

FRANKLIN ELECTRIC CO INC

Form 10-Q

April 30, 2019

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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549**

\_\_\_\_\_  
**FORM 10-Q**  
\_\_\_\_\_

**ý QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d)  
OF THE SECURITIES EXCHANGE ACT OF 1934  
For the quarterly period ended March 31, 2019**

**OR**

**o 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 0-362**

**FRANKLIN ELECTRIC CO., INC.  
(Exact name of registrant as specified in its charter)**

**Indiana 35-0827455  
(State or other jurisdiction of incorporation or organization) (I.R.S. Employer Identification No.)**

**9255 Coverdale Road  
Fort Wayne, Indiana 46809  
(Address of principal executive offices) (Zip Code)**

**(260) 824-2900  
(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** x **NO** o

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 (Section 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** x **NO** o

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**  **Non-Accelerated Filer**  **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 Act).

**YES**  **NO**

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

<b>Class of Common Stock Par Value</b>	<b>Outstanding at April 26, 2019</b>
<b>\$0.10</b>	<b>46,405,578 shares</b>

**FRANKLIN ELECTRIC CO., INC.**  
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**PART I - FINANCIAL INFORMATION****ITEM 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**FRANKLIN ELECTRIC CO., INC. AND CONSOLIDATED SUBSIDIARIES  
CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(Unaudited)

(In thousands, except per share amounts)	First Quarter Ended	
	March 31, 2019	March 31, 2018
Net sales	\$290,715	\$295,630
Cost of sales	201,209	196,648
Gross profit	89,506	98,982
Selling, general, and administrative expenses	76,299	76,275
Restructuring expense	1,086	7
Operating income	12,121	22,700
Interest (expense)	(2,342)	(2,428)
Other income/(expense), net	239	(204)
Foreign exchange income/(expense)	589	(551)
Income before income taxes	10,607	19,517
Income tax (benefit)/expense	1,480	(1,698)
Net income	\$9,127	\$21,215
Less: Net income attributable to noncontrolling interests	(71)	(41)
Net income attributable to Franklin Electric Co., Inc.	\$9,056	\$21,174
Income per share:		
Basic	\$0.19	\$0.45
Diluted	\$0.19	\$0.45

See Notes to Condensed Consolidated Financial Statements.



FRANKLIN ELECTRIC CO., INC. AND CONSOLIDATED SUBSIDIARIES  
 CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(Unaudited)

(In thousands)	First Quarter Ended	
	March 31, 2019	March 31, 2018
Net income	\$9,127	\$21,215
Other comprehensive income/(loss), before tax:		
Foreign currency translation adjustments	(2,810 )	6,995
Employee benefit plan activity	650	778
Other comprehensive income/(loss)	(2,160 )	7,773
Income tax expense related to items of other comprehensive income/(loss)	(141 )	(177 )
Other comprehensive income/(loss), net of tax	(2,301 )	7,596
Comprehensive income	6,826	28,811
Less: Comprehensive income attributable to noncontrolling interests	32	93
Comprehensive income attributable to Franklin Electric Co., Inc.	\$6,794	\$28,718

See Notes to Condensed Consolidated Financial Statements.

FRANKLIN ELECTRIC CO., INC. AND CONSOLIDATED SUBSIDIARIES  
 CONDENSED CONSOLIDATED BALANCE SHEETS  
 (Unaudited)

(In thousands)	March 31, 2019	December 31, 2018
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$54,364	\$59,173
Receivables, less allowances of \$4,623 and \$4,394, respectively	180,584	172,899
Inventories:		
Raw material	107,010	98,858
Work-in-process	20,698	18,649
Finished goods	208,931	196,542
Total inventories	336,639	314,049
Other current assets	34,115	33,758
Total current assets	605,702	579,879
Property, plant, and equipment, at cost:		
Land and buildings	141,397	144,299
Machinery and equipment	267,722	269,484
Furniture and fixtures	49,710	49,426
Other	26,145	22,795
Property, plant, and equipment, gross	484,974	486,004
Less: Allowance for depreciation	(282,377)	(278,940)
Property, plant, and equipment, net	202,597	207,064
Right-of-Use Asset, net	25,411	—
Deferred income taxes	9,115	8,694
Intangible assets, net	132,813	135,052
Goodwill	249,900	248,748
Other assets	3,221	2,928
Total assets	\$1,228,759	\$1,182,365

	March 31, 2019	December 31, 2018
<b>LIABILITIES AND EQUITY</b>		
Current liabilities:		
Accounts payable	\$91,399	\$ 76,652
Accrued expenses and other current liabilities	51,242	64,811
Current lease liability	7,738	—
Income taxes	1,748	2,419
Current maturities of long-term debt and short-term borrowings	131,957	111,975
Total current liabilities	284,084	255,857
Long-term debt	93,803	94,379
Long-term lease liability	17,675	—
Income taxes payable non-current	10,881	10,881
Deferred income taxes	28,927	28,949
Employee benefit plans	36,963	38,020
Other long-term liabilities	19,826	17,934
Commitments and contingencies (see Note 14)	—	—
Redeemable noncontrolling interest	408	518
Shareholders' equity:		
Common stock (65,000 shares authorized, \$.10 par value) outstanding (46,370 and 46,326, respectively)	4,637	4,632
Additional capital	262,002	257,535
Retained earnings	652,737	654,724
Accumulated other comprehensive loss	(185,281 )	(183,019 )
Total shareholders' equity	734,095	733,872
Noncontrolling interest	2,097	1,955
Total equity	736,192	735,827
Total liabilities and equity	\$ 1,228,759	\$ 1,182,365

See Notes to Condensed Consolidated Financial Statements.

FRANKLIN ELECTRIC CO., INC. AND CONSOLIDATED SUBSIDIARIES  
 CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS  
 (Unaudited)

(In thousands)	Three Months Ended	
	March 31, 2019	March 31, 2018
Cash flows from operating activities:		
Net income	\$9,127	\$21,215
Adjustments to reconcile net income to net cash flows from operating activities:		
Depreciation and amortization	9,268	9,896
Non-cash lease expense	2,805	—
Share-based compensation	3,230	3,326
Deferred income taxes	(37)	(5,417)
(Gain)/loss on disposals of plant and equipment	530	(396)
Foreign exchange (income)/expense	(589)	551
Changes in assets and liabilities, net of acquisitions:		
Receivables	(6,517)	(17,242)
Inventory	(20,986)	(23,932)
Accounts payable and accrued expenses	1,309	(15,378)
Operating Leases	(2,804)	—
Income taxes	(509)	(2,463)
Employee benefit plans	(31)	(786)
Other, net	2,269	3,442
Net cash flows from operating activities	(2,935)	(27,184)
Cash flows from investing activities:		
Additions to property, plant, and equipment	(5,220)	(5,921)
Proceeds from sale of property, plant, and equipment	64	208
Cash paid for acquisitions, net of cash acquired	(5,405)	(8,428)
Other, net	3	—
Net cash flows from investing activities	(10,558)	(14,141)
Cash flows from financing activities:		
Proceeds from issuance of debt	53,202	59,561
Repayment of debt	(33,533)	(7,554)
Proceeds from issuance of common stock	1,251	642
Purchases of common stock	(4,329)	(7,949)
Dividends paid	(6,723)	(5,037)
Net cash flows from financing activities	9,868	39,663
Effect of exchange rate changes on cash	(1,184)	1,799
Net change in cash and equivalents	(4,809)	137
Cash and equivalents at beginning of period	59,173	67,233
Cash and equivalents at end of period	\$54,364	\$67,370

(In thousands)	Three Months Ended	
	March 31, 2019	March 31, 2018
Cash paid for income taxes, net of refunds	\$1,896	\$ 6,029
Cash paid for interest	\$3,113	\$ 2,502
Non-cash items:		
Additions to property, plant, and equipment, not yet paid	\$368	\$ —
Payable to seller of Valley Farms Supply, Inc.	\$—	\$ 450

See Notes to Condensed Consolidated Financial Statements.

**FRANKLIN ELECTRIC CO., INC. AND CONSOLIDATED SUBSIDIARIES**  
**INDEX TO NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**(Unaudited)**

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## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

### 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

The accompanying condensed consolidated balance sheet as of December 31, 2018, which has been derived from audited financial statements, and the unaudited interim condensed consolidated financial statements as of March 31, 2019, and for the first quarters ended March 31, 2019 and March 31, 2018 have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Certain information and note disclosures normally included in annual financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to those rules and regulations. In the opinion of management, all accounting entries and adjustments (including normal, recurring adjustments) considered necessary for a fair presentation of the financial position and the results of operations for the interim periods have been made. Operating results for the first quarter ended March 31, 2019 are not necessarily indicative of the results that may be expected for the fiscal year ending December 31, 2019. For further information, including a description of the critical accounting policies of Franklin Electric Co., Inc. (the "Company"), refer to the consolidated financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2018.

### 2. ACCOUNTING PRONOUNCEMENTS

#### *Adoption of New Accounting Standards*

In February 2018, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2018-02, *Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income*. This ASU was issued following the enactment of the U.S. Tax Cuts and Jobs Act of 2017 ("Tax Act") and permits entities to elect a reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects resulting from the Tax Act. The ASU is effective for interim and annual periods beginning after December 15, 2018, with early adoption permitted, and may be applied either at the beginning of the period of adoption or retrospectively to each period in which the effect of the change in the U.S. federal corporate income tax rate in the Tax Act is recognized. The Company adopted the standard effective January 1, 2019 and did not reclassify tax effects stranded in accumulated other comprehensive loss. As such, there is no impact on the Company's consolidated financial position, results of operations, and cash flows as a result of the adoption of the ASU.

In February 2016, the FASB issued ASU 2016-02, *Leases (Topic 842)*, which supersedes existing guidance on accounting for leases found in Accounting Standards Codification ("ASC") Topic 840. This ASU requires lessees to present right-of-use ("ROU") assets and lease liabilities on the balance sheet for all leases with terms longer than 12 months. In July 2018, the FASB issued ASU 2018-10, *Codification Improvements to Topic 842, Leases* and ASU 2018-11, *Leases (Topic 842): Targeted Improvements*. ASU 2018-10 clarifies certain aspects of Topic 842, including the rate implicit in the lease, impairment of the net investment in the lease, lessee reassessment of lease classification, lessor reassessment of lease term and purchase options, variable payments that depend on an index or rate and certain transition adjustments, among other things. ASU 2018-11 allows entities adopting ASU 2016-02 to choose an additional (and optional) transition method of adoption, under which an entity initially applies the new lease standard at the adoption date and recognizes a cumulative-effect adjustment to the opening balance of retained earnings in the period of adoption. Additionally, ASU 2018-11 allows lessors to not separate non-lease components from the associated lease component if certain conditions are met. The guidance is to be applied using either the transition method prescribed in ASU 2018-11 or a modified retrospective approach at the beginning of the earliest comparative period in the financial statements.

The Company adopted the standard effective January 1, 2019 utilizing the optional transition method prescribed in ASU 2018-11. The Company utilized the transition practical expedients, per ASC 842-10-65-11, that are permitted with the new standard when elected as a package. The Company will also utilize other available practical expedients, including the election not to separate non-lease components and the election to use hindsight when determining the lease terms. Finally, the Company has made an accounting policy election to not present leases with an initial term of 12 months or less (short-term leases) on the balance sheet.

The Company has recorded on the Balance Sheet ROU assets and lease liabilities. The initial ROU asset at the implementation of the standard was approximately \$26.3 million with a corresponding lease liability of the same amount. The Company segregated the lease liabilities between short term and long term based on the related contractual maturities. The Company has recognized the cash paid for lease liabilities in the Statement of Cash Flows. The Company did not have an adjustment to retained earnings as a result of the adoption of this standard. Additional disclosures regarding the Company's leases can be found in Footnote 14 - Commitments and Contingencies. In May 2014, the FASB issued ASU 2014-09, *Revenue from Contracts with Customers (Topic 606)* as modified by subsequently issued ASUs 2015-14, 2016-08, 2016-10, 2016-12 and 2016-20 (collectively ASU 2014-09). Topic 606 supersedes the revenue recognition requirements in Accounting Standards Codification ("ASC") Topic 605, Revenue Recognition ("Topic 605"), and requires the recognition of revenue when promised goods or services are transferred to



customers in an amount that reflects the considerations to which the entity expects to be entitled to in exchange for those goods or services. The Company made the accounting policy election allowed by ASC 606-10-32-2A to continue to present sales tax on a net basis, consistent with current guidance in ASC 605-45-15-2(e). The guidance permits two methods of adoption: retrospectively to each prior reporting period presented (full retrospective method), or retrospectively with the cumulative effect of initially applying the guidance recognized at the date of initial application (modified retrospective method). The Company adopted ASU 2014-09 during the first quarter ended March 31, 2018 utilizing the modified retrospective approach. The adoption of this ASU did not have a material impact to the Company's condensed consolidated financial position, results of operations, or cash flow; however, the adoption of this ASU requires the Company to disclose sufficient information to enable users of financial statements to understand the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. The Company completed its assessment of the additional disclosure requirements with the following results:

#### *Disaggregation of Revenue*

The adoption of this ASU requires the Company to disaggregate revenue into categories to depict how the nature, timing, and uncertainty of revenue and cash flows are affected by economic factors. As evidenced in Footnote 13 Segment and Geographic Information, the Company's business consists of the Water, Fueling, Distribution, and Other segments. The Other segment includes unallocated corporate expenses and intersegment eliminations. A reconciliation of disaggregated revenue to segment revenue as well as Water Segment revenue by geographical regions is provided in Footnote 13, consistent with how the Company evaluates financial performance.

#### *Performance Obligations*

A performance obligation is a promise in a contract to transfer a distinct good or service to the customer, and is the unit of account in ASC Topic 606. The Company typically sells its products to customers by purchase order, and does not have any additional performance obligations included in contracts to customers other than the shipment of products. The Company records net sales revenues after discounts at the time of sale based on specific discount programs in effect, related historical data, and experience. The Company typically ships products FOB shipping at which point control of the products passes to the customers. Any shipping and handling fees prior to shipment are considered activities required to fulfill the Company's promise to transfer goods, and do not qualify as a separate performance obligation. Shipping and handling costs are recorded as a component of cost of sales. Additionally, the Company offers assurance-type warranties (vs. service warranties) which do not qualify as a separate performance obligation. Therefore, the Company allocates the transaction price based on a single performance obligation. The Company offers normal and customary trade terms to its customers, no significant part of which is of an extended nature. The Company considers the performance obligation satisfied and recognizes revenue at a point in time, the time of shipment. The Company does not generally allow for refunds or returns to customers and does not have outstanding performance obligations for contracts with original durations of greater than one year at the end of the reporting period.

#### *Contract Costs*

The Company does not have outstanding contracts with an original term greater than one year; therefore, the Company expenses costs to obtain a contract as incurred.

#### ***Accounting Standards Issued But Not Yet Adopted***

In August 2018, the FASB issued ASU 2018-14, *Compensation-Retirement Benefits-Defined Benefit Plans-General (Topic 715-20): Disclosure Framework-Changes to the Disclosure Requirements for Defined Benefit Plans*, which modifies the disclosure requirements for employers that sponsor defined benefit pension or other postretirement plans. The amendments remove disclosures that no longer are considered cost beneficial, including the estimated amounts in accumulated other comprehensive income expected to be recognized as components of net periodic expense over the next fiscal year. The amendments clarify the specific requirements of disclosures, and add disclosure requirements identified as relevant, including the reasons for significant gains and losses related to change in the benefit obligation for the period. The ASU should be applied retrospectively and is effective for interim and annual periods beginning after December 15, 2020. The Company is still determining the date of adoption for this ASU but does not anticipate the adoption to have a material impact on the Company's consolidated financial position, results of operations, or cash

flows.

In August 2018, the FASB issued ASU 2018-15, *Goodwill and Other - Internal-Use Software (Subtopic 350-40): Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract*. This ASU aligns the requirements for capitalizing implementation costs incurred in a hosting arrangement that is a service contract with

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the requirements for capitalizing implementation costs incurred to develop or obtain internal-use software (and hosting arrangements that include internal-use software license). The ASU should be applied either retrospectively or prospectively to all implementation costs incurred after the date of adoption and is effective for interim and annual periods beginning after December 15, 2019 with early adoption permitted. The Company is still determining the date of adoption for this ASU but does not anticipate the adoption to have a material impact on the Company's consolidated financial position, results of operations, or cash flows.

In January 2017, the FASB issued ASU 2017-04, *Intangibles - Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment*. ASU 2017-04 removes step two from the goodwill impairment test and instead requires an entity to recognize a goodwill impairment charge for the amount by which the goodwill carrying amount exceeds the reporting unit's fair value. The ASU is effective on a prospective basis for interim and annual periods beginning after December 15, 2019 with early adoption permitted. The Company is still determining the date of adoption for this ASU but does not anticipate the adoption to have a material impact on the Company's consolidated financial position, results of operations, or cash flows.

### **3. ACQUISITIONS**

During the first quarter ended March 31, 2019, the Company acquired 100 percent of the ownership interests of Mt. Pleasant, Michigan-based Milan Supply Company ("Milan Supply"), for a purchase price of approximately \$6.1 million after working capital adjustments. Milan Supply is a professional groundwater distributor operating six locations in the State of Michigan. Milan Supply is part of the Company's Distribution Segment, which is a collection of professional groundwater equipment distributors. The Company has not presented separate results of operations since closing or combined pro forma financial information of the Company and the acquired interest since the beginning of 2019, as the results of operations for this acquisition is immaterial.

During the third quarter ended September 30, 2018, the Company acquired, in separate transactions, substantially all of the assets of Stationary Power Division ("SPD") of Midtronics, Inc., and 100 percent of the ownership interest in Industrias Rotor Pump S.A. ("Industrias Rotor Pump") for a combined purchase price of approximately \$37 million. The acquisitions were not material individually or in the aggregate. The fair value of the assets acquired and the liabilities assumed are preliminary as of March 31, 2019.

During the first quarter ended March 31, 2018, the Company acquired 100 percent of the ownership interests of Valley Farms Supply, Inc ("Valley Farms"). The fair value of the assets acquired and the liabilities assumed related to the Valley Farms acquisition are considered final as of March 31, 2019, and the final purchase price was \$9.5 million after working capital adjustments. The Company has not presented fair values of the assets acquired and the liabilities assumed as the values are not material.

Transaction costs were expensed as incurred under the guidance of FASB Accounting Standards Codification Topic 805, *Business Combinations*. There were \$0.0 million and \$0.1 million of transaction costs included in the "Selling, general, and administrative expenses" line of the Company's condensed consolidated statements of income for the first quarters ended March 31, 2019 and March 31, 2018, respectively.

### **4. FAIR VALUE MEASUREMENTS**

FASB ASC Topic 820, *Fair Value Measurements and Disclosures*, provides guidance for defining, measuring, and disclosing fair value within an established framework and hierarchy. Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. The standard established a fair value hierarchy which requires an entity to maximize the use of observable inputs and to minimize the use of unobservable inputs when measuring fair value. The three levels of inputs that may be used to measure fair value within the hierarchy are as follows:

Level 1 – Quoted prices for identical assets and liabilities in active markets;

Level 2 – Quoted prices for similar assets and liabilities in active markets, quoted prices for identical or similar assets and liabilities in markets that are not active, and model-derived valuations in which all significant inputs and significant value drivers are observable in active markets; and

Level 3 – Valuations derived from valuation techniques in which one or more significant inputs or significant value drivers are unobservable.

As of March 31, 2019 and December 31, 2018, the assets measured at fair value on a recurring basis were as set forth in the table below:

(In millions)		March 31, 2019	Quoted	Significant	Significant
			Prices in Active Markets for Identical Assets (Level 1)	Other Observable Inputs (Level 2)	Unobservable Inputs (Level 3)
Cash equivalents \$	3.5	\$ 3.5	\$	—\$	—
		December 31, 2018	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Cash equivalents \$	2.5	\$ 2.5	\$	—\$	—

The Company's Level 1 assets consist of cash equivalents which are generally comprised of foreign bank guaranteed certificates of deposit.

The Company has no assets measured on a recurring basis classified as Level 2 or Level 3.

Total debt, including current maturities, have carrying amounts of \$225.7 million and \$206.3 million and estimated fair values of \$228 million and \$205 million as of March 31, 2019 and December 31, 2018, respectively. In the absence of quoted prices in active markets, considerable judgment is required in developing estimates of fair value. Estimates are not necessarily indicative of the amounts the Company could realize in a current market transaction. In determining the fair value of its debt, the Company uses estimates based on rates currently available to the Company for debt with similar terms and remaining maturities. Accordingly, the fair value of debt is classified as Level 2 within the valuation hierarchy.

## 5. FINANCIAL INSTRUMENTS

The Company's deferred compensation stock program is subject to variable plan accounting and, accordingly, is adjusted for changes in the Company's stock price at the end of each reporting period. The Company has entered into share swap transaction agreements (the "swap") to mitigate the Company's exposure to the fluctuations in the Company's stock price. The swap has not been designated as a hedge for accounting purposes and is cancellable with 30 days' written notice by either party. As of March 31, 2019, the swap had a notional value based on 235,000 shares. For the first quarters ended March 31, 2019 and March 31, 2018, the swap resulted in a gain of \$1.9 million and a loss of \$1.1 million, respectively. Gains and losses resulting from the the swap were primarily offset by gains and losses on the fair value of the deferred compensation stock liability. All gains or losses and expenses related to the swap are recorded in the Company's condensed consolidated statements of income within the "Selling, general, and administrative expenses" line.

## 6. GOODWILL AND OTHER INTANGIBLE ASSETS

The carrying amounts of the Company's intangible assets are as follows:

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(In millions)	March 31, 2019		December 31, 2018	
	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
Amortizing intangibles:				
Patents	\$7.5	\$ (6.9 )	\$7.5	\$ (6.9 )
Technology	7.5	(6.5 )	7.5	(6.4 )
Customer relationships	150.8	(65.6 )	151.0	(63.8 )
Other	2.8	(2.6 )	2.8	(2.5 )
Total	\$168.6	\$ (81.6 )	\$168.8	\$ (79.6 )
Unamortizing intangibles:				
Trade names	45.8	—	45.9	—
Total intangibles	\$214.4	\$ (81.6 )	\$214.7	\$ (79.6 )

Amortization expense related to intangible assets for the first quarters ended March 31, 2019 and March 31, 2018 was \$2.3 million and \$2.2 million, respectively.

Amortization expense for each of the five succeeding years is projected as follows:

(In millions) 2019 2020 2021 2022 2023  
 \$9.2 \$9.0 \$8.7 \$8.5 \$8.4

The change in the carrying amount of goodwill by reportable segment for the three months ended March 31, 2019, is as follows:

(In millions)

	Water Systems	Fueling Systems	Distribution	Consolidated
Balance as of December 31, 2018	\$ 145.5	\$ 67.5	\$ 35.7	\$ 248.7
Acquisitions	—	—	1.7	1.7
Foreign currency translation	(0.6 )	0.1	—	(0.5 )
Balance as of March 31, 2019	\$ 144.9	\$ 67.6	\$ 37.4	\$ 249.9

## 7. EMPLOYEE BENEFIT PLANS

**Defined Benefit Plans** - As of March 31, 2019, the Company maintained two domestic pension plans and three German pension plans. The Company used a December 31, 2018 measurement date for these plans. One of the Company's domestic pension plans covers one active management employee, while the other domestic plan covers all eligible employees (plan was frozen as of December 31, 2011). The two domestic and three German plans collectively comprise the 'Pension Benefits' disclosure caption.

**Other Benefits** - The Company's other post-retirement benefit plan provides health and life insurance to domestic employees hired prior to 1992.

The following table sets forth the aggregated net periodic benefit cost for all pension plans for the first quarters ended March 31, 2019 and March 31, 2018:

(In millions)	Pension Benefits		Other Benefits	
	First Quarter Ended March 31, 2019 2018		First Quarter Ended March 31, 2019 2018	
Service cost	\$0.2	\$ 0.2	\$—	\$ —
Interest cost	1.5	1.3	0.1	0.1
Expected return on assets	(2.0 )	(2.1 )	—	—
Amortization of:				
Prior service cost	—	—	—	—
Actuarial loss	0.6	0.7	—	0.1
Settlement cost	—	—	—	—
Net periodic benefit cost	\$0.3	\$ 0.1	\$0.1	\$ 0.2

In the first quarter ended March 31, 2019, the Company made contributions of \$0.0 million to the funded plans. The amount of contributions to be made to the plans during the calendar year 2019 will be finalized by September 15, 2019, based upon the funding level requirements identified and year-end valuation performed at December 31, 2018.

**8. INCOME TAXES**

The Company's effective tax rate from continuing operations for the three month period ended March 31, 2019 was 13.9 percent as compared to negative 8.7 percent for the three month period ended March 31, 2018. The effective tax rate is lower than the U.S. statutory rate of 21 percent primarily due to foreign earnings taxed at rates below the U.S. statutory rate, t

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he recognition of the foreign-derived intangible income (FDII) provisions, and certain discrete events including excess tax benefits from share-based compensation.

The increase in the effective tax rate for the three months ended March 31, 2019, compared with the same period in 2018, was primarily a result of the release of a valuation allowance of \$5.4 million related to NOLs and incentives during the three month period ended March 31, 2018.

## 9. DEBT

Debt consisted of the following:

(In millions)	March 31, December 31,	
	2019	2018
Prudential Agreement	\$ 30.0	\$ 30.0
Tax increment financing debt	19.3	19.8
New York Life Agreement	75.0	75.0
Credit Agreement	95.7	76.3
Financing Leases	0.1	0.1
Foreign subsidiary debt	5.8	5.4
Less: unamortized debt issuance costs	(0.1 )	(0.2 )
	\$ 225.8	\$ 206.4
Less: current maturities	(132.0 )	(112.0 )
Long-term debt	\$ 93.8	\$ 94.4

Debt outstanding, excluding unamortized debt issuance costs, at March 31, 2019 matures as follows:

(In millions)	Total	Year 1	More					Than
			Year 2	Year 3	Year 4	Year 5	Years	
Debt	\$225.8	\$132.0	\$1.2	\$1.3	\$1.3	\$1.3	\$88.7	
Financing Leases	0.1	—	0.1	—	—	—	—	
	\$225.9	\$132.0	\$1.3	\$1.3	\$1.3	\$1.3	\$88.7	

### **Prudential Agreement**

The Company maintains the Third Amended and Restated Note Purchase and Private Shelf Agreement (the "Prudential Agreement") with an initial borrowing capacity of \$250.0 million. The Prudential Agreement bears a coupon of 5.79 percent with a final maturity in 2019. Principal installments of \$30.0 million are payable annually, including the date of maturity of April 30, 2019, with any unpaid balance due at that time. There is no additional borrowing capacity resulting from principal payments made by the Company. As of March 31, 2019, the Company has \$150.0 million borrowing capacity available under the Prudential Agreement.

### **Project Bonds**

The Company, Allen County, Indiana and certain institutional investors maintain a Bond Purchase and Loan Agreement. Under the agreement, Allen County, Indiana issued a series of Project Bonds entitled "Taxable Economic Development Bonds, Series 2012 (Franklin Electric Co., Inc. Project)." The aggregate principal amount of the Project Bonds that were issued, authenticated, and are now outstanding thereunder was limited to \$25.0 million. These Project Notes ("Tax increment financing debt") bear interest at 3.6 percent per annum. Interest and principal balance of the Project Notes are due and payable by the Company directly to the institutional investors in aggregate semi-annual installments commencing on July 10, 2013, and concluding on January 10, 2033.

***New York Life Agreement***

The Company maintains an uncommitted and unsecured private shelf agreement with NYL Investors LLC, an affiliate of New York Life, and each of the undersigned holders of Notes (the "New York Life Agreement"), with a maximum aggregate borrowing capacity of \$200.0 million. On September 26, 2018, the Company issued and sold \$75.0 million of fixed rate senior notes due September 26, 2025. These senior notes bear an interest rate of 4.04 percent with interest-only payments due semi-annually. The proceeds from the issuance of the notes were used to pay off existing variable interest rate indebtedness. As

of March 31, 2019, there was \$125.0 million remaining borrowing capacity under the New York Life Agreement.

### ***Credit Agreement***

The Company maintains the Third Amended and Restated Credit Agreement (the "Credit Agreement"). The Credit Agreement has a maturity date of October 28, 2021 and commitment amount of \$300.0 million. The Credit Agreement provides that the Borrowers may request an increase in the aggregate commitments by up to \$150.0 million (not to exceed a total commitment of \$450.0 million). Under the Credit Agreement, the Borrowers are required to pay certain fees, including a facility fee of 0.100% to 0.275% (depending on the Company's leverage ratio) of the aggregate commitment, which fee is payable quarterly in arrears. Loans may be made either at (i) a Eurocurrency rate based on LIBOR plus an applicable margin of 0.75% to 1.60% (depending on the Company's leverage ratio) or (ii) an alternative base rate as defined in the Credit Agreement.

As of March 31, 2019, the Company had \$95.7 million in outstanding borrowings which were primarily used for acquisition and working capital needs, \$3.7 million in letters of credit outstanding, and \$200.6 million of available capacity under the Credit Agreement.

### ***Covenants***

The Company's credit agreements contain customary financial covenants. The Company's most significant agreements and restrictive covenants are in the New York Life Agreement, the Project Bonds, the Prudential Agreement, and the Credit Agreement; each containing both affirmative and negative covenants. The affirmative covenants relate to financial statements, notices of material events, conduct of business, inspection of property, maintenance of insurance, compliance with laws and most favored lender obligations. The negative covenants include limitations on loans, advances and investments, and the granting of liens by the Company or its subsidiaries, as well as prohibitions on certain consolidations, mergers, sales and transfers of assets. The covenants also include financial requirements including a maximum leverage ratio of 3.50 to 1.00 and a minimum interest coverage ratio of 3.00 to 1.00. Cross default is applicable with the Prudential Agreement, the Project Bonds, the New York Life Agreement, and the Credit Agreement but only if the Company is defaulting on an obligation exceeding \$10.0 million. The Company was in compliance with all financial covenants as of March 31, 2019.

## **10. EARNINGS PER SHARE**

The Company calculates basic and diluted earnings per common share using the two-class method. Under the two-class method, net earnings are allocated to each class of common stock and participating security as if all of the net earnings for the period had been distributed. The Company's participating securities consist of share-based payment awards that contain a nonforfeitable right to receive dividends and therefore are considered to participate in undistributed earnings with common shareholders.

Basic earnings per common share excludes dilution and is calculated by dividing net earnings allocable to common shares by the weighted-average number of common shares outstanding for the period. Diluted earnings per common share is calculated by dividing net earnings allocated to common shares by the weighted-average number of common shares outstanding for the period, as adjusted for the potential dilutive effect of non-participating share-based awards.

The following table sets forth the computation of basic and diluted earnings per share:

(In millions, except per share amounts)	First Quarter Ended	
	March 31, 2019	March 31, 2018
Numerator:		
Net income attributable to Franklin Electric Co., Inc.	\$9.1	\$ 21.2
Less: Earnings allocated to participating securities	0.1	0.2
Net income available to common shareholders	\$9.0	\$ 21.0
Denominator:		
Basic weighted average common shares outstanding	46.3	46.6
Effect of dilutive securities:		
Non-participating employee stock options and performance awards	0.4	0.5
Diluted weighted average common shares outstanding	46.7	47.1
Basic earnings per share	\$0.19	\$ 0.45
Diluted earnings per share	\$0.19	\$ 0.45

There were 0.1 million and 0.3 million stock options outstanding for the first quarters ended March 31, 2019 and March 31, 2018, respectively, that were excluded from the computation of diluted earnings per share, as their inclusion would be anti-dilutive.

**11. EQUITY ROLL FORWARD**

The schedules below set forth equity changes in the first quarters ended March 31, 2019 and March 31, 2018:

(In thousands)	Common Stock	Additional Paid in Capital	Retained Earnings	Minimum Pension Liability	Cumulative Translation Adjustment	Noncontrolling Interest	Total Equity	Redeemable Noncontrolling Interest
Balance as of December 31, 2018	\$ 4,632	\$ 257,535	\$ 654,724	\$(48,585)	\$(134,434)	\$ 1,955	\$ 735,827	\$ 518
Net income			9,056			174	9,230	(103)
Dividends on common stock (\$0.145/share)			(6,723)				(6,723)	
Common stock issued	6	1,245					1,251	
Common stock repurchased	(9)		(4,320)				(4,329)	
Share-based compensation	8	3,222					3,230	
Currency translation adjustment					(2,771)	(32)	(2,803)	(7)
Pension liability, net of tax				509			509	
Balance as of March 31, 2019	\$ 4,637	\$ 262,002	\$ 652,737	\$(48,076)	\$(137,205)	\$ 2,097	\$ 736,192	\$ 408

(In thousands)	Common Stock	Additional Paid in Capital	Retained Earnings	Minimum Pension Liability	Cumulative Translation Adjustment	Noncontrolling Interest	Total Equity	Redeemable Noncontrolling Interest
Balance as of December 31, 2017	\$ 4,663	\$ 240,136	\$ 604,905	\$(49,364)	\$(99,683)	\$ 1,964	\$ 702,621	\$ 1,502
Net Income			21,174			195	21,369	(154)
Dividends on common stock (\$0.1075/share)			(5,037)				(5,037)	
Common stock issued	3	639					642	
Common stock repurchased	(20)		(7,929)				(7,949)	
Share-based compensation	6	3,320					3,326	
Currency translation adjustment					6,943	40	6,983	12
Pension liability, net of tax				601			601	
Balance as of March 31, 2018	\$ 4,652	\$ 244,095	\$ 613,113	\$(48,763)	\$(92,740)	\$ 2,199	\$ 722,556	\$ 1,360

**12. ACCUMULATED OTHER COMPREHENSIVE INCOME/(LOSS)**

Changes in accumulated other comprehensive income/(loss) by component for the first quarters ended March 31, 2019 and March 31, 2018, are summarized below:

(In millions)

	Foreign Currency Translation Adjustments	Pension and Post-Retirement Plan Benefit Adjustments <sup>(2)</sup>	Total
<b>For the first quarter ended March 31, 2019:</b>			
Balance as of December 31, 2018	\$ (134.5 )	\$ (48.5 )	\$ (183.0 )
Other comprehensive income/(loss) before reclassifications	(2.8 )	—	(2.8 )
Amounts reclassified from accumulated other comprehensive income/(loss) <sup>(1)</sup>	—	0.5	0.5
Net other comprehensive income/(loss)	(2.8 )	0.5	(2.3 )
Balance as of March 31, 2019	\$ (137.3 )	\$ (48.0 )	\$ (185.3 )
<b>For the first quarter ended March 31, 2018</b>			
Balance as of December 31, 2017	\$ (99.7 )	\$ (49.3 )	\$ (149.0 )
Other comprehensive income/(loss) before reclassifications	6.9	—	6.9
Amounts reclassified from accumulated other comprehensive income/(loss) <sup>(1)</sup>	—	0.6	0.6
Net other comprehensive income/(loss)	6.9	0.6	7.5
Balance as of March 31, 2018	\$ (92.8 )	\$ (48.7 )	\$ (141.5 )

(1) This accumulated other comprehensive income/(loss) component is included in the computation of net periodic pension cost (refer to Note 7 for additional details) and is included in the "Other income/(expense), net" line of the Company's condensed consolidated statements of income.

(2) Net of tax expense of \$0.1 million and \$0.2 million for the three months ended March 31, 2019 and March 31, 2018, respectively.

Amounts related to noncontrolling interests were not material.

### 13. SEGMENT AND GEOGRAPHIC INFORMATION

The accounting policies of the operating segments are the same as those described in Note 1 of the Company's Form 10-K. Revenue is recognized based on the invoice price at the point in time when the customer obtains control of the product, which is typically upon shipment to the customer. The Water and Fueling segments include manufacturing operations and supply certain components and finished goods, both between segments and to the Distribution segment. The Company reports these product transfers between Water and Fueling as inventory transfers as a significant number of the Company's manufacturing facilities are shared across segments for scale and efficiency purposes. The Company reports intersegment transfers from Water to Distribution as intersegment revenue at market prices to properly reflect the commercial arrangement of vendor to customer that exists between the Water and Distribution segments.

Segment operating income is a key financial performance measure. Operating income by segment is based on net sales less identifiable operating expenses and allocations and includes profits recorded on sales to other segments of the Company. During the first quarter of 2019, the Company changed management reporting for transfers of certain

products between the Water and Fueling segments. This reclassification resulted in \$0.8 million of sales and \$0.1 million of operating income for the quarter ended March 31, 2018, being reclassified from the Fueling Segment to the Water segment. There is no impact on the Company's previously reported consolidated financial position, results of operations, or cash flows.

Financial information by reportable business segment is included in the following summary:

(In millions)	First Quarter Ended March 31	
	2019	2018
	Net sales	
<b>Water Systems</b>		
External sales		
United States & Canada	\$86.8	\$ 84.7
Latin America	30.5	29.1
Europe, Middle East & Africa	37.7	46.2
Asia Pacific	22.2	20.8
Intersegment sales		
United States & Canada	11.2	11.8
Total sales	188.4	192.6
<b>Distribution</b>		
External sales		
United States & Canada	53.3	56.2
Intersegment sales	—	—
Total sales	53.3	56.2
<b>Fueling Systems</b>		
External sales		
United States & Canada	35.1	32.0
All other	25.1	26.6
Intersegment sales	—	—
Total sales	60.2	58.6
Intersegment Eliminations/Other	(11.2 )	(11.8 )
Consolidated	\$290.7	\$ 295.6

	First Quarter Ended March 31	
	2019	2018
	Operating income/(loss)	
Water Systems	\$19.2	\$ 25.1
Distribution	(4.3 )	(0.8 )
Fueling Systems	12.3	13.7
Intersegment Eliminations/Other	(15.1 )	(15.3 )
Consolidated	\$12.1	\$ 22.7

	March 31, December 31,	
	2019	2018
	Total assets	
Water Systems	\$694.3	\$ 679.7
Distribution	185.1	165.1
Fueling Systems	283.5	275.7
Other	65.9	61.9
Consolidated	\$1,228.8	\$ 1,182.4





Other Assets are generally Corporate assets that are not allocated to the segments and are comprised primarily of cash and property, plant and equipment.

#### 14. COMMITMENTS AND CONTINGENCIES

The Company is defending various claims and legal actions which have arisen in the ordinary course of business. In the opinion of management, based on current knowledge of the facts and after discussion with counsel, these claims and legal actions can be defended or resolved without a material effect on the Company's financial position, results of operations, and net cash flows.

At March 31, 2019, the Company had \$7.8 million of commitments primarily for capital expenditures and purchase of raw materials to be used in production.

The Company provides warranties on most of its products. The warranty terms vary but are generally two years to five years from date of manufacture or one year to five years from date of installation. Provisions for estimated expenses related to product warranty are made at the time products are sold or when specific warranty issues are identified. These estimates are established using historical information about the nature, frequency, and average cost of warranty claims. The Company actively studies trends of warranty claims and takes actions to improve product quality and minimize warranty claims. The Company believes that the warranty reserve is appropriate; however, actual claims incurred could differ from the original estimates, requiring adjustments to the reserve.

The changes in the carrying amount of the warranty accrual, as recorded in the "Accrued expenses and other current liabilities" line of the Company's condensed consolidated balance sheet for the first quarter ended March 31, 2019, are as follows:

(In millions)

Balance as of December 31, 2018	\$9.0
Accruals related to product warranties	2.5
Additions related to acquisitions	0.2
Reductions for payments made	(2.9 )
Balance as of March 31, 2019	\$8.8

The Company maintains certain warehouses, distribution centers, office space, and equipment operating leases. The Company also has lease agreements that are classified as financing. These financing leases are immaterial to the Company.

The Company utilizes interest rates from lease agreements unless the lease agreement does not provide a readily determinable rate. In these instances, the Company utilized its incremental borrowing rate based on the information available as of the adoption of ASU 2016-02 or at the inception of any new leases entered into thereafter when determining the present value of future lease payments.

Some of the Company's leases include renewal options. The Company excludes these renewal options in the expected lease term unless the Company is reasonably certain that the option will be exercised.

The components of the Company's operating lease portfolio as of the first quarter ended March 31, 2019 are as follows:

Lease Cost (in millions):

Operating lease cost	\$2.8
Short-term lease cost	0.1

Other Information:

Weighted-average remaining lease term

	6
	years
Weighted-average discount rate	4.4 %

As of March 31, 2019 the Company has approximately \$1.4 million of additional ROU assets related to leases that have not yet commenced, but create future lease obligations.

The minimum rental payments for non-cancellable operating leases as of March 31, 2019, are as follows:

(In millions)	2019	2020	2021	2022	2023	Thereafter
Future Minimum Rental Payments	\$ 7.0	\$ 7.2	\$ 4.9	\$ 3.4	\$ 2.5	\$ 6.7

The minimum rental payments for non-cancellable operating leases as of December 31, 2018, were reported as follows:

(In millions)	2019	2020	2021	2022	2023	Thereafter
Future Minimum Rental Payments	\$ 8.9	\$ 5.9	\$ 3.5	\$ 2.0	\$ 1.1	\$ 5.7

## 15. SHARE-BASED COMPENSATION

The Franklin Electric Co., Inc. 2017 Stock Plan (the "2017 Stock Plan") is a stock-based compensation plan that provides for discretionary grants of stock options, stock awards, stock unit awards, and stock appreciation rights ("SARs") to key employees and non-employee directors. The number of shares that may be issued under the Plan is 1,400,000. Stock options and SARs reduce the number of available shares by one share for each share subject to the option or SAR, and stock awards and stock unit awards settled in shares reduce the number of available shares by 1.5 shares for every one share delivered.

The Company also maintains the Franklin Electric Co., Inc. 2012 Stock Plan (the "2012 Stock Plan"), which is a stock-based compensation plan that provides for discretionary grants of stock options, stock awards, and stock unit awards to key employees and non-employee directors.

The 2012 Stock Plan authorized 2,400,000 shares for issuance as follows:

2012 Stock Plan	Authorized Shares
Stock Options	1,680,000
Stock/Stock Unit Awards	720,000

The Company also maintains the Amended and Restated Franklin Electric Co., Inc. Stock Plan (the "2009 Stock Plan") which, as amended in 2009, provided for discretionary grants of stock options and stock awards. The 2009 Stock Plan authorized 4,400,000 shares for issuance as follows:

2009 Stock Plan Authorized Shares	
Stock Options	3,200,000
Stock Awards	1,200,000

All options in the 2009 Stock Plan have been awarded.

The Company currently issues new shares from its common stock balance to satisfy option exercises and the settlement of stock awards and stock unit awards made under the outstanding stock plans.

### **Stock Options:**

The fair value of each option award is estimated on the date of grant using the Black-Scholes option valuation model with a single approach and amortized using a straight-line attribution method over the option's vesting period.

The assumptions used for the Black-Scholes model to determine the fair value of options granted during the first quarters ended March 31, 2019 and March 31, 2018 are as follows:

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	March 31, 2019	March 31, 2018		
Risk-free interest rate	2.53	% 2.69	%	
Dividend yield	1.05	% 1.05	%	
Volatility factor	29.38	% 28.71	%	
Expected term	5.5 years	5.6 years		

A summary of the Company's outstanding stock option activity and related information for the first quarter ended March 31, 2019 is as follows:

(Shares in thousands)	March 31, 2019	
	Shares	Weighted-Average Exercise Price
Stock Options		
Outstanding at beginning of period	1,229	\$ 33.25
Granted	190	55.16
Exercised	(59 )	21.14
Forfeited	—	—
Outstanding at end of period	1,360	\$ 36.84
Expected to vest after applying forfeiture rate	1,351	\$ 36.78
Vested and exercisable at end of period	839	\$ 31.86

A summary of the weighted-average remaining contractual term and aggregate intrinsic value as of March 31, 2019 is as follows:

	Weighted-Average Remaining Contractual Term	Aggregate Intrinsic Value (000's)
Outstanding at end of period	6.55 years	\$ 20,155
Expected to vest after applying forfeiture rate	6.53 years	\$ 20,088
Vested and exercisable at end of period	5.10 years	\$ 16,129

The total intrinsic value of options exercised during the first quarters ended March 31, 2019 and March 31, 2018 was \$2.0 million and \$0.4 million, respectively.

As of March 31, 2019, there was \$2.4 million of total unrecognized compensation cost related to non-vested stock options granted under the 2012 Stock Plan. That cost is expected to be recognized over a weighted-average period of 2.17 years.

**Stock/Stock Unit Awards:**

A summary of the Company's restricted stock/stock unit award activity and related information for the first quarter ended March 31, 2019 is as follows:

(Shares in thousands)	March 31, 2019	
	Shares	Weighted-Average Grant- Date Fair Value
Restricted Stock/Stock Unit Awards		
Non-vested at beginning of period	498	\$ 37.27

Awarded	118	54.61
Vested	(67)	36.60
Forfeited	(5)	37.56
Non-vested at end of period	544	\$ 41.12

As of March 31, 2019, there was \$12.6 million of total unrecognized compensation cost related to non-vested restricted stock/stock unit awards granted under the 2012 Stock Plan and the 2009 Stock Plan. That cost is expected to be recognized over a weighted-average period of 1.98 years.

## ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

### *First Quarter 2019 vs. First Quarter 2018*

#### OVERVIEW

Sales in the first quarter of 2019 decreased from the first quarter of last year. The sales decrease was primarily from foreign currency translation. The Company's consolidated gross profit was \$89.5 million for the first quarter of 2019, a decrease of \$9.5 million from the prior year's first quarter. The gross profit decrease was primarily due to lower sales. The gross profit as a percent of net sales was 30.8 percent in the first quarter of 2019 versus 33.5 percent during the first quarter 2018.

#### RESULTS OF OPERATIONS

##### *Net Sales*

Net sales in the first quarter of 2019 were \$290.7 million, a decrease of \$4.9 million or about 2 percent compared to 2018 first quarter sales of \$295.6 million. The sales increase from acquisitions was \$8.6 million. Sales revenue decreased by \$12.9 million or about 4 percent in the first quarter of 2019 due to foreign currency translation. Excluding the impact of foreign currency translation, the Company's organic sales growth was flat.

(In millions)	Net Sales		
	Q1 2019	Q1 2018	2019 v 2018
Water Systems	\$188.4	\$192.6	\$(4.2)
Fueling Systems	60.2	58.6	\$1.6
Distribution	53.3	56.2	\$(2.9)
Eliminations/Other	(11.2 )	(11.8 )	\$0.6
Consolidated	\$290.7	\$295.6	\$(4.9)

##### *Net Sales-Water Systems*

Water Systems revenues were \$188.4 million in the first quarter 2019, a decrease of \$4.2 million or about 2 percent versus the first quarter 2018 sales of \$192.6 million. In the first quarter of 2019, sales from businesses acquired since the first quarter of 2018 were \$4.3 million. Sales decreased by \$11.5 million or 6 percent in the quarter due to foreign currency translation. Water Systems sales were up about 2 percent, excluding foreign currency translation, in the first quarter of 2019 versus the first quarter of 2018.

Water Systems sales in the U.S. and Canada increased by about 2 percent compared to the first quarter 2018. Foreign currency translation decreased sales by about 1 percent. Sales of Pioneer branded dewatering equipment increased by about 10 percent in the first quarter when compared to the prior year due to diversification of product sales channels. Sales of other surface pumping equipment increased by about 2 percent on stronger sales of wastewater products. Sales of groundwater pumping equipment were down about 5 percent versus the first quarter 2018. The decline in groundwater pumping systems was primarily due to adverse winter weather conditions in North America that reduced demand for the Company's groundwater pumping systems including sales through the Headwater Distribution segment.



Water Systems sales in markets outside the U.S. and Canada declined by about 6 percent overall. Foreign currency translation decreased sales by about 11 percent. Outside the U.S. and Canada, Water Systems realized organic sales growth of about 11 percent in Asia Pacific and about 15 percent in Brazil versus the first quarter 2018. These increases were offset by an organic sales decline in Europe, the Middle East and Central America.

***Net Sales-Fueling Systems***

Fueling Systems sales were \$60.2 million in the first quarter of 2019, an increase of \$1.6 million or about 3 percent versus the first quarter 2018 sales of \$58.6 million. In the first quarter of 2019, sales from businesses acquired since the first quarter of

2018 were \$1.5 million. Fueling Systems sales decreased by \$1.4 million or 2 percent in the quarter due to foreign currency translation. Fueling Systems sales growth, excluding foreign currency translation, was about 3 percent.

Fueling Systems sales in the U.S. and Canada increased by about 10 percent compared to the first quarter 2018. The increase was principally in the fuel management and service station hardware product lines. Outside the U.S. and Canada, Fueling Systems revenues declined by about 5 percent, due to lower sales of storage tanks, fuel pumping systems, and underground pipe and containment systems primarily in Europe and China.

### ***Net Sales-Distribution***

Distribution sales were \$53.3 million in the first quarter 2019, versus first quarter 2018 sales of \$56.2 million. In the first quarter of 2019, sales from businesses acquired since the first quarter of 2018 were \$2.8 million. The Distribution segment organic sales were down about 10 percent compared to the first quarter of 2018 primarily due to unfavorable weather conditions.

### ***Cost of Sales***

Cost of sales as a percentage of net sales for the first quarters of 2019 and 2018 was 69.2 percent and 66.5 percent, respectively. Correspondingly, the gross profit margin decreased to 30.8 percent from 33.5 percent, a decline of 270 basis points. The Company's consolidated gross profit was \$89.5 million for the first quarter of 2019, a decrease from the first quarter of 2018 gross profit of \$99.0 million. The gross profit decrease was primarily due to lower sales volume primarily due to unfavorable weather conditions in North America. The decline in gross profit margin percentage is primarily due to the lost leverage on fixed cost from the lower sales, unfavorable product and geographic sales mix shifts, mostly in the Water Systems segment, and higher freight costs.

### ***Selling, General, and Administrative ("SG&A")***

Selling, general, and administrative (SG&A) expenses were \$76.3 million in the first quarter of 2019 and 2018. SG&A expenses from acquired businesses was \$3.0 million and excluding the acquired entities, the Company's SG&A expenses in the first quarter of 2019 were \$73.3 million, a decrease of about 4 percent from the first quarter 2018, due primarily to the effect of foreign currency translations in the first quarter of 2019 versus the prior year.

### ***Restructuring Expenses***

There were \$1.1 million of restructuring expenses for the first quarter of 2019. Restructuring expenses for the first quarter of 2019 were \$0.6 million in the Distribution segment and related to miscellaneous branch closings and consolidation. Restructuring expenses for the first quarter of 2019 were \$0.5 million in the Water segment and related to continued miscellaneous manufacturing realignment activities. There were no meaningful restructuring expenses for the first quarter of 2018.

### ***Operating Income***

Operating income was \$12.1 million in the first quarter of 2019, down \$10.6 million or about 47 percent from \$22.7 million in the first quarter of 2018.

(In millions)	Operating income (loss)		
	Q1 2019	Q1 2018	2019 v 2018
Water Systems	\$19.2	\$25.1	\$(5.9 )
Fueling Systems	12.3	13.7	(1.4 )
Distribution	(4.3 )	(0.8 )	(3.5 )
Eliminations/Other	(15.1 )	(15.3 )	0.2
Consolidated	\$12.1	\$22.7	\$(10.6)

### ***Operating Income-Water Systems***

Water Systems operating income was \$19.2 million in the first quarter 2019, down \$5.9 million versus the first quarter 2018. The first quarter operating income margin was 10.2 percent, down 280 basis points from 13.0 percent in the first quarter of 2018. Operating income decreased in Water Systems primarily due to lower sales volume, the resultant lost leverage on fixed costs, adverse product sales mix and higher freight costs.

*Operating Income-Fueling Systems*

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Fueling Systems operating income was \$12.3 million in the first quarter of 2019 compared to \$13.7 million in the first quarter of 2018, a decrease of about 10 percent. The decrease in operating income was primarily related to higher fixed costs. The first quarter Fueling Systems operating income margin was 20.4 percent, a decrease of 300 basis points from the 23.4 percent of net sales in the first quarter of 2018. Operating income margin declined primarily due to lost leverage on fixed costs as growth from higher sales was offset by higher fixed costs.

#### ***Operating Income-Distribution***

The Distribution segment recorded an operating loss of \$4.3 million in the first quarter of 2019 compared to a \$0.8 million loss in the first quarter of 2018. The Distribution loss was primarily due to lower sales volume, higher product costs partially offset by sales price increases, adverse geographic and product sales mix and lost leverage on fixed costs from lower sales.

#### ***Operating Income-Eliminations/Other***

Operating income-Eliminations/Other is composed primarily of intersegment sales and profit eliminations and unallocated general and administrative expenses. The intersegment profit elimination impact in the first quarter of 2019 versus the first quarter of 2018 was expense of \$0.6 million. The intersegment elimination of operating income effectively defers the operating income on sales from Water Systems to Distribution in the consolidated financial results until such time as the transferred product is sold from the Distribution segment to its end third party customer. General and administrative expenses were lower by \$0.8 million or about 6 percent to last year, primarily due to lower variable incentive-based compensation expenses.

#### ***Interest Expense***

Interest expense for the first quarters of 2019 and 2018 was \$2.3 million and \$2.4 million, respectively.

#### ***Other Income or Expense***

Other income or expense was income in the first quarter of 2019 of \$0.2 million and a loss of \$0.2 million in the first quarter of 2018. Included in other income in the first quarter of 2019 was interest income of \$0.2 million, primarily derived from the investment of cash balances in short-term securities. Included in other income in the first quarter of 2018 was interest income of \$0.1 million, primarily derived from the investment of cash balances in short-term securities.

#### ***Foreign Exchange***

Foreign currency-based transactions produced a gain of \$0.6 million for the first quarter of 2019. Foreign currency-based transactions produced a loss of \$0.6 million for the first quarter of 2018.

#### ***Income Taxes***

The provision for income taxes in the first quarter of 2019 was an expense of \$1.5 million and for the same period 2018 a benefit of \$1.7 million. The effective tax rate for the first quarter of 2019 was about 14 percent and, before the impact of discrete events, was about 20 percent. The effective tax rate for the first quarter of 2018 was a benefit of about 9 percent and, before the impact of discrete events, was about 19 percent. The increase in the effective tax rate was primarily the result of the release of a valuation allowance of \$5.4 million related to state net operating losses and incentives during the first quarter of 2018. The tax rate as a percentage of pre-tax earnings for the full year of 2019 is projected to be about 20 percent, compared to the full year 2018 tax rate of about 19 percent, both before discrete adjustments.

#### ***Net Income***

Net income for the first quarter of 2019 was \$9.1 million compared to the prior year first quarter net income of \$21.2 million. Net income attributable to Franklin Electric Co., Inc. for the first quarter of 2019 was \$9.1 million, or \$0.19 per diluted share, compared to the prior year first quarter net income attributable to Franklin Electric Co., Inc. of \$21.2 million or \$0.45 per diluted share.

## **CAPITAL RESOURCES AND LIQUIDITY**

### ***Sources of Liquidity***

The Company's primary sources of liquidity are cash on hand, cash flows from operations, revolving credit agreements, and long-term debt funds available. The Company believes its capital resources and liquidity position at March 31, 2019 is adequate to meet projected needs for the foreseeable future. The Company expects that ongoing requirements for operations, capital expenditures, pension obligations, dividends, share repurchases, and debt service will be adequately funded from cash on hand, operations, and exiting credit agreements.

As of March 31, 2019 the Company had \$300.0 million revolving credit facility. The facility is scheduled to mature on October 28, 2021. As of March 31, 2019, the Company had \$200.6 million borrowing capacity under the Credit Agreement as \$3.7

million in letters of commercial and standby letters of credit were outstanding and undrawn and \$95.7 million in revolver borrowings were drawn and outstanding which were primarily used for acquisition and working capital needs.

The Company also has other long-term debt borrowing outstanding as of March 31, 2019. See Note 9 - Debt for additional specifics regarding these obligations and future maturities.

At March 31, 2019, the Company had \$49.9 million of cash and cash equivalents held in foreign jurisdictions, which is intended to be used to fund foreign operations. There is currently no need to repatriate these funds in order to meet domestic funding obligations or scheduled cash distributions.

### **Cash Flows**

The following table summarizes significant sources and uses of cash and cash equivalents for the first three months of 2019 and 2018.

(in millions)	2019	2018
Net cash used in operating activities	\$(2.9)	\$(27.2)
Net cash used in investing activities	(10.6)	(14.2)
Net cash provided by financing activities	9.9	39.7
Impact of exchange rates on cash and cash equivalents	(1.2)	1.8
Change in cash and cash equivalents	\$(4.8)	\$0.1

### **Cash Flows Used in Operating Activities**

#### **2019 vs. 2018**

Net cash used in operating activities was \$2.9 million for the first quarter ended March 31, 2019 compared to \$27.2 million used in operating activities for the first quarter ended March 31, 2018. The decrease in cash used by operating activities was due to a decrease of \$30.3 million in working capital requirements, primarily customer accounts receivable and accounts payable offset by a decrease in net earnings of about \$6.6 million before the prior year non-cash gain of the release of a valuation allowance in deferred income taxes.

### **Cash Flows Used in Investing Activities**

#### **2019 vs. 2018**

Net cash used in investing activities was \$10.6 million for the first quarter ended March 31, 2019 compared to \$14.2 million used in investing activities for the first quarter ended March 31, 2018. The decrease in cash used in investing activities is primarily attributable to decreased acquisition activity and lower spending for property, plant and equipment during the current year.

### **Cash Flows Provided by Financing Activities**

#### **2019 vs. 2018**

Net cash provided by financing activities was \$9.9 million for the first quarter ended March 31, 2019 compared to \$39.7 million provided by financing activities for the first quarter ended March 31, 2018. The decrease in cash provided by financing activities was primarily attributable to lower net debt borrowings, down approximately \$32.3 million in the current year consistent with reduced working capital requirements as well as an increase in dividends paid of \$1.7 million in the current year compared to dividends paid in the prior year. These were offset by a decrease in common stock repurchases of \$3.6 million in the current year compared to common stock repurchases in the prior year.

### **FACTORS THAT MAY AFFECT FUTURE RESULTS**

This quarterly report on Form 10-Q contains certain forward-looking information, such as statements about the Company's financial goals, acquisition strategies, financial expectations including anticipated revenue or expense levels, business prospects, market positioning, product development, manufacturing re-alignment, capital expenditures, tax benefits and expenses, and the effect of contingencies or changes in accounting policies.

Forward-looking statements are typically identified by words or phrases such as "believe," "expect," "anticipate," "intend," "estimate," "may increase," "may fluctuate," "plan," "goal," "target," "strategy," and similar expressions or future or condition

verbs such as “may,” “will,” “should,” “would,” and “could.” While the Company believes that the assumptions underlying such forward-looking statements are reasonable based on present conditions, forward-looking statements made by the Company involve risks and uncertainties and are not guarantees of future performance. Actual results may differ materially from those forward-looking statements as a result of various factors, including regional or general economic and currency conditions, various conditions specific to the Company’s business and industry, new housing starts, weather conditions, market demand, competitive factors, changes in distribution

channels, supply constraints, effect of price increases, raw material costs and availability, technology factors, integration of acquisitions, litigation, government and regulatory actions, the Company's accounting policies, and other risks, all as described in the Company's Securities and Exchange Commission filings, included in Part I, Item 1A of the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2018, and in Exhibit 99.1 thereto. Any forward-looking statements included in this Form 10-Q are based upon information presently available. The Company does not assume any obligation to update any forward-looking information, except as required by law.



### **ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

There have been no significant changes in the Company's exposure to market risk during the first quarter ended March 31, 2019. For additional information, refer to Part II, Item 7A of the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2018.

### **ITEM 4. CONTROLS AND PROCEDURES**

As of the end of the period covered by this report (the "Evaluation Date"), the Company carried out an evaluation, under the supervision and with the participation of the Company's management, including the Company's Chief Executive Officer and the Company's Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures pursuant to Exchange Act Rules 13a-15. Based upon that evaluation, the Company's Chief Executive Officer and the Company's Chief Financial Officer concluded that, as of the Evaluation Date, the Company's disclosure controls and procedures were effective.

In the third quarter of 2016, the Company began the process of a multi-year implementation of a global enterprise resource planning ("ERP") system. The new ERP system was designed to better support the Company's business needs in response to the changing operating environment and for many business units within the Company is an update to a legacy system product. The implementation of a worldwide ERP system affects the processes that constitute the Company's internal control over financial reporting and requires testing for effectiveness as the implementation progresses. The Company expects that the new ERP system will enhance the overall system of internal controls over financial reporting through further automation and integration of business processes, although it is not being implemented in response to any identified deficiency in the Company's internal controls over financial reporting. The Conversion will happen in two stages. The first stage involved converting the primary legacy ERP system. As of the quarter ended, all business units previously on the primary legacy system have converted to the new ERP system. The second stage will convert those companies that remained on their local ERP system after the date of acquisition. The second stage is ongoing as of March 31, 2019.

Other than the ERP implementation, there have been no changes in the Company's internal control over financial reporting identified in connection with the evaluation required by Rules 13a-15 under the Exchange Act during the last fiscal quarter that have materially affected, or are reasonably likely to materially affect the Company's internal control over financial reporting.

**PART II - OTHER INFORMATION****ITEM 1A. RISK FACTORS**

There have been no material changes to our risk factors as set forth in the Company's annual report on Form 10-K for the fiscal year ended December 31, 2018. Additional risks and uncertainties, not presently known to the Company or currently deemed immaterial, could negatively impact the Company's results of operations or financial condition in the future.

**ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS****(c) Issuer Repurchases of Equity Securities**

In April 2007, the Company's Board of Directors approved a plan to increase the number of shares remaining for repurchase from 628,692 to 2,300,000 shares. There is no expiration date for this plan. On August 3, 2015, the Company's Board of Directors approved a plan to increase the number of shares remaining for repurchase by an additional 3,000,000 shares. The authorization was in addition to the 535,107 shares that remained available for repurchase as of July 31, 2015. The Company repurchased 57,793 shares for approximately \$2.5 million under the plan during the first quarter of 2019. The maximum number of shares that may still be purchased under this plan as of March 31, 2019 is 1,348,955.

Period	Total Number of Shares Repurchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plan	Maximum Number of Shares that may yet to be Repurchased
January 1 - January 31	57,793	\$ 42.93	57,793	1,348,955
February 1 - February 28	—	\$ —	—	1,348,955
March 1 - March 31	—	\$ —	—	1,348,955
Total	57,793	\$ 42.93	57,793	1,348,955

**ITEM 6. EXHIBITS**

Exhibits are set forth in the Exhibit Index located on page 33.

**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

FRANKLIN ELECTRIC CO., INC.  
Registrant

Date: April 30, 2019 By/s/ Gregg C. Sengstack  
Gregg C. Sengstack, Chairman and Chief Executive Officer  
(Principal Executive Officer)

Date: April 30, 2019 By/s/ John J. Haines  
John J. Haines  
Vice President and Chief Financial Officer  
(Principal Financial and Accounting Officer)

FRANKLIN ELECTRIC CO., INC.  
EXHIBIT INDEX TO THE QUARTERLY REPORT ON FORM 10-Q  
FOR THE FIRST QUARTER ENDED MARCH 31, 2019

Number	Description
3.1	<u>Amended and Restated Articles of Incorporation of Franklin Electric Co., Inc. (incorporated by reference to Exhibit 3.1 of the Company's Form 8-K filed on May 3, 2007)</u>
3.2	<u>Amended and Restated Bylaws of Franklin Electric Co., Inc., as amended December 16, 2016 (incorporated by reference to Exhibit 3.1 of the Company's Form 8-K filed on December 21, 2016)</u>
31.1	<u>Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002</u>
31.2	<u>Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002</u>
32.1	<u>Chief Executive Officer Certification Pursuant to 18 U.S.C. Section 1350 As Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002</u>
32.2	<u>Chief Financial Officer Certification Pursuant to 18 U.S.C. Section 1350 As Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002</u>
101.INS	XBRL Instance Document - the instance document does not appear in the Interactive Data File because its XBRL tags are embedded within the Inline XBRL document.
101.SCH	XBRL Taxonomy Extension Schema
101.CAL	XBRL Taxonomy Extension Calculation Linkbase
101.LAB	XBRL Taxonomy Extension Label Linkbase
101.PRE	XBRL Taxonomy Extension Presentation Linkbase
101.DEF	XBRL Taxonomy Extension Definition Linkbase

\*Management Contract, Compensatory Plan or Arrangement