\$ 1,050,223
LIABILITIES AND STOCKHOLDERS' INVESTMENT		
Current liabilities:		
Notes payable	\$—	\$ 3,228
Accounts payable	68,627	66,817
Wages and amounts withheld from employees	56,995	58,192
Taxes, other than income taxes	7,772	7,970
Accrued income taxes	5,564	7,373
Other current liabilities	42,436	43,618
Total current liabilities	181,394	187,198
Long-term obligations	58,157	104,536
Other liabilities	59,209	58,349
Total liabilities	298,760	350,083
Stockholders' investment:		
Class A nonvoting common stock—Issued 51,261,487 and 51,261,487 shares, respectively, and outstanding 48,205,763 and 47,814,818 shares, respectively	513	513

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Class B voting common stock—Issued and outstanding, 3,538,628 shares	35	35
Additional paid-in capital	327,401	322,608
Earnings retained in the business	531,135	507,136
Treasury stock—3,055,724 and 3,446,669 shares, respectively, of Class A nonvoting common stock, at cost	(76,291)	(85,470)
Accumulated other comprehensive loss	(48,146)	(44,682)
Total stockholders' investment	734,647	700,140
Total	\$1,033,407	\$1,050,223

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, Unaudited)

	Three months ended		Nine months ended	
	April 30,		April 30,	
	2018	2017	2018	2017
Net sales	\$298,421	\$275,927	\$876,352	\$824,104
Cost of products sold	147,339	136,018	435,513	409,679
Gross margin	151,082	139,909	440,839	414,425
Operating expenses:				
Research and development	11,678	9,950	33,512	28,577
Selling, general and administrative	101,695	98,409	299,411	291,128
Total operating expenses	113,373	108,359	332,923	319,705
Operating income	37,709	31,550	107,916	94,720
Other income (expense):				
Investment and other income	31	453	1,303	560
Interest expense	(761)	(1,375)	(2,453)	(4,565)
Earnings before income taxes	36,979	30,628	106,766	90,715
Income tax expense	10,979	8,075	50,657	20,312
Net earnings	\$26,000	\$22,553	\$56,109	\$70,403
Net earnings per Class A Nonvoting Common Share:				
Basic	\$0.50	\$0.44	\$1.09	\$1.38
Diluted	\$0.49	\$0.43	\$1.07	\$1.36
Dividends	\$0.21	\$0.21	\$0.62	\$0.62
Net earnings per Class B Voting Common Share:				
Basic	\$0.50	\$0.44	\$1.07	\$1.37
Diluted	\$0.49	\$0.43	\$1.05	\$1.34
Dividends	\$0.21	\$0.21	\$0.61	\$0.60
Weighted average common shares outstanding (in thousands):				
Basic	51,747	51,227	51,628	50,972
Diluted	52,729	52,201	52,610	51,882

See Notes to Condensed Consolidated Financial Statements.

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

	Three months ended April 30,		Nine months ended April 30,	
	2018	2017	2018	2017
Net earnings	\$26,000	\$22,553	\$56,109	\$70,403
Other comprehensive (loss) income:				
Foreign currency translation adjustments	(12,869)	4,819	(407)	(11,729)
Net investment hedge and long-term intercompany loan translation adjustments	35	(1,251)	(3,142)	3,919
Cash flow hedges:				
Net gain recognized in other comprehensive (loss) income	657	508	119	402
Reclassification adjustment for losses included in net earnings	264	114	446	530
	921	622	565	932
Pension and other post-retirement benefits:				
Net gain recognized in other comprehensive (loss) income	—	—	592	72
Actuarial gain amortization	(163)	(136)	(434)	(408)
	(163)	(136)	158	(336)
Other comprehensive (loss) income, before tax	(12,076)	4,054	(2,826)	(7,214)
Income tax (expense) benefit related to items of other comprehensive (loss) income	(980)	821	(638)	(1,380)
Other comprehensive (loss) income, net of tax	(13,056)	4,875	(3,464)	(8,594)
Comprehensive income	\$12,944	\$27,428	\$52,645	\$61,809
See Notes to Condensed Consolidated Financial Statements.				

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

	Nine months ended April 30,	
	2018	2017
Operating activities:		
Net earnings	\$56,109	\$70,403
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation and amortization	19,047	20,789
Non-cash portion of stock-based compensation expense	7,581	7,445
Deferred income taxes	26,501	(2,707)
Changes in operating assets and liabilities:		
Accounts receivable	(10,710)	(931)
Inventories	(7,790)	666
Prepaid expenses and other assets	480	(1,987)
Accounts payable and other liabilities	(133)	754
Income taxes	(1,863)	(3,270)
Net cash provided by operating activities	89,222	91,162
Investing activities:		
Purchases of property, plant and equipment	(14,755)	(10,856)
Other	(197)	38
Net cash used in investing activities	(14,952)	(10,818)
Financing activities:		
Payment of dividends	(32,110)	(31,362)
Proceeds from exercise of stock options	10,011	18,674
Proceeds from borrowing on credit facilities	17,439	154,653
Repayment of borrowing on credit facilities	(69,012)	(215,068)
Principal payments on debt	—	(16,371)
Income tax on equity-based compensation, and other	(3,622)	(512)
Net cash used in financing activities	(77,294)	(89,986)
Effect of exchange rate changes on cash	(17)	(2,509)
Net decrease in cash and cash equivalents	(3,041)	(12,151)
Cash and cash equivalents, beginning of period	133,944	141,228
Cash and cash equivalents, end of period	\$130,903	\$129,077

See Notes to Condensed Consolidated Financial Statements.

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BRADY CORPORATION AND SUBSIDIARIES
 NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
 Nine Months Ended April 30, 2018

(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 April 30, 2018 and July 31, 2017, its results of operations and comprehensive income for the three and nine months ended April 30, 2018 and 2017, and cash flows for the nine months ended April 30, 2018 and 2017. The condensed consolidated balance sheet as of July 31, 2017, has been derived from the audited consolidated financial statements as 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 annual report on Form 10-K for the year ended July 31, 2017.

NOTE B — Goodwill and Other Intangible Assets

Changes in the carrying amount of goodwill for the nine months ended April 30, 2018, were as follows:

	IDS	WPS	Total
Balance as of July 31, 2017	\$391,864	\$45,833	\$437,697
Translation adjustments	(2,392)	121	(2,271)
Balance as of April 30, 2018	\$389,472	\$45,954	\$435,426

Goodwill at April 30, 2018 and July 31, 2017, 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 nine months ended April 30, 2018.

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Other intangible assets include patents, trademarks, and customer relationships 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:

	April 30, 2018				July 31, 2017			
	Weighted				Weighted			
	Average	Gross	Accumulated	Net	Average	Gross	Accumulated	Net
	Amortization	Carrying	Amortization	Book	Amortization	Carrying	Amortization	Book
	Period	Amount		Value	Period	Amount		Value
	(Years)				(Years)			
Amortized other intangible assets:								
Patents	5	\$ 1,448	\$ (816)	\$ 632	5	\$ 1,358	\$ (471)	\$ 887
Trademarks and other	9	4,593	(4,449)	144	9	4,528	(4,229)	299
Customer relationships	8	60,742	(36,336)	24,406	8	60,759	(31,909)	28,850
Unamortized other intangible assets:								
Trademarks	N/A	22,854	—	22,854	N/A	23,040	—	23,040
Total		\$ 89,637	\$ (41,601)	\$ 48,036		\$ 89,685	\$ (36,609)	\$ 53,076

The decrease in the gross carrying amount of other intangible assets as of April 30, 2018, compared to July 31, 2017, was due to the effect of currency translations during the nine-month period.

Amortization expense of intangible assets was \$1,620 and \$1,766 for the three months ended April 30, 2018 and 2017, respectively, and \$4,930 and \$5,349 for the nine months ended April 30, 2018 and 2017, respectively. The amortization over each of the next five fiscal years is projected to be \$6,513, \$6,174, \$5,210, \$5,168 and \$5,014 for the fiscal years ending July 31, 2018, 2019, 2020, 2021 and 2022, 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 nine months ended April 30, 2018:

	Unrealized	Unamortized	Foreign	Accumulated
	gain on	gain on	currency	other
	cash flow	post-retirement	translation	comprehensive
	hedges	plans	adjustments	loss
Beginning balance, July 31, 2017	\$ 109	\$ 2,620	\$ (47,411)	\$ (44,682)
Other comprehensive (loss) income before reclassification	(124)	414	(3,630)	(3,340)
Amounts reclassified from accumulated other comprehensive loss	310	(434)	—	(124)
Ending balance, April 30, 2018	\$ 295	\$ 2,600	\$ (51,041)	\$ (48,146)

The increase in accumulated other comprehensive loss as of April 30, 2018, compared to July 31, 2017, was primarily due to the appreciation of the U.S. dollar against certain other currencies during the nine-month period. The foreign currency translation adjustments column in the table above includes the impact of foreign currency translation, including foreign currency translation on intercompany notes and net investment hedges, net of tax. Of the total \$124 in amounts reclassified from accumulated other comprehensive loss, the \$310 loss on cash flow hedges was reclassified into cost of products sold, and the \$434 gain on post-retirement plans was reclassified into selling, general and administrative expenses ("SG&A") on the condensed consolidated statement of earnings for the nine months ended April 30, 2018.

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The changes in accumulated other comprehensive loss by component, net of tax, for the nine months ended April 30, 2017, were as follows:

	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, 2016	\$ (857)	\$ 2,236	\$ (56,124)	\$ (54,745)
Other comprehensive income (loss) before reclassification	563	72	(9,144)	(8,509)
Amounts reclassified from accumulated other comprehensive loss	323	(408)	—	(85)
Ending balance, April 30, 2017	\$ 29	\$ 1,900	\$ (65,268)	\$ (63,339)

The increase in accumulated other comprehensive loss as of April 30, 2017, compared to July 31, 2016, was primarily due to the appreciation of the U.S. dollar against certain other currencies during the nine-month period. The foreign currency translation adjustments column in the table above includes the impact of foreign currency translation, including foreign currency translation on intercompany notes and net investment hedges, net of tax. Of the total \$85 in amounts reclassified from accumulated other comprehensive loss, the \$323 loss on cash flow hedges was reclassified into cost of products sold, and the \$408 gain on post-retirement plans was reclassified into SG&A on the condensed consolidated statement of earnings for the nine months ended April 30, 2017.

The following table illustrates the income tax (expense) benefit on the components of other comprehensive (loss) income for the three and nine months ended April 30, 2018 and 2017:

	Three months ended April 30, 2018		Nine months ended April 30, 2017	
Income tax (expense) benefit related to items of other comprehensive loss (income):				
Net investment hedge translation adjustments	\$(306)	\$752	\$388	\$(1,373)
Cash flow hedges	(262)	90	(379)	(46)
Pension and other post-retirement benefits	—	—	(178)	—
Other income tax adjustments and currency translation	(412)	(21)	(469)	39
Income tax (expense) benefit related to items of other comprehensive (loss) income	\$(980)	\$821	\$(638)	\$(1,380)

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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 April 30,		Nine months ended April 30,	
	2018	2017	2018	2017
Numerator: (in thousands)				
Earnings (Numerator for basic and diluted Class A Nonvoting Common Share)	\$26,000	\$22,553	\$56,109	\$70,403
Less:				
Preferential dividends	—	—	(799)	(788)
Preferential dividends on dilutive stock options	—	—	(16)	(14)
Numerator for basic and diluted earnings per Class B Voting Common Share	\$26,000	\$22,553	\$55,294	\$69,601
Denominator: (in thousands)				
Denominator for basic earnings per share for both Class A and Class B	51,747	51,227	51,628	50,972
Plus: Effect of dilutive stock options and restricted stock units	982	974	982	910
Denominator for diluted earnings per share for both Class A and Class B	52,729	52,201	52,610	51,882
Net earnings per Class A Nonvoting Common Share:				
Basic	\$0.50	\$0.44	\$1.09	\$1.38
Diluted	\$0.49	\$0.43	\$1.07	\$1.36
Net earnings per Class B Voting Common Share:				
Basic	\$0.50	\$0.44	\$1.07	\$1.37
Diluted	\$0.49	\$0.43	\$1.05	\$1.34

Options to purchase 675,329 and 577,557 shares of Class A Nonvoting Common Stock for the three months ended April 30, 2018 and 2017, respectively, and 705,843 and 705,859 shares for the nine months ended April 30, 2018 and 2017, respectively, were not included in the computation of diluted net earnings per share because the option exercise price was greater than the average market price of the common shares and, therefore, the effect would have been anti-dilutive.

NOTE E — Segment Information

The Company is organized and managed on a global basis within three operating segments, Identification Solutions, Workplace Safety, and People Identification ("People ID"), which aggregate into two reportable segments that are organized around businesses with consistent products and services: IDS and WPS. The Identification Solutions and People ID operating segments aggregate into the IDS reporting segment, while the WPS reporting segment is comprised solely of the Workplace Safety operating segment. The Company evaluates short-term segment performance based on segment profit and customer sales. Interest expense, investment and other income, income taxes, and certain corporate administrative expenses are excluded when evaluating segment performance.

The following is a summary of segment information for the three and nine months ended April 30, 2018 and 2017:

	Three months ended April 30,		Nine months ended April 30,	
	2018	2017	2018	2017
Sales to External Customers				
ID Solutions	\$212,154	\$196,880	\$628,291	\$589,106
Workplace Safety	86,267	79,047	248,061	234,998
Total Company	\$298,421	\$275,927	\$876,352	\$824,104
Segment Profit				
ID Solutions	\$36,970	\$32,633	\$106,896	\$94,676
Workplace Safety	7,537	5,120	21,037	17,615
Total Company	\$44,507	\$37,753	\$127,933	\$112,291

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The following is a reconciliation of segment profit to earnings before income taxes for the three and nine months ended April 30, 2018 and 2017:

	Three months ended April 30,		Nine months ended April 30,	
	2018	2017	2018	2017
Total profit from reportable segments	\$44,507	\$37,753	\$127,933	\$112,291
Unallocated amounts:				
Administrative costs	(6,798)	(6,203)	(20,017)	(17,571)
Investment and other income	31	453	1,303	560
Interest expense	(761)	(1,375)	(2,453)	(4,565)
Earnings before income taxes	\$36,979	\$30,628	\$106,766	\$90,715

NOTE F – Stock-Based Compensation

The Company has an incentive stock plan under which the Board of Directors may grant nonqualified stock options to purchase shares of Class A Nonvoting Common Stock, restricted stock units ("RSUs"), or restricted and unrestricted shares of Class A Nonvoting Common Stock to employees and non-employee directors. Certain awards may be subject to pre-established performance goals.

The options issued under the plan have an exercise price equal to the fair market value of the underlying stock at the date of grant and generally vest over a three-year service period, with one-third becoming exercisable one year after the grant date and one-third additional in each of the succeeding two years. Options issued under the plan, referred to herein as "service-based" stock options, generally expire 10 years from the date of grant.

Restricted and unrestricted shares and RSUs issued under the plan have a grant date fair value equal to the average of the high and low trading price of the stock at the date of grant. Shares issued under the plan are referred to herein as either "service-based" or "performance-based" restricted shares and RSUs. The service-based RSUs granted under the plan generally vest over a three-year service period, with one-third becoming exercisable one year after the grant date and one-third additional in each of the succeeding two years. The performance-based RSUs granted under the plan generally vest at the end of a three-year service period provided specified Company financial performance metrics are met.

As of April 30, 2018, the Company has reserved 3,275,315 shares of Class A Nonvoting Common Stock for outstanding stock options, RSUs, and restricted shares and 4,046,476 shares of Class A Nonvoting Common Stock remain for future issuance of stock options, RSUs, and restricted and unrestricted shares under the plan. The Company uses treasury stock or will issue new Class A Nonvoting Common Stock to deliver shares under the plan.

The Company recognizes the compensation cost of all share-based awards at the time it is deemed probable the award will vest. This cost is recognized on a straight-line basis over the vesting period of the award. If it is determined that it is unlikely the award will vest, the expense recognized to date for the award is reversed in the period in which this is evident and the remaining expense is not recorded. Total stock-based compensation expense recognized by the Company during the three months ended April 30, 2018 and 2017, was \$1,684 (\$1,263 net of taxes) and \$2,051 (\$1,272 net of taxes), respectively. Expense recognized during the nine months ended April 30, 2018 and 2017, was \$7,581 (\$5,685 net of taxes) and \$7,445 (\$4,616 net of taxes), respectively.

As of April 30, 2018, total unrecognized compensation cost related to stock-based compensation awards was \$12,273 pre-tax, net of estimated forfeitures, which the Company expects to recognize over a weighted-average period of 1.8 years.

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The Company has estimated the grant date fair value of its service-based stock option awards granted during the nine months ended April 30, 2018 and 2017, using the Black-Scholes option valuation model. The weighted-average assumptions used in the Black-Scholes valuation model are reflected in the following table:

Black-Scholes Option Valuation Assumptions	Nine months ended	
	April 30,	
	2018	2017
Expected term (in years)	6.07	6.11
Expected volatility	26.52 %	29.55 %
Expected dividend yield	2.72 %	2.70 %
Risk-free interest rate	1.96 %	1.26 %
Weighted-average market value of underlying stock at grant date	\$36.85	\$35.14