## RAVEN INDUSTRIES INC

Form 10-Q
November 30, 2007

# UNITED STATES SECURITIES AND EXCHANGE COMMISSION <br> WASHINGTON, DC 20549 <br> FORM 10-Q 

(Mark One)

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

For the quarterly period ended October 31, 2007
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: 001-07982
RAVEN INDUSTRIES, INC.
(Exact name of registrant as specified in its charter)

South Dakota<br>(State of incorporation)

46-0246171
(IRS Employer Identification No.)

## 205 East 6th Street

P.O. Box 5107

Sioux Falls, SD 57117-5107
(Address of principal executive offices)
(605) 336-2750
(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. p Yes o No Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. (as defined in Rule 12b-2 of the Exchange Act).

Large accelerated filer o Accelerated filer p Non-accelerated filer o
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). o Yes p No
As of November 27, 2007 there were $18,119,815$ shares of common stock, $\$ 1$ par value, of Raven Industries, Inc. outstanding. There were no other classes of stock outstanding.

## RAVEN INDUSTRIES, INC.

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## PART I FINANCIAL INFORMATION RAVEN INDUSTRIES, INC. CONSOLIDATED BALANCE SHEETS (unaudited)

|  | October | January | October |
| :--- | :---: | :---: | :---: |
| (in thousands except share data) | 31, | 31, | 31, |
|  | $\mathbf{2 0 0 7}$ | $\mathbf{2 0 0 7}$ | $\mathbf{2 0 0 6}$ |

## ASSETS

Current Assets

| Cash and cash equivalents | \$ | 19,274 | \$ | 6,783 | \$ | 8,555 |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Short-term investments |  | 4,000 |  | 4,000 |  | 2,000 |
| Accounts receivable, net of allowances of $\$ 360, \$ 258$, and $\$ 258$, respectively |  | 35,119 |  | 31,336 |  | 27,275 |
| Inventories: |  |  |  |  |  |  |
| Materials |  | 24,268 |  | 21,709 |  | 21,254 |
| In process |  | 4,463 |  | 2,612 |  | 3,219 |
| Finished goods |  | 3,565 |  | 3,750 |  | 3,605 |
| Total inventories |  | 32,296 |  | 28,071 |  | 28,078 |
| Deferred income taxes |  | 1,982 |  | 1,761 |  | 1,777 |
| Prepaid expenses and other current assets |  | 2,002 |  | 1,268 |  | 1,640 |
| Total current assets |  | 94,673 |  | 73,219 |  | 69,325 |


| Property, plant and equipment | 79,639 | 75,273 | 73,177 |
| :--- | ---: | ---: | ---: |
| Accumulated depreciation | $(43,419)$ | $(39,009)$ | $(37,843)$ |
|  |  |  |  |
| Property, plant and equipment, net | 36,220 | 36,264 | 35,334 |
| Goodwill | 6,840 | 6,604 | 6,571 |
| Amortizable intangible assets, net | 1,805 | 1,956 | 2,060 |
| Other assets, net | 2,665 | 1,721 | 703 |

## TOTAL ASSETS

\$ 142,203 \$ 119,764
\$ 113,993

## LIABILITIES AND SHAREHOLDERS EQUITY

Current Liabilities
Accounts payable
Accrued liabilities
Income taxes payable
\$

Customer advances
Total current liabilities
20,762
16,464
15,033

| Other liabilities | 7,143 | 5,032 | 2,046 |
| :---: | :---: | :---: | :---: |
| Total liabilities | 27,905 | 21,496 | 17,079 |
| Commitments and contingencies |  |  |  |
| Shareholders equity: |  |  |  |
| Common stock, \$1 par value, authorized shares 100,000,000; issued $32,393,257,32,306,656,32,287,349$, respectively | 32,393 | 32,307 | 32,287 |
| Paid in capital | 3,207 | 2,341 | 2,119 |
| Retained earnings | 128,193 | 113,103 | 108,883 |
| Accumulated other comprehensive income (loss) | $(1,623)$ | $(1,893)$ | 22 |
|  | 162,170 | 145,858 | 143,311 |
| Less treasury stock, at cost, $14,277,583,14,267,433$, and $14,223,386$ shares, respectively | 47,872 | 47,590 | 46,397 |
| Total shareholders equity | 114,298 | 98,268 | 96,914 |
| TOTAL LIABILITIES AND SHAREHOLDERS EQUITY | \$ 142,203 | \$ 119,764 | \$ 113,993 |

The accompanying notes are an integral part of the unaudited consolidated financial information.

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## RAVEN INDUSTRIES, INC. CONSOLIDATED STATEMENTS OF INCOME (unaudited)

|  | Three Months Ended |  |  | Nine Months Ended |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| (in thousands except per share data) | $\begin{gathered} \text { October } \\ 31, \\ 2007 \end{gathered}$ |  | $\begin{gathered} \text { October } \\ \text { 31, } \\ 2006 \end{gathered}$ | $\begin{gathered} \text { October } \\ 31, \\ 2007 \end{gathered}$ |  | $\begin{gathered} \text { October } \\ \text { 31, } \\ 2006 \end{gathered}$ |
| Net sales | \$ 61,842 | \$ | 57,435 | \$ 175,598 | \$ | 166,281 |
| Cost of goods sold | 46,543 |  | 42,955 | 129,518 |  | 123,727 |
| Gross profit | 15,299 |  | 14,480 | 46,080 |  | 42,554 |
| Selling, general and administrative expenses | 4,359 |  | 3,940 | 13,759 |  | 12,665 |
| Operating income | 10,940 |  | 10,540 | 32,321 |  | 29,889 |
| Interest income and other, net | (314) |  | (173) | (815) |  | (376) |
| Income before income taxes | 11,254 |  | 10,713 | 33,136 |  | 30,265 |
| Income taxes | 3,856 |  | 3,745 | 11,355 |  | 10,668 |
| Net income | \$ 7,398 | \$ | 6,968 | \$ 21,781 | \$ | 19,597 |
| Net income per common share: |  |  |  |  |  |  |
| Basic | \$ 0.41 | \$ | 0.39 | \$ 1.20 | \$ | 1.08 |
| Diluted | \$ 0.41 | \$ | 0.38 | \$ 1.20 | \$ | 1.07 |
| Cash dividends paid per common share | \$ 0.11 | \$ | 0.09 | \$ 0.33 | \$ | 0.27 |
| The accompanying notes are an integral part of the unaudited consolidated financial information.$4$ |  |  |  |  |  |  |

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## RAVEN INDUSTRIES, INC. CONSOLIDATED STATEMENTS OF CASH FLOWS (unaudited)

|  | Nine Months Ended October |  |  |
| :---: | :---: | :---: | :---: |
| (in thousands) |  |  |  |
| OPERATING ACTIVITIES: |  |  |  |
| Net income | \$ 21,781 | \$ | 19,597 |
| Adjustments to reconcile net income to net cash provided by operating activities: |  |  |  |
| Depreciation and amortization | 5,265 |  | 4,264 |
| Deferred income taxes | (703) |  | (246) |
| Share-based compensation expense | 708 |  | 433 |
| Change in operating assets and liabilities: |  |  |  |
| Accounts receivable | $(3,797)$ |  | 2,066 |
| Inventories | $(4,174)$ |  | (250) |
| Prepaid expenses and other current assets | (492) |  | (546) |
| Operating liabilities | 5,243 |  | $(4,209)$ |
| Other operating activities, net | 99 |  | (32) |
| Net cash provided by operating activities | 23,930 |  | 21,077 |
| INVESTING ACTIVITIES: |  |  |  |
| Capital expenditures | $(5,139)$ |  | $(14,223)$ |
| Purchase of short-term investments | $(2,200)$ |  | $(3,000)$ |
| Sale of short-term investments | 2,200 |  | 3,000 |
| Other investing activities, net | (315) |  | (183) |
| Net cash used in investing activities | $(5,454)$ |  | $(14,406)$ |
| FINANCING ACTIVITIES: |  |  |  |
| Dividends paid | $(5,972)$ |  | $(4,884)$ |
| Purchases of treasury stock | (282) |  | $(3,007)$ |
| Excess tax benefits on stock option exercises | 352 |  | 351 |
| Other financing activities, net | (110) |  | 11 |
| Net cash used in financing activities | $(6,012)$ |  | $(7,529)$ |
| Effect of exchange rate changes on cash | 27 |  | 4 |
| Net increase (decrease) in cash and cash equivalents | 12,491 |  | (854) |

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| Cash and cash equivalents: |  |  |  |
| :--- | ---: | ---: | ---: |
| Beginning of period | 6,783 |  | 9,409 |
| End of period | $\mathbf{\$ 1 9 , 2 7 4}$ | $\mathbf{8}$ | $\mathbf{8 , 5 5 5}$ |

The accompanying notes are an integral part of the unaudited consolidated financial information.

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## RAVEN INDUSTRIES, INC. NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited)

## (1) Basis of Presentation and Description of Business

The accompanying unaudited consolidated financial information has been prepared by Raven Industries, Inc. (the company ) in accordance with accounting principles generally accepted in the United States of America for interim financial information and the instructions to Form
$10-\mathrm{Q}$ and Article 10 of Regulation S-X of the Securities and Exchange Commission (SEC). Accordingly, it does not include all of the information and notes required by accounting principles generally accepted in the United States of America for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring adjustments) considered necessary for a fair statement of this financial information have been included. Financial results for the interim three and nine month periods ended October 31, 2007 are not necessarily indicative of the results that may be expected for the year ending January 31, 2008. The January 31, 2007 consolidated balance sheet was derived from audited financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States of America. This financial information should be read in conjunction with the consolidated financial statements and notes included in the company s Annual Report on Form 10-K for the year ended January 31, 2007.

## (2) Net Income Per Share

Basic net income per share is computed by dividing net income by the weighted-average common shares and stock units outstanding. Diluted net income per share is computed by dividing net income by the weighted-average common and common equivalent shares outstanding (which includes the shares issuable upon exercise of employee stock options net of shares assumed purchased with the option proceeds) and stock units outstanding. Certain outstanding options were excluded from the diluted net income per-share calculations because their effect would have been anti-dilutive, as their exercise prices were greater than the average market price of the company s common stock during those periods. There were no shares excluded for the three month period ended October 31, 2007. For the nine month period ended October 31, 2007, 71,800 shares were excluded. For the three and nine month periods ended October 31, 2006, 74,833 and 75,833 shares were excluded, respectively. Details of the earnings per share computation are presented below:

|  | Three Months Ended |  | Nine Months Ended |  |
| :---: | :---: | :---: | :---: | :---: |
|  | $\begin{gathered} \text { October 31, } \\ 2007 \end{gathered}$ | $\begin{gathered} \text { October 31, } \\ 2006 \end{gathered}$ | $\begin{gathered} \text { October 31, } \\ 2007 \end{gathered}$ | $\begin{gathered} \text { October 31, } \\ 2006 \end{gathered}$ |
| Numerator: |  |  |  |  |
| Net income (in thousands) | \$ 7,398 | \$ 6,968 | \$ 21,781 | \$ 19,597 |
| Denominator: |  |  |  |  |
| Weighted average common shares outstanding | 18,107,868 | 18,070,242 | 18,091,002 | 18,092,866 |
| Weighted average stock units outstanding | 9,828 | 4,803 | 8,154 | 3,197 |
| Denominator for basic calculation | 18,117,696 | 18,075,045 | 18,099,156 | 18,096,063 |
| Weighted average common shares outstanding | 18,107,868 | 18,070,242 | 18,091,002 | 18,092,866 |
| Weighted average stock units outstanding | 9,828 | 4,803 | 8,154 | 3,197 |


| Dilutive impact of stock options | 122,926 |  | 172,337 | 103,838 | 202,059 |  |  |
| :--- | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Denominator for diluted calculation | $18,240,622$ | $18,247,382$ | $18,202,994$ | $18,298,122$ |  |  |  |
|  |  |  |  |  |  |  |  |
| Net income per share basic | $\$$ | 0.41 | $\$$ | 0.39 | $\$$ | 1.20 | $\$$ |
| Net income per share diluted | $\$$ | 0.41 | $\$$ | 0.38 | $\$$ | 1.20 | $\$$ |

(3) Segment Reporting

The company s reportable segments are defined by their common technologies, production processes and inventories. These segments are consistent with the company s management reporting structure. The company measures the performance of its segments based on their operating income exclusive of administrative and general expenses. The results of these segments are shown on the following table:

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| (in thousands) | Three Months Ended |  |  | Nine Months Ended |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | $\begin{gathered} \text { October } \\ \text { 31, } \\ 2007 \end{gathered}$ |  | $\begin{gathered} \text { October } \\ \text { 31, } \\ 2006 \end{gathered}$ |  | $\begin{aligned} & \text { October } \\ & \text { 31, } \\ & 2007 \end{aligned}$ |  | $\begin{gathered} \text { October } \\ \text { 31, } \\ 2006 \end{gathered}$ |
| Net sales |  |  |  |  |  |  |  |
| Engineered Films | \$ 21,700 | \$ | 26,230 |  | \$ 64,824 | \$ | 71,339 |
| Flow Controls | 16,081 |  | 10,335 |  | 47,696 |  | 35,099 |
| Electronic Systems | 20,245 |  | 17,641 |  | 51,363 |  | 49,276 |
| Aerostar | 3,816 |  | 3,229 |  | 11,715 |  | 10,567 |
| Consolidated net sales | \$ 61,842 | \$ | 57,435 |  | \$ 175,598 | \$ | 166,281 |
| Operating income |  |  |  |  |  |  |  |
| Engineered Films | \$ 4,009 | \$ | 6,851 |  | \$ 14,257 | \$ | 19,128 |
| Flow Controls | 4,889 |  | 2,117 |  | 14,598 |  | 8,053 |
| Electronic Systems | 3,528 |  | 3,012 |  | 8,421 |  | 7,920 |
| Aerostar | 299 |  | 147 |  | 817 |  | 69 |
| Total reportable segment income | 12,725 |  | 12,127 |  | 38,093 |  | 35,170 |
| Administrative and general expenses | $(1,785)$ |  | $(1,587)$ |  | $(5,772)$ |  | $(5,281)$ |
| Consolidated operating income | \$ 10,940 | \$ | 10,540 |  | \$ 32,321 | \$ | 29,889 |

## (4) Financing Arrangements

The company has an uncollateralized credit agreement providing a line of credit of $\$ 8.0$ million with a maturity date of July 1, 2008 bearing interest at $1.00 \%$ under the prime rate. Letters of credit totaling $\$ 1.4$ million have been issued under the line, primarily to support self-insured workers compensation bonding requirements. No borrowings were outstanding as of October 31, 2007, January 31, 2007 or October 31, 2006.

## (5) Short-term Investments

The company has invested $\$ 4.0$ million in certificates of deposit with rates ranging from $5.05 \%$ to $5.20 \%$. The investments have varying maturity dates, all of which are less than twelve months. At January 31, 2007, $\$ 4.0$ million was invested in certificates of deposits and U.S. Treasury Bills with rates ranging from $5.00 \%$ to $5.25 \%$. At October 31, 2006, $\$ 2.0$ million was invested in certificates of deposit and U.S. Treasury Bills with rates ranging from $4.80 \%$ to $5.00 \%$.

## (6) Dividends

The company announced on November 19, 2007, that its board of directors approved a quarterly cash dividend of 11 cents per share, payable January 15, 2008, to shareholders of record on December 24, 2007.

## (7) Comprehensive Income

Comprehensive income consists of two components, net income and other comprehensive income. Other comprehensive income refers to revenues, expenses, gains, and losses that under U.S. generally accepted accounting principles are recorded as an element of shareholders equity but are excluded from net income. The components of total comprehensive income follow:

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## (8) Employee Retirement Benefits

The components of net periodic benefit cost for postretirement benefits are as follows:


## (9) Product Warranty Costs

Accruals necessary for product warranties are estimated based upon historical warranty costs and average time elapsed between purchases and returns for each division. Any warranty issues that are unusual in nature are accrued individually. Changes in the carrying amount of accrued product warranty costs follow:

| (in thousands) | Three Months Ended |  |  |  | Nine Months Ended |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  |  | tober <br> 31, <br> 007 | $\begin{gathered} \text { October } \\ \text { 31, } \\ 2006 \end{gathered}$ |  | October 31, 2007 |  | October 31, 2006 |  |
| Balance, beginning of period |  |  | \$ | 398 |  |  | \$ | 569 |
| Accrual for warranties |  | 337 |  | 200 |  | 812 |  | 1,008 |
| Settlements made (in cash or in kind) |  | (349) |  | (216) |  | (728) |  | $(1,195)$ |
| Balance, end of period | \$ | 481 | \$ | 382 | \$ | 481 | \$ | 382 |

## (10) Income Taxes

In June 2006, the Financial Accounting Standards Board ( FASB ) issued FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes ( FIN 48 ). FIN 48 is an interpretation of SFAS 109, Accounting for Income Taxes, and seeks to reduce the diversity in practice associated with certain aspects and measurement and recognition in accounting for income taxes.
The company adopted the provisions of FIN 48 on February 1, 2007. Upon adoption of FIN 48, the company recorded a net $\$ 715,000$ increase in the liability for unrecognized tax benefits, which was recorded as a reduction to the February 1, 2007 beginning retained earnings balance. As of the adoption date, the company has gross unrecognized tax benefits of $\$ 1.6$ million. Of this total, $\$ 1.1$ million (net of tax benefits available in other jurisdictions) represents the amount of unrecognized tax benefits that, if recognized, would impact the effective tax rate.
Interest and penalties related to unrecognized tax benefits are recorded in income tax expense. As of February 1, 2007, the company had $\$ 264,000$ of accrued interest and penalties included in the $\$ 1.6$ million of unrecognized tax benefits. The company files tax returns, including returns for its subsidiaries, with various federal, state and local jurisdictions. Uncertain tax positions are related to tax years that remain subject to examination. As of the date of the adoption, U.S. tax returns for fiscal years ended January 31, 20042007 remain subject to examination by federal tax authorities. In state and local jurisdictions, tax returns for fiscal years January 31, 20032007 remain subject to examination by state and local tax authorities.

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As of October 31, 2007, the company has approximately $\$ 1.9$ million of total gross unrecognized tax benefits. Of this total, $\$ 1.3$ million (net of tax benefits available in other jurisdictions) represents the amount of unrecognized tax benefits that, if recognized, would impact the effective tax rate. The entire liability for unrecognized tax benefits is classified as non-current as no payments are expected in the coming year.
The effective tax rate for the nine months ended October 31, 2007 was $34.3 \%$ versus $35.2 \%$ for the period ended October 31, 2006. An increase in the estimated U.S. federal tax deduction for income attributable to manufacturing activities accounted for most of the decrease in the effective tax rate and was partially offset by additional current year tax provisions made relating to uncertain tax positions as provided for under FIN 48.

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## (11) Maneuverable Canopy (MC-6) Parachute System Contracts

In April 2006, Aerostar was awarded a $\$ 5.8$ million contract by the federal government to produce parachute systems for the U.S. Army Research, Development and Engineering Command (RDECOM). Additional contracts of \$846,000 and $\$ 7.3$ million were awarded in August 2006 and April 2007, respectively, bringing the total amount of parachute orders to approximately $\$ 14$ million. Aerostar began parachute production in March 2007. During subsequent field tests, RDECOM identified a flaw in their design of the canopy release assembly and halted production of the affected components pending re-design. RDECOM authorized continued production of the main canopies with initial shipments beginning in the fourth quarter. Additionally, Aerostar determined that the production of \$650,000 of canopies included approximately $\$ 10,000$ of material that was manufactured outside the U.S. The $\$ 10,000$ cost of non-compliant material was expensed. In October 2007, the Defense Contract Management Agency issued procedures for the acceptance of this non-compliant product. Consequently, Aerostar will ultimately deliver all of the product containing non-compliant material, but as of October 31, 2007 no shipments had been made.

## (12) Recent Accounting Pronouncements

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities ( SFAS 159 ). SFAS 159 permits companies to choose to measure many financial instruments and certain other items at fair value. SFAS 159 is effective for the beginning of the company s 2009 fiscal year. The company does not expect the provisions of SFAS 159 to have a material impact on its consolidated results of operations, financial condition, or cash flows.

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

Raven Industries, Inc. is an industrial manufacturer providing a variety of products to customers within the industrial, agricultural, construction and military/aerospace markets primarily in North America. The company operates in four business segments: Engineered Films, Flow Controls, Electronic Systems and Aerostar. Engineered Films produces rugged reinforced plastic sheeting for industrial, construction, manufactured housing and agriculture applications. Flow Controls, including Raven Canada and Raven GmbH (Europe), provides electronic and Global Positioning System (GPS) products for the precision agriculture, marine navigation and other niche markets. Electronic Systems is a total-solutions provider of electronics manufacturing services. Aerostar manufactures military parachutes, government service uniforms, custom-shaped inflatable products and high-altitude balloons for public and commercial research.

## EXECUTIVE SUMMARY

Record earnings for the three months ended October 31, 2007 of $\$ 7.4$ million improved $6.2 \%$ as compared with earnings of $\$ 7.0$ million for the three months ended October 31, 2006. Third quarter diluted earnings per share increased three cents per share from 38 cents to 41 cents. Flow Controls reported strong operating results for the third quarter and drove the company s increases in sales and earnings. Electronic Systems and Aerostar also reported sales and profit growth for the quarter as compared with one year ago, while Engineered Films fell short of last year sthird quarter results.
For the nine month period, net income rose $11.1 \%$ to $\$ 21.8$ million, or $\$ 1.20$ per diluted share, as compared with $\$ 19.6$ million, or $\$ 1.07$ per diluted share one year ago. As with the quarter, the Flow Controls segment was the main driver of the net sales and earnings growth for the first nine months. Partially offsetting this growth was the expected downturn in Engineered Films sales and profits as compared with last year. Net income as a percent of sales was $12.4 \%$ for the nine month period, up from $11.8 \%$ reported one year ago due to the higher ratio of Flow Controls sales and profits to the overall company results, as relatively higher gross profit margins are realized on the company s Flow Controls products.

## Net Sales

Consolidated net sales for the just-ended quarter of $\$ 61.8$ million were $\$ 4.4$ million, or $7.7 \%$, higher than last year s third quarter, with Flow Controls and Electronic Systems pushing the revenue growth. Flow Controls third quarter sales rose $\$ 5.7$ million over last year s third quarter, reaching $\$ 16.1$ million, a $55.6 \%$ improvement. Flow Controls experienced solid demand across all product lines reflecting an improved agricultural equipment market, specifically equipment related to corn production. Electronic Systems revenues of $\$ 20.2$ million were up $14.8 \%$

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versus one year earlier due to increased deliveries of secure communication and aviation electronics. Engineered Films sales for the quarter were $\$ 21.7$ million, a decrease of $\$ 4.5$ million from last year s third quarter. Disaster film revenue of $\$ 5.5$ million was included in the prior year s third quarter and did not recur in the most recent quarter. Aerostar increased sales $18.2 \%$ over last year s $\$ 3.2$ million, reaching $\$ 3.8$ million for the quarter just ended. Aerostar s revenue level improved over last year $s$ third quarter due to the fulfillment of a large, tethered aerostat order during the quarter.
For the nine months ended October 31, 2007, consolidated net sales climbed to $\$ 175.6$ million, a $\$ 9.3$ million, or $5.6 \%$, increase from last year s $\$ 166.3$ million. Flow Controls was the main driver of the year-to-date sales growth and, combined with revenue increases reported for Electronic Systems and Aerostar, offset lower Engineered Films sales. Flow Controls sales of $\$ 47.7$ million improved $\$ 12.6$ million, or $35.9 \%$, due to an improved agricultural equipment market increasing product demand, higher deliveries of marine navigational products, and an increase in international sales activity. For the nine months, Electronic Systems sales rose $4.2 \%$ to $\$ 51.4$ million as compared with $\$ 49.3$ million one year ago, while Aerostar s year-to-date sales of $\$ 11.7$ million showed an improvement of $\$ 1.1$ million, or $10.9 \%$. Engineered Films nine month sales dropped $9.1 \%$ to $\$ 64.8$ million versus $\$ 71.3$ million at this time last year due primarily to the lack of disaster film deliveries, which in contrast totaled $\$ 9.9$ million for last year s nine month period.

## Operating Income

Third quarter consolidated operating income of $\$ 10.9$ million increased $3.8 \%$, or $\$ 400,000$, as compared with the quarter ended one year earlier, while gross profit as a percentage of sales declined slightly from $25.2 \%$ to $24.7 \%$. A strong Flow Controls third quarter performance together with profit growth reported for both Electronic Systems and Aerostar, offset an Engineered Films operating income shortfall of $\$ 2.8$ million. Flow Controls operating income for the quarter ended October 31, 2007 of $\$ 4.9$ more than doubled last year s results, increasing $\$ 2.8$ million due to the higher sales level. Electronic Systems third quarter operating income of $\$ 3.5$ million reflects a $17.1 \%$, or $\$ 516,000$, increase over the year-ago quarter on higher sales volume, while Aerostar quarterly operating income grew $\$ 152,000$. Engineered Films operating income of $\$ 4.0$ million decreased $\$ 2.8$ million, or $41.5 \%$, from last year s third quarter due to lower sales, increased raw material costs with no corresponding selling price adjustment and higher depreciation expense.
Consolidated operating income for the nine month period reached $\$ 32.3$ million, an increase of $\$ 2.4$ million, or $8.1 \%$, versus last year s comparable period, while gross profit as a percentage of sales increased from $25.6 \%$ to $26.2 \%$. Flow Controls continues to be the main driver of the year-to-date profit increase, improving operating income by $\$ 6.5$ million as compared with the nine months ended October 31, 2006. Leveraging higher sales volume on the existing manufacturing cost base enabled the segment to realize $81.3 \%$ profit growth on a $35.9 \%$ revenue increase. Engineered Films operating income of $\$ 14.3$ million decreased $\$ 4.9$ million, or $25.5 \%$ from one year ago, reflecting a lower sales level, increased raw material costs, and higher depreciation expense. Electronic Systems operating income of $\$ 8.4$ million was up $\$ 501,000$ as a result of higher sales volume, while Aerostar reported $\$ 817,000$ of year-to-date operating income, an improvement of $\$ 748,000$ over the prior year.
Third quarter administrative expenses of $\$ 1.8$ million increased $12.5 \%$ from $\$ 1.6$ million reported for the quarter ended October 31, 2006, while year-to-date administrative expenses of $\$ 5.8$ million reflect a $\$ 491,000$, or $9.3 \%$, increase from one year ago. The increases for both reporting periods were due primarily to higher compensation expense.

## Interest Income and Other, Net

Interest income and other consists mainly of interest income and foreign currency transaction gain or loss. Interest income and other was $\$ 314,000$ for the quarter ended October 31, 2007 which compared favorably to $\$ 173,000$ reported for the prior year sthird quarter. For the most recent nine months, interest income and other more than doubled last year s $\$ 376,000$ to reach $\$ 815,000$. Higher cash balances as compared to one year ago increased interest income for both reporting periods.

## Income Tax

Income tax expense increased from $\$ 3.7$ million for the quarter ended October 31, 2006 to $\$ 3.9$ million for the just-ended quarter and for the nine month period increased from last year s $\$ 10.7$ million to $\$ 11.4$ million. The
increases reflect higher taxable income as earnings have risen, partially offset by a lower effective tax rate for both reporting periods. The effective tax rate for the third quarter and the nine month period was $34.3 \%$ versus $35.0 \%$ for the quarter ended one year ago and $35.2 \%$ for last year s first nine months. An increase in the estimated U.S. federal tax deduction for income attributable to manufacturing activities accounted for most of the decrease in the effective tax rates and was partially offset by additional current year tax provisions made relating to uncertain tax positions as provided for under FIN 48.

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## Outlook

The company anticipates sales and earnings to be up for the fourth quarter ending January 31, 2008 as compared with last year s comparable quarter and as a result, expects record sales and earnings for fiscal 2008. Engineered Films revenues are expected to be relatively flat in the upcoming quarter, though a decrease in operating income is anticipated as higher raw material costs and competitive pricing pressures continue. With the additional capabilities and capacity of the new extrusion equipment recently placed into service, Engineered Films continues to position itself for future revenue and profit growth, although no significant impact is anticipated for the next few quarters. Benefitting from the strong agricultural market and the resulting demand for Flow Controls products, sales growth for this segment versus last year s fourth quarter is expected to be significant. The higher sales should increase divisional operating income in terms of overall dollars and as a percentage of sales. An Electronic Systems customer, which accounted for $\$ 8$ million in sales in fiscal 2007, was recently acquired and will be moving its manufacturing elsewhere. While closeout orders may benefit the fourth quarter, the company expects Electronic Systems will show lower sales and profits in fiscal 2009. Aerostar sales of high-altitude research balloons, as well as initial deliveries under the government protective wear and MC-6 parachute contracts, are expected to increase fourth quarter revenue above last year $s$ fourth quarter. Fourth quarter operating income for Aerostar, despite the revenue growth, is anticipated to be flat versus the same time last year due to lower margins expected on the initial government contract shipments.
Overall, the company expects modest sales and income growth for the fourth quarter and growth in fiscal 2009 to be similar to fiscal 2008.

## RESULTS OF OPERATIONS BY SEGMENT

## Engineered Films

## Net Sales

Sales of $\$ 21.7$ million for the quarter ended October 31 , 2007 were $\$ 4.5$ million, or $17.3 \%$, behind the $\$ 26.2$ million mark posted one year ago. Last year s third quarter sales included $\$ 5.5$ million of disaster film shipments. Excluding the disaster film sales, third quarter sales were up $4.0 \%$ due to revenue growth in the segment $s$ energy market. Drilling activity in the oil and gas industries remained strong during the quarter and as a result, increased demand for temporary pit liners.
Sales of $\$ 64.8$ million for the first nine months represent a $\$ 6.5$ million, or $9.1 \%$, decline in revenue as compared with the prior year. Lower disaster film shipments of $\$ 9.9$ million and a decrease in industrial market sales have been partially offset by higher sales of pit liners used in the energy sector and an increase in vapor barrier deliveries. Competitive pricing pressures have hampered revenue growth for the fiscal year. Selling prices were down approximately $4 \%$ from last year s comparable period as a result of lower product pricing.

## Operating Income

Operating income of $\$ 4.0$ million for the just-ended quarter was below results of one year earlier, decreasing $\$ 2.8$ million, or $41.5 \%$, and in addition, gross profit as a percent of sales dropped from $29.2 \%$ to $22.5 \%$. An increase in resin cost that was not passed on to customers in the form of higher selling prices, lower sales volume, and higher depreciation expense negatively impacted operating income and gross margins for the quarter. Selling expenses reached $\$ 877,000$ for the quarter, an increase of $\$ 63,000$, or $7.7 \%$, due to new product development spending. For the nine months ended October 31, 2007, operating income of $\$ 14.3$ million fell behind the prior year s comparable period by $25.5 \%$ and the gross profit margin decreased from $30.3 \%$ to $26.1 \%$. As with the quarter, profit margins have been negatively impacted by a more competitive pricing environment as higher input costs have not equated to increased selling prices due to competitors selling excess film capacity into the segment s markets. Product mix has also affected operating income for the nine months as compared with one year ago, replacing disaster film shipments with sales of lower-margin product. Increased depreciation expense and start-up costs related to the new extrusion lines contributed to the decrease in year-to-date operating income for Engineered Films. Nine month selling expenses of $\$ 2.7$ million were up from one year ago, increasing $\$ 215,000$, or $8.7 \%$. Like the third quarter, the year-to-date selling expense increase reflects product introduction and development costs incurred to support additional market and product expansion.

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## Flow Controls

## Net Sales

Third quarter sales rose to $\$ 16.1$ million, a $\$ 5.7$ million, or $55.6 \%$, improvement over last year s third quarter. While all product lines (standard, precision, steering, and Autoboom ${ }^{\mathrm{TM}}$ ) reflected significant revenue growth for the quarter due to the strong agricultural economy, standard sprayer systems reported the largest increase in sales. Anhydrous ammonia control systems used in corn production accounted for the majority of revenue growth within the standard sprayer system product group.
For the nine months, sales of $\$ 47.7$ million reflect $\$ 12.6$ million, or $35.9 \%$, of revenue growth versus one year ago. The main driver of the sales improvement was the favorable agricultural market environment. As with the quarter, the strong farm economy has pushed product sales higher in all of the segment s product groups, with standard sprayer control systems contributing significantly to the growth. Supplementing the higher domestic agricultural revenue for the current nine month period have been increases in international agricultural sales and marine navigation system deliveries.

## Operating Income

Third quarter operating income of $\$ 4.9$ million more than doubled last year $s$ third quarter, increasing $\$ 2.8$ million. The profit growth was due to higher sales volume and the effect of leveraging the increased sales on a relatively fixed cost base. Likewise, gross profit as a percent of sales increased from $30.6 \%$ one year ago to $38.2 \%$ for the just-ended quarter. For the first half of the fiscal year, selling expenses had been relatively flat as compared to last year. In contrast, third quarter selling expenses of $\$ 1.2$ million were up from one year earlier, increasing $\$ 205,000$, or $19.7 \%$, due to higher compensation expense to support current and future revenue growth. As a percentage of sales, selling expenses were $7.8 \%$ as compared with $10.1 \%$ for the quarter ended October 31, 2006.
For the nine month period, operating income increased $\$ 6.5$ million, or $81.3 \%$, over last year sfirst nine months to reach $\$ 14.6$ million. Year-to-date gross profit as a percentage of sales was $38.7 \%$ and compared favorably to $32.7 \%$ reported at this time last year. As with the quarter, the increased sales volume for the nine month period had a positive effect on operating income and gross margins, with strong margins realized due to favorable plant utilization and leveraging the existing manufacturing cost base against higher revenue. For the nine months, selling expenses reached $\$ 3.7$ million, an increase of $\$ 260,000$, or $7.5 \%$. The selling expense increase was due to higher compensation expense related to domestic selling efforts, as the investment in the segment $s$ international sales initiatives was maintained during the first nine months of the year but not expanded. Selling expenses as a percent of sales for the current year were $7.8 \%$ versus $9.9 \%$ for last year s nine months.

## Electronic Systems

## Net Sales

Segment sales of $\$ 20.2$ million for the just-ended quarter were $\$ 2.6$ million ahead of the prior year sthird quarter, an improvement of $14.8 \%$. On a year-to-date basis, revenue reached $\$ 51.4$ million, up $\$ 2.1$ million, or $4.2 \%$, from one year earlier. Increased deliveries of secure communication and aviation electronics for the quarter and first nine months offset the decline in shipments of hand-held bed controls.

## Operating Income

Electronic Systems reported an operating income increase of $\$ 516,000$, or $17.1 \%$, over last year s third quarter, with profits reaching $\$ 3.5$ million versus $\$ 3.0$ million. The increased sales volume accounted for the favorable profit variance as the current year s third quarter gross profit margin of $18.8 \%$ was flat compared to a year ago. Selling expenses for the just-ended quarter were down $\$ 32,000$ to $\$ 269,000$ versus $\$ 301,000$ in last year s third quarter. Higher sales pushed the segment s nine month operating income of $\$ 8.4$ million over the prior year by $\$ 501,000$, or $6.3 \%$. As a percentage of sales, gross profit increased from $17.8 \%$ for the first nine months of last year to $18.1 \%$. Year-to-date shipments made on a high-margin closeout order placed by a former customer were the primary cause of the increase, offsetting an otherwise unfavorable product mix. Selling expenses for the nine month period were $\$ 901,000$, an increase of $\$ 59,000$ from last year s first nine months due to higher personnel costs.
Aerostar
Net Sales

Third quarter sales of $\$ 3.8$ million were $\$ 587,000$, or $18.2 \%$, more than revenue reported for the quarter ended one year ago. A large tethered aerostat shipment was made during the quarter which accounted for the sales improvement. For the nine month period, current year sales of $\$ 11.7$ million were favorable as compared with the prior year, increasing $10.9 \%$, or $\$ 1.1$ million. In addition to the large aerostat shipment made during the quarter, higher research balloon sales contributed to the year-to-date revenue growth. Partially offsetting this sales growth was lower parachute product shipments.

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## Operating Income

Operating income for the third quarter increased $\$ 152,000$ to $\$ 299,000$ when compared to operating income for the quarter ended October 31, 2006, with gross profit as a percentage of sales improving from $10.6 \%$ to $12.3 \%$. The higher sales level for the just-ended quarter and improvements in efficiencies and plant utilization on the MC-6 parachute contract were the main factors in the increased operating income. Selling expenses were down as compared with last year s third quarter, decreasing from $\$ 195,000$ to $\$ 171,000$.
For the nine months, operating income of $\$ 817,000$ exceeded the prior year s comparable period by $\$ 748,000$ due to higher research balloon and protective wear profits partially offset by year-to-date start-up costs under the MC-6 parachute contract. As a percentage of sales, gross profit increased from $6.7 \%$ for last year s first nine months to $11.8 \%$. Selling expense for the first nine months decreased, dropping from last year s $\$ 636,000$ to $\$ 564,000$.

## LIQUIDITY AND CAPITAL RESOURCES

## Operating Activities and Cash Position

Operations generated $\$ 23.9$ million of positive cash flows in the first nine months of the current fiscal year, an increase of $\$ 2.9$ million from the same period of fiscal 2007 when cash flows from operating activities totaled $\$ 21.1$ million. The improvement in current year operating cash flows as compared with last year s first nine months of operations was due to higher earnings, improved accounts payable aging and an increase in accrued liabilities. Partially offsetting these positive operating cash flows was cash consumed in financing higher accounts receivable and inventory levels as of October 31, 2007 versus one year ago.
The company continues to maintain a strong cash position. Total cash, cash equivalents, and short-term investments were $\$ 23.3$ million as of October 31, 2007, an increase of $\$ 12.5$ million as compared to the company s January 31, 2007 cash and investments balance of $\$ 10.8$ million and more than doubled the cash and investments position of one year earlier of $\$ 10.6$ million. Higher cash balances resulted from strong operating cash flows, lower capital spending, and a decrease in treasury stock purchases.
The company expects that current cash and short-term investments, combined with continued positive operating cash flows and the company s short-term line of credit, will be sufficient to fund day-to-day operations.

## Investing and Financing Activities

Cash used in investing activities totaled $\$ 5.5$ million, decreasing $\$ 9.0$ million for the nine month period as compared with cash used of $\$ 14.4$ million for the nine months ended October 31, 2006. Year-to-date capital expenditures totaled $\$ 5.1$ million, down $\$ 9.1$ million from the $\$ 14.2$ million of cash used in the first nine months of last year. Last year s nine month investing activities included significantly higher investments in the Engineered Films segment for additional manufacturing capacity and facilities.
Financing activities consumed $\$ 6.0$ million in cash for the nine months ended October 31, 2007 as compared to $\$ 7.5$ million used in last year s comparable period. The quarterly dividend increased from 9 cents to 11 cents per share, resulting in dividend payments of $\$ 6.0$ million for the first nine months of the current year as compared with $\$ 4.9$ million of dividends paid one year ago. Treasury shares purchased during the current year totaled $\$ 282,000$, with 10,150 shares repurchased at an average share price of $\$ 27.82$. At this time last year, 102,200 shares were purchased at an average share price of $\$ 29.43$, totaling $\$ 3.0$ million.

## COMMITMENTS AND CONTINGENCIES

There have been no material changes to the company s contractual obligations since the fiscal year ended January 31, 2007.

The adoption of FIN 48, Accounting for Uncertainty in Income Taxes, increased the company s long-term liabilities by $\$ 1.6$ million but management believes that the change in accounting for uncertain tax positions has no impact on the company s liquidity or operating cash flows. The period in which the uncertain tax positions will be settled cannot be determined at this time.

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## RECENT ACCOUNTING DEVELOPMENTS

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities ( SFAS 159 ). SFAS 159 permits companies to choose to measure many financial instruments and certain other items at fair value. SFAS 159 is effective for the beginning of the company s 2009 fiscal year. The company does not expect the provisions of SFAS 159 to have a material impact on its consolidated results of operations, financial condition, or cash flows.

## ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISKS

The exposure to market risks pertains mainly to changes in interest rates on cash and cash equivalents and short-term investments. The company has no debt. The company does not expect operating results or cash flows to be significantly affected by changes in interest rates. Additionally, the company does not enter into derivatives or other financial instruments for trading or speculative purposes. However, the company has utilized derivative financial instruments to manage the economic impact of fluctuation in foreign currency exchange rates on those transactions that are denominated in currency other than its functional currency, which is the US dollar. The use of these financial instruments had no material effect on the company s financial condition, results of operations or cash flows. The company s subsidiaries that operate outside the United States use their local currency as the functional currency. The functional currency is translated into US dollars for balance sheet accounts using the period-end exchange rates, and average exchange rates for the statement of income. Adjustments resulting from financial statement translations are included as cumulative translation adjustments in accumulated other comprehensive income (loss) within shareholders equity. Foreign currency transaction gains or losses are recognized in the period incurred and are included in interest income and other, net in the Consolidated Statements of Income. Foreign currency fluctuations had no material effect on the company s financial condition, results of operations or cash flows.

## ITEM 4. CONTROLS AND PROCEDURES

## Evaluation of Disclosure Controls and Procedures

As of October 31, 2007, the end of the period covered by this report, management, including the Chief Executive Officer ( CEO ) and the Chief Financial Officer ( CFO ) evaluated the effectiveness of disclosure controls and procedures (as defined in the Exchange Act Rules 13a-15(e) and 15d-15(e)) as of such date. Based on that evaluation, the CEO and CFO have concluded that the company s disclosure controls and procedures were effective as of October 31, 2007.

## Changes in Internal Control over Financial Reporting

There were no changes in the company s internal control over financial reporting that occurred during the quarter ended October 31, 2007 that have materially affected, or are reasonably likely to materially affect, the company s internal control over financial reporting.
FORWARD-LOOKING STATEMENTS
Certain statements contained in this quarterly report on Form 10-Q are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, including statements regarding the expectations, beliefs, intentions or strategies regarding the future. Without limiting the foregoing, the words anticipates, believes, expects, intends, may, plans and simil expressions are intended to identify forward-looking statements. The company intends that all forward-looking statements be subject to the safe harbor provisions of the Private Securities Litigation Reform Act. Although the company believes that the expectations reflected in such forward-looking statements are based on reasonable assumptions, there is no assurance that such assumptions are correct or that these expectations will be achieved. Such assumptions involve important risks and uncertainties that could significantly affect results in the future. These risks and uncertainties include, but are not limited to, those relating to weather conditions, which could affect certain of the company s primary markets, such as agriculture and construction, or changes in competition, raw material availability, technology or relationships with the company slargest customers, any of which could adversely impact any of the company sproduct lines, as well as other risks described in the company s 10-K under Item 1A. The foregoing list is not exhaustive and the company disclaims any obligation to subsequently revise any forward-looking statements to reflect events or circumstances after the date of such statements.

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## RAVEN INDUSTRIES, INC. PART II OTHER INFORMATION

Item 1. Legal Proceedings:
The company is involved as a defendant in lawsuits, claims or disputes arising in the normal course of business. The settlement of such claims cannot be determined at this time. Management believes that any liability resulting from these claims will be substantially mitigated by insurance coverage. Accordingly, management does not believe the ultimate outcome of these matters will be significant to its results of operations, financial position or cash flows.
Item 1A. Risk Factors:
No material change.
Item 2. Changes in Securities:
Under a resolution from the Board of Directors dated May 22, 2007, the company was authorized to repurchase up to $\$ 2.0$ million of stock on the open market. No shares were purchased during the third quarter. The Board of Directors has renewed these authorizations quarterly; there is no assurance the Board will continue this practice.
Item 3. Defaults upon Senior Securities: None
Item 4. Submission of Matters to a Vote of Security Holders: None
Item 5. Other Information: None
Item 6. Exhibits Filed:
31.1 Certification of CEO Pursuant to Section 302 of Sarbanes-Oxley Act
31.2 Certification of CFO Pursuant to Section 302 of Sarbanes-Oxley Act
32.1 Certification of CEO Pursuant to Section 906 of Sarbanes-Oxley Act
32.2 Certification of CFO Pursuant to Section 906 of Sarbanes-Oxley Act

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.

# RAVEN INDUSTRIES, INC. 

/s/ Thomas Iacarella
Thomas Iacarella
Vice President and CFO, Secretary and
Treasurer
(Principal Financial and Accounting
Officer)
Date: November 30, 2007

