TENNANT CO
Form 10-Q
November 02, 2018

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

[ü] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended September 30, 2018

OR

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from ___________ to __________

Commission File Number 1-16191

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

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

701 North Lilac Drive
P.O. Box 1452
Minneapolis, Minnesota 55440
(Address of principal executive offices)
(Zip Code)
(763) 540-1200
(Registrant’s telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.
Yes ü No

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files).
Yes ü No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, smaller reporting company, or an emerging growth company. See the definitions of “large accelerated filer,” “accelerated filer,” “smaller reporting company,” and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer	ü	Accelerated filer
Non-accelerated filer		Smaller reporting company
Emerging growth company		

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If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
Yes Noü
As of October 19, 2018, there were 18,125,000 shares of Common Stock outstanding.

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

(In thousands, except shares and per share data)	Three Months Ended September 30		Nine Months Ended September 30	
	2018	2017	2018	2017
Net Sales	$273,255	$261,921	$838,299	$723,771
Cost of Sales	165,170	157,317	500,778	434,877
Gross Profit	108,085	104,604	337,521	288,894
Operating Expense:				
Research and Development Expense	7,506	7,907	23,408	24,239
Selling and Administrative Expense	85,140	85,711	269,273	246,993
Total Operating Expense	92,646	93,618	292,681	271,232
Profit from Operations	15,439	10,986	44,840	17,662
Other Income (Expense):				
Interest Income	839	698	2,540	1,575
Interest Expense	(5,986)	(6,093)	(17,736)	(18,720)
Net Foreign Currency Transaction Losses	(295)	(842)	(1,381)	(2,375)
Other Expense, Net	(130)	(422)	(890)	(774)
Total Other Expense, Net	(5,572)	(6,659)	(17,467)	(20,294)
Profit (Loss) Before Income Taxes	9,867	4,327	27,373	(2,632)
Income Tax Expense	158	731	1,598	385
Net Earnings (Loss) Including Noncontrolling Interest	9,709	3,596	25,775	(3,017)
Net Earnings (Loss) Attributable to Noncontrolling Interest	33	37	81	(28)
Net Earnings (Loss) Attributable to Tennant Company	$9,676	$3,559	$25,694	$(2,989)
Net Earnings (Loss) Attributable to Tennant Company per Share:				
Basic	$0.54	$0.20	$1.43	$(0.17)
Diluted	$0.52	$0.20	$1.40	$(0.17)
Weighted Average Shares Outstanding:				
Basic	17,998,917	17,729,857	17,911,880	17,673,656
Diluted	18,439,621	18,171,444	18,344,813	17,673,656
Cash Dividend Declared per Common Share	$0.21	$0.21	$0.63	$0.63

See accompanying Notes to the Condensed Consolidated Financial Statements.

TENNANT COMPANY
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(Unaudited)

(In thousands)	Three Months Ended September 30		Nine Months Ended September 30	
	2018	2017	2018	2017
Net Earnings (Loss) Including Noncontrolling Interest	$9,709	$3,596	$25,775	$(3,017)
Other Comprehensive (Loss) Income:				
Foreign currency translation adjustments	(3,110)	9,033	(14,202)	25,073
Pension and retiree medical benefits	12	379	105	541
Cash flow hedge	(28)	(1,732)	(1,367)	(6,311)
Income Taxes:				
Foreign currency translation adjustments	280	—	524	—
Pension and retiree medical benefits	(2)	(138)	(156)	(160)
Cash flow hedge	6	646	(814)	2,354
Total Other Comprehensive (Loss) Income, net of tax	(2,842)	8,188	(15,910)	21,497
Total Comprehensive Income Including Noncontrolling Interest	6,867	11,784	9,865	18,480
Comprehensive Income (Loss) Attributable to Noncontrolling Interest	33	37	81	(28)
Comprehensive Income Attributable to Tennant Company	$6,834	$11,747	$9,784	$18,508

See accompanying Notes to the Condensed Consolidated Financial Statements.

TENNANT COMPANY
CONDENSED CONSOLIDATED BALANCE SHEETS
(Unaudited)

(In thousands, except shares and per share data)	September 30, 2018	December 31, 2017
ASSETS		
Current Assets:		
Cash and Cash Equivalents	$53,473	$58,398
Restricted Cash	534	653
Accounts Receivable, less Allowances of $2,203 and $3,241, respectively	208,119	209,516
Inventories	139,793	127,694
Prepaid Expenses	28,356	19,351
Other Current Assets	8,865	7,503
Total Current Assets	439,140	423,115
Property, Plant and Equipment	381,443	382,768
Accumulated Depreciation	(217,625)	(202,750)
Property, Plant and Equipment, Net	163,818	180,018
Deferred Income Taxes	15,062	11,134
Goodwill	184,619	186,044
Intangible Assets, Net	152,974	172,347
Other Assets	14,953	21,319
Total Assets	$970,566	$993,977
LIABILITIES AND TOTAL EQUITY		
Current Liabilities:		
Current Portion of Long-Term Debt	$30,999	$30,883
Accounts Payable	90,778	96,082
Employee Compensation and Benefits	42,157	37,257
Income Taxes Payable	2,972	2,838
Other Current Liabilities	71,842	69,447
Total Current Liabilities	238,748	236,507
Long-Term Liabilities:		
Long-Term Debt	316,937	345,956
Employee-Related Benefits	21,828	23,867
Deferred Income Taxes	48,491	53,225
Other Liabilities	35,479	35,948
Total Long-Term Liabilities	422,735	458,996
Total Liabilities	661,483	695,503
Commitments and Contingencies (Note 13)		
Equity:		
Common Stock, $0.375 par value; 60,000,000 shares authorized; 18,122,576 and 17,881,177 shares issued and outstanding, respectively	6,796	6,705
Additional Paid-In Capital	26,087	15,089
Retained Earnings	312,539	297,032
Accumulated Other Comprehensive Loss	(38,233)	(22,323)
Total Tennant Company Shareholders' Equity	307,189	296,503
Noncontrolling Interest	1,894	1,971
Total Equity	309,083	298,474
Total Liabilities and Total Equity	$970,566	$993,977

See accompanying Notes to the Condensed Consolidated Financial Statements.

TENNANT COMPANY
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

(In thousands)	Nine Months Ended September 30	
	2018	2017
OPERATING ACTIVITIES		
Net Earnings (Loss) Including Noncontrolling Interest	$25,775	$(3,017)
Adjustments to Reconcile Net Earnings (Loss) to Net Cash Provided by Operating Activities:		
Depreciation	24,090	18,515
Amortization of Intangible Assets	17,378	11,430
Amortization of Debt Issuance Costs	1,883	896
Debt Issuance Cost Charges Related to Short-Term Financing	—	6,200
Fair Value Step-Up Adjustment to Acquired Inventory	—	8,445
Deferred Income Taxes	(9,908)	(4,848)
Share-Based Compensation Expense	6,008	4,915
Allowance for Doubtful Accounts and Returns	835	983
Other, Net	(459)	175
Changes in Operating Assets and Liabilities, Net of Assets Acquired:		
Receivables, Net	(342)	(524)
Inventories	(19,550)	(9,866)
Accounts Payable	(1,756)	5,747
Employee Compensation and Benefits	5,186	(9,462)
Other Current Liabilities	(138)	10,019
Income Taxes	(1,105)	4,149
Other Assets and Liabilities	(4,428)	(11,634)
Net Cash Provided by Operating Activities	43,469	32,123
INVESTING ACTIVITIES		
Purchases of Property, Plant and Equipment	(12,768)	(16,239)
Proceeds from Disposals of Property, Plant and Equipment	108	2,456
Proceeds from Principal Payments Received on Long-Term Note Receivable	828	500
Issuance of Long-Term Note Receivable	—	(1,500)
Proceeds from Sale of Business	4,000	—
Acquisition of Businesses, Net of Cash, Cash Equivalents and Restricted Cash Acquired	—	(353,535)
Purchase of Intangible Assets	(2,607)	(2,500)
Net Cash Used in Investing Activities	(10,439)	(370,818)
FINANCING ACTIVITIES		
Proceeds from Short-Term Debt	—	300,000
Repayments of Short-Term Debt	—	(300,000)
Proceeds from Issuance of Long-Term Debt	—	440,000
Payments of Long-Term Debt	(30,216)	(81,262)
Payments of Debt Issuance Costs	—	(16,465)
Change in Capital Lease Obligations	7	—
Proceeds from Issuance of Common Stock	5,735	4,728
Dividends Paid	(11,356)	(11,204)
Net Cash (Used in) Provided by Financing Activities	(35,830)	335,797
Effect of Exchange Rate Changes on Cash, Cash Equivalents and Restricted Cash	(2,244)	1,587
Net Decrease in Cash, Cash Equivalents and Restricted Cash	(5,044)	(1,311)

Cash, Cash Equivalents and Restricted Cash at Beginning of Period	59,051	58,550
Cash, Cash Equivalents and Restricted Cash at End of Period	$54,007	$57,239

Supplemental Disclosure of Cash Flow Information:		
Cash Paid for Income Taxes	$7,314	$8,127
Cash Paid for Interest	$11,297	$3,741
Supplemental Non-cash Investing and Financing Activities:		
Capital Expenditures in Accounts Payable	$635	$1,265

See accompanying Notes to the Condensed Consolidated Financial Statements.

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

1. Summary of Significant Accounting Policies

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

These statements should be read in conjunction with the Consolidated Financial Statements and Notes included in our annual report on Form 10-K for the year ended December 31, 2017. The results of operations for interim periods are not necessarily indicative of the results to be expected for the full year.

Revenue Recognition – Revenue is recognized upon transfer of control of promised products or services to customers in an amount that reflects the consideration we expect to receive in exchange for those products and services. Generally, these criteria are met at the time the product is shipped.

We also enter into contracts that can include combinations of products and services, which are generally capable of being distinct and are accounted for as separate performance obligations. Revenue is recognized net of allowances for returns and any taxes collected from customers, which are subsequently remitted to governmental authorities.

Further details regarding revenue recognition are discussed in Notes 2 and 3.

New Accounting Pronouncements – Further details regarding the adoption of new accounting standards are discussed in Note 2.

We documented the summary of significant accounting policies in the Notes to the Consolidated Financial Statements of our annual report on Form 10-K for the fiscal year ended December 31, 2017. Other than the accounting policies noted above, there have been no material changes to our accounting policies since the filing of that report.

2. Newly Adopted Accounting Pronouncements

Revenue from Contracts with Customers

On January 1, 2018, we adopted Accounting Standards Update ("ASU") No. 2014-09, Revenue from Contracts with Customers (Topic 606) and all the related amendments ("new revenue standard") to all contracts not completed at the date of initial application using the modified retrospective method. The cumulative effect of initially applying the new revenue standard as an adjustment to the opening balance of retained earnings was not material to the company. The comparative information has not been restated and continues to be reported under the accounting standards in effect for those periods, and there are no material differences between the reported results under the new revenue standard and those that would have been reported under legacy U.S. GAAP.

The new revenue standard also required us to record a refund liability and a corresponding asset for our right to recover products from customers upon settling the refund liability to account for the transfer of products with a right of return. The impact of this provision of the new revenue standard is immaterial to our financial statements. The new revenue standard also provided additional clarity that resulted in a reclassification from Accounts Receivable to Other Current Liabilities to reflect a change in the presentation of our sales return reserves on the balance sheet, which were previously recorded net of Accounts Receivable. Provisions for estimated sales returns will continue to be recorded at the time the related revenue is recognized.

The reclassification from Accounts Receivable to Other Current Liabilities in accordance with the detail described above impacted the Condensed Consolidated Balance Sheet as of September 30, 2018, as follows (in thousands):

	As Reported	Balances Without Adoption of ASC 606	Effect of Change Higher/(Lower)
ASSETS			
Accounts Receivable	$208,119	$206,960	$ 1,159
Total Current Assets	439,140	437,981	1,159
Total Assets	$970,566	$969,407	$ 1,159
LIABILITIES			
Other Current Liabilities	$71,842	$70,683	$ 1,159
Total Current Liabilities	238,748	237,589	1,159
Total Liabilities	$661,483	$660,324	$ 1,159

For additional disclosures regarding the new revenue standard, see Note 3.

Intra-Entity Transfers of Assets Other than Inventory

On January 1, 2018, we adopted ASU No. 2016-16, Income Taxes (Topic 740): Intra-Entity Transfers of Assets Other than Inventory. The ASU requires the tax effects of all intra-entity sales of assets other than inventory to be recognized in the period in which the transaction occurs. The adoption of this ASU resulted in a $94 cumulative effect adjustment recorded in Retained Earnings as of the beginning of 2018 that reflects a $1,281 reduction in a long-term deferred charge, mostly offset by the establishment of a deferred tax asset of $1,187. The reduction in the long-term asset and establishment of the deferred tax asset impacted Other Assets and Deferred Income Taxes, respectively, on our Condensed Consolidated Balance Sheets.

Statement of Cash Flows – Restricted Cash

On January 1, 2018, we adopted ASU No. 2016-18, Statement of Cash Flows (Topic 230): Restricted Cash. The ASU requires companies to explain the changes in the combined total of restricted and unrestricted balances in the Condensed Consolidated Statements of cash flows. Therefore, amounts generally described as restricted cash or restricted cash equivalents should be combined with unrestricted cash and cash equivalents when reconciling the beginning and end of period balances on the Condensed Consolidated Statements of Cash Flows. In accordance with the ASU, we adopted the standard on a retrospective basis to all periods presented.

Compensation – Retirement Benefits

On January 1, 2018, we adopted ASU No. 2017-07, Compensation—Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost. The ASU requires employers to report the service cost component of net pension and postretirement benefit costs in the same line item or items as other compensation costs arising from services rendered by the pertinent employees during the period. The other components of net pension and postretirement benefit costs are required to be presented in the Condensed Consolidated Statements of Operations separately from the service cost component in nonoperating expenses. In accordance with the ASU, we adopted the standard on a retrospective basis to all periods presented. As a result, we reclassified $60 of net benefit credits and $74 of net benefit costs from Selling and Administrative Expense to Other Expense, Net on the Condensed Consolidated Statements of Operations for the three and nine months ended September 30, 2017, respectively. The reclassification represents the other components of net pension and postretirement benefit costs that are now presented in the Condensed Consolidated Statements of Operations separately from the service cost in Total Other Expense, Net. As a basis for the retrospective application of the ASU, we used the practical expedient that permits us to use the amounts disclosed for the various components of net benefit cost in Note 12.

Income Statement—Reporting Comprehensive Income

On January 1, 2018, we elected to adopt early ASU No. 2018-02, Income Statement—Reporting Comprehensive Income (Topic 220). The ASU gives companies the option to reclassify stranded tax effects caused by the newly enacted

legislation referred to as the Tax Cuts and Jobs Act (the "Tax Act") from Accumulated Other Comprehensive Loss to Retained Earnings. The adoption resulted in a $1,263 cumulative effect adjustment which increased Retained Earnings as of the beginning of 2018 and reduced the deferred income tax benefits in Accumulated Other Comprehensive Loss relating to cash flow hedges and pension and retiree medical benefits.

Income Taxes

In March 2018, we adopted ASU No. 2018-05, Income Taxes (Topic 740): Amendments to SEC paragraphs Pursuant to SEC Staff Accounting Bulletin No. 118. The ASU updates the income tax accounting in U.S. GAAP to reflect the SEC interpretive guidance released on December 22, 2017, when the Tax Act was signed into law. Additional information regarding the adoption of this standard is contained in Note 15.

3. Revenue from Contracts with Customers

Under the new revenue standard, revenue is recognized when control transfers under the terms of the contract with our customers. Revenue is measured as the amount of consideration we expect to receive in exchange for transferring goods or providing services. Sales and other taxes we collect concurrent with revenue-producing activities are excluded from revenue. We do not account for shipping and handling as a distinct performance obligation as we generally perform shipping and handling activities after we transfer control of goods to the customer. We have elected to account for shipping and handling costs associated with outbound freight after control of goods has transferred to a customer as a fulfillment cost. Incidental items that are immaterial in the context of the contract are not recognized as a separate performance obligation. We do not have any significantly extended payment terms as payment is generally received within one year of the point of sale.

In general, we transfer control and recognize a sale at the point in time when products are shipped from our manufacturing facilities both direct to consumers and to distributors. Service revenue is recognized in the period the service is performed or ratably over the period of the related service contract. Consideration related to service contracts is deferred if the proceeds are received in advance of the satisfaction of the performance obligations and recognized over the contract period as the performance obligation is met. We use an output method to measure progress toward completion for certain prepaid service contracts, as this method appropriately depicts performance towards satisfaction of the performance obligations.

For contracts with multiple performance obligations (i.e., a product and service component), we allocate the transaction price to the performance obligations in proportion to their stand-alone selling prices. We use an observable price to determine the stand-alone selling price for separate performance obligations. When allocating on a relative stand-alone selling price basis, any discounts contained within the contract are allocated proportionately to all of the performance obligations in the contract.

Disaggregation of Revenue

The following tables illustrate the disaggregation of revenue by geographic area, groups of similar products and services and sales channels for the three and nine months ended September 30, 2018 and 2017 (in thousands):

Net Sales by geographic area

	Three Months Ended		Nine Months Ended	
	September 30		September 30	
	2018	2017	2018	2017
Americas	$175,341	$161,037	$516,731	$472,953
Europe, Middle East and Africa	74,254	78,851	250,480	189,483
Asia Pacific	23,660	22,033	71,088	61,335
Total	$273,255	$261,921	$838,299	$723,771

Net Sales are attributed to each geographic area based on the end user country and are net of intercompany sales.

Net Sales by groups of similar products and services

	Three Months Ended		Nine Months Ended	
	September 30		September 30	
	2018	2017	2018	2017
Equipment	$178,165	$165,203	$542,317	$455,311
Parts and Consumables	53,639	53,535	168,491	149,260
Specialty Surface Coatings	7,139	8,007	21,434	22,491
Service and Other	34,312	35,176	106,057	96,709

Total	$273,255	$261,921	$838,299	$723,771

Net Sales by sales channel

	Three Months Ended		Nine Months Ended	
	September 30		September 30	
	2018	2017	2018	2017
Sales Direct to Consumer	$180,901	$172,484	$547,079	$490,533
Sales to Distributors	92,354	89,437	291,220	233,238
Total	$273,255	$261,921	$838,299	$723,771

Contract Liabilities

Sales Returns

The right of return may exist explicitly or implicitly with our customers. When the right of return exists, we adjust the transaction price for the estimated effect of returns. We estimate the expected returns using the expected value method by assessing historical sales levels and the timing and magnitude of historical sales return levels as a percent of sales and projecting this experience into the future.

Sales Incentives

Our sales contracts may contain various customer incentives, such as volume-based rebates or other promotions. We reduce the transaction price for certain customer programs and incentive offerings that represent variable consideration. Sales incentives given to our customers are recorded using the most likely amount approach for estimating the amount of consideration to which the company will be entitled. We forecast the most likely amount of the incentive to be paid at the time of sale, update this forecast quarterly, and adjust the transaction price accordingly to reflect the new amount of incentives expected to be earned by the customer. A majority of our customer incentives are settled within one year. We record our accruals for volume-based rebates and other promotions in Other Current Liabilities on our Condensed Consolidated Balance Sheets.

The change in our sales incentive accrual balance for the nine months ended September 30, 2018 was as follows:

	Nine Months Ended September 30 2018
Beginning balance	$ 13,466
Additions to sales incentive accrual	22,078
Contract payments	(21,677)
Foreign currency fluctuations	(239)
Ending balance	$ 13,628

Deferred Revenue

We sell separately priced prepaid contracts to our customers where we receive payment at the inception of the contract and defer recognition of the consideration received because we have to satisfy future performance obligations. Our deferred revenue balance is primarily attributed to prepaid maintenance contracts on our machines ranging from 12 months to 60 months. In circumstances where prepaid contracts are bundled with machines, we use an observable price to determine stand-alone selling price for separate performance obligations.

The change in the deferred revenue balance for the nine months ended September 30, 2018 was as follows:

	Nine Months Ended September 30 2018
Beginning balance	$ 7,787
Increase in deferred revenue representing our obligation to satisfy future performance obligations	11,032
Decrease in deferred revenue for amounts recognized in Net Sales for satisfied performance obligations	(10,475)
Foreign currency fluctuations	(140)

Ending balance	$	8,204

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At September 30, 2018, $5,064 and $3,140 of deferred revenue was reported in Other Current Liabilities and Other Liabilities, respectively, on our Condensed Consolidated Balance Sheets. Of this, we expect to recognize the following approximate amounts in Net Sales in the following periods:

Remaining 2018	$2,502
2019	2,958
2020	1,595
2021	692
2022	381
Thereafter	76
Total	$8,204

At December 31, 2017, $5,304 and $2,483 of deferred revenue was reported in Other Current Liabilities and Other Liabilities, respectively, on our Condensed Consolidated Balance Sheets.

Practical Expedients and Exemptions

We generally expense the incremental costs of obtaining a contract when incurred because the amortization period would be less than one year. These costs relate primarily to sales commissions and are recorded in Selling and Administrative Expense in the Condensed Consolidated Statements of Operations.

We do not disclose the value of unsatisfied performance obligations for contracts with an original expected length of one year or less. In addition, we do not adjust the promised amount of consideration for the effects of a significant financing component if we expect, at contract inception, that the period between when we transfer a promised good or service to a customer and when the customer pays for that good or service will be one year or less.

4. Management Actions

During the first quarter of 2017, we implemented a restructuring action to better align our global resources and expense structure with a lower growth global economic environment. The pre-tax charge of $8,018, including other associated costs of $961, consisted primarily of severance and was included within Selling and Administrative Expense in the Condensed Consolidated Statements of Operations. The charge impacted our Americas, Europe, Middle East and Africa (EMEA) and Asia Pacific (APAC) operating segments. The savings offset the pre-tax charge approximately one year from the date of the action. Additional costs will not be incurred related to this restructuring action.

During the fourth quarter of 2017, we implemented a restructuring action primarily driven by integration actions related to our acquisition of the IPC Group. The restructuring action consisted primarily of severance and included reductions in overall staffing to streamline and right-size the organization to support anticipated business requirements. The pre-tax charge of $2,501 was included within Selling and Administrative Expense in the Condensed Consolidated Statements of Operations. The charge impacted our Americas, EMEA and APAC operating segments. We believe the anticipated savings will offset the pre-tax charge in approximately one year from the date of the action. Additional costs will not be incurred related to this restructuring action.

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

	Severance and Related Costs
2017 restructuring actions	$ 9,558
Cash payments	(6,312)
Foreign currency adjustments	190
December 31, 2017 balance	$ 3,436
2018 utilization:	
Cash payments	(1,694)
Foreign currency adjustments	(64)
September 30, 2018 balance	$ 1,678

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5. Acquisitions and Divestitures

On September 4, 2018, we signed a definitive agreement to acquire Hefei Gaomei Cleaning Machines Co., Ltd. and Anhui Rongen Environmental Protection Technology Co., Ltd (collectively "Gaomei"), privately held designers and manufacturers of commercial cleaning solutions based in China. We expect the acquisition to be completed in the first quarter of 2019. The purchase price and net assets to be acquired are not significant to our consolidated financial statements.

During the third quarter of 2018, we sold our Waterstar business for $4,000 in cash. The resulting gain was approximately $1,000 and is reflected within Selling and Administrative Expense in operating profit in our Condensed Consolidated Statements of Operations.

On April 6, 2017, we acquired the outstanding capital stock of IP Cleaning S.p.A. and its subsidiaries ("IPC Group") for a purchase price of $353,769, net of cash acquired of $8,804. The primary seller was Ambienta SGR S.p.A., a European private equity fund. IPC Group, based in Italy, is a designer and manufacturer of innovative professional cleaning equipment, cleaning tools and supplies. The acquisition strengthens our presence and market share in Europe and allows us to better leverage our EMEA cost structure. We funded the acquisition of IPC Group, along with related fees, including refinancing of existing debt, with funds raised through borrowings under a senior secured credit facility in an aggregate principal amount of $420,000. Further details regarding our acquisition financing arrangements are discussed in Note 8.

The following table summarizes the final fair value measurement of the assets acquired and liabilities assumed as of the date of acquisition:

ASSETS	
Receivables	$39,984
Inventories	46,442
Other Current Assets	7,456
Assets Held for Sale	2,247
Property, Plant and Equipment	63,890
Intangible Assets Subject to Amortization:	
Trade Name	26,753
Customer Lists	123,061
Technology	9,631
Other Assets	2,000
Total Identifiable Assets Acquired	321,464
LIABILITIES	
Accounts Payable	32,227
Accrued Expenses	18,130
Deferred Income Taxes	56,950
Other Liabilities	10,964
Total Identifiable Liabilities Assumed	118,271
Net Identifiable Assets Acquired	203,193
Noncontrolling Interest	(1,896)
Goodwill	152,472
Total Purchase Price, net of Cash Acquired	$353,769

Based on the final fair value measurement of the assets acquired and liabilities assumed, we allocated $152,472 to goodwill for the expected synergies from combining IPC Group with our existing business. None of the goodwill is expected to be deductible for income tax purposes. In connection with the finalization of the fair value measurements in the first quarter of 2018, we recorded a measurement period adjustment, which increased goodwill by $4,627 with offsetting adjustments to various income tax assets and liabilities.

The final fair value of the acquired intangible assets is $159,445. The expected lives of the acquired amortizable intangible assets are approximately 15 years for customer lists, 10 years for trade names and 10 years for technology. Trade names are being amortized on a straight-line basis while the customer lists and technology are being amortized on an accelerated basis. We recorded amortization expense of $5,401 and $16,424 in Selling and Administrative Expense on our Condensed Consolidated Statements of Operations for these acquired intangible assets for the three and nine months ended September 30, 2018, respectively.

The following unaudited pro forma financial information presents the combined results of operations of Tennant Company as if the 2017 acquisition of the IPC Group had occurred as of January 1, 2016. The unaudited pro forma financial information is presented for informational purposes only. It is not necessarily indicative of what our consolidated results of operations actually would have been had the acquisition occurred at the beginning of fiscal 2016. No pro forma results are presented for the three or nine months ended September 30, 2018, as the results of the acquired company are included in the actual results.

Pro Forma Financial Information (Unaudited)

(In thousands, except per share data)	Three Months Ended September 30 2017	Nine Months Ended September 30 2017
Net Sales		
Pro forma	$ 261,921	$ 777,832
As reported	261,921	723,771
Net Earnings (Loss) Attributable to Tennant Company		
Pro forma	$ 5,800	$ 14,875
As reported	3,559	(2,989)
Net Earnings (Loss) Attributable to Tennant Company per Share		
Pro forma	$ 0.32	$ 0.84
As reported	0.20	(0.17)

The unaudited pro forma financial information above gives effect to the following:

- incremental depreciation and amortization expense related to the fair value of the property, plant and equipment and identified intangible assets;
- exclusion of the purchase accounting impact of the inventory step-up related to the sale of acquired inventory;
- incremental interest expense related to additional debt used to finance the acquisition;
- exclusion of non-recurring acquisition-related transaction and financing costs; and
- pro forma adjustments tax affected based on the jurisdiction where the costs were incurred.

6. Inventories

Inventories are valued at the lower of cost or market. Inventories at September 30, 2018 and December 31, 2017 consisted of the following:

	September 30, 2018	December 31, 2017
Inventories carried at LIFO:		
Finished goods	$ 48,471	$ 43,439
Raw materials, production parts and work-in-process	28,994	23,694
LIFO reserve	(30,668)	(28,429)
Total LIFO inventories	46,797	38,704
Inventories carried at FIFO:		
Finished goods	53,138	54,161
Raw materials, production parts and work-in-process	39,858	34,829
Total FIFO inventories	92,996	88,990
Total inventories	$ 139,793	$ 127,694

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

7. Goodwill and Intangible Assets

The changes in the carrying value of Goodwill for the nine months ended September 30, 2018 were as follows:

	Goodwill	Accumulated Impairment Losses	Total
Balance as of December 31, 2017	$227,224	$ (41,180)	$186,044
Purchase accounting adjustments	4,627	—	4,627
Foreign currency fluctuations	(7,542)	1,490	(6,052)
Balance as of September 30, 2018	$224,309	$ (39,690)	$184,619

The balances of acquired Intangible Assets, excluding Goodwill, as of September 30, 2018 and December 31, 2017, were as follows:

	Customer Lists	Trade Names	Technology	Total
Balance as of September 30, 2018				
Original cost	$144,760	$30,945	$ 17,134	$192,839
Accumulated amortization	(29,908)	(4,631)	(5,326)	(39,865)
Carrying value	$114,852	$26,314	$ 11,808	$152,974
Weighted average original life (in years)	15	10	11	
Balance as of December 31, 2017				
Original cost	$149,355	$31,968	$ 14,589	$195,912
Accumulated amortization	(17,870)	(2,436)	(3,259)	(23,565)
Carrying value	$131,485	$29,532	$ 11,330	$172,347
Weighted average original life (in years)	15	10	11	

The purchase accounting adjustments recorded during the first quarter of 2018 were based on the fair value adjustments related to our acquisition of the IPC Group, as described further in Note 5.

During the first nine months of 2018, we purchased a technology license for $2,500. The license was recorded in Intangible Assets, Net as technology on the Condensed Consolidated Balance Sheets as of September 30, 2018.

Amortization expense on Intangible Assets for the three and nine months ended September 30, 2018 was $5,720 and $17,378, respectively. Amortization expense on Intangible Assets for the three and nine months ended September 30, 2017 was $7,650 and $11,430, respectively.

Estimated aggregate amortization expense based on the current carrying value of amortizable Intangible Assets for each of the five succeeding years and thereafter is as follows:

Remaining 2018	$5,456
2019	21,268
2020	19,827
2021	18,244
2022	15,965
Thereafter	72,214
Total	$152,974

8. Debt

Financial Covenants

In 2017, the Company and certain of our foreign subsidiaries entered into a Credit Agreement (the "2017 Credit Agreement) with JPMorgan, as administrative agent, Goldman Sachs Bank USA, as syndication agent, Wells Fargo, National Association, U.S. Bank National Association, and HSBC Bank USA, National Association, as co-documentation agents, and the lenders (including JPMorgan) from time to time party thereto.

The 2017 Credit Agreement contains customary representations, warranties and covenants, including, but not limited to, covenants restricting the company's ability to incur indebtedness and liens and merge or consolidate with another entity. The 2017 Credit Agreement also contains financial covenants, requiring us to maintain a ratio of consolidated total indebtedness to consolidated earnings before income, taxes, depreciation and amortization, subject to certain adjustments ("Adjusted EBITDA") of not greater than 4.00 to 1, as well as requiring us to maintain a ratio of consolidated Adjusted EBITDA to consolidated interest expense of no less than 3.50 to 1 for the quarter ended September 30, 2018. The 2017 Credit Agreement also contains a financial covenant requiring us to maintain a senior secured net indebtedness to Adjusted EBITDA ratio of not greater than 3.50 to 1. These financial covenants may restrict our ability to pay dividends and purchase outstanding shares of our common stock. We were in compliance with our financial covenants at September 30, 2018.

We will be required to repay the senior credit agreement with 25% to 50% of our excess cash flow from the preceding fiscal year, as defined in the agreement, unless our net leverage ratio for such preceding fiscal year is less than or equal to 3.00 to 1, which will be first measured using our fiscal year ended December 31, 2018.

Our Senior Notes also contain certain restrictions, which are generally less restrictive than those contained in the 2017 Credit Agreement.

Registration Rights Agreement

In connection with the issuance and sale of the Senior Notes, the company entered into a Registration Rights Agreement, dated April 18, 2017, among the company, the Guarantors and Goldman, Sachs & Co. and J.P. Morgan Securities LLC (the "Registration Rights Agreement"). Pursuant to the Registration Rights Agreement, the company agreed (1) to use its commercially reasonable efforts to consummate an exchange offer to exchange the Senior Notes for new registered notes (the "Exchange Notes"), with terms substantially identical in all material respects with the Senior Notes (except that the Exchange Notes will not contain terms with respect to additional interest, registration rights or transfer restrictions) and (2) if required, to have a shelf registration statement declared effective with respect to resales of the Senior Notes.

On January 22, 2018, we commenced the exchange offer required by the Registration Rights Agreement. The exchange offer closed on February 23, 2018. We did not incur any additional indebtedness as a result of the exchange offer. As a result, we are not required to pay additional interest on the Senior Notes.

Debt Outstanding

Debt outstanding at September 30, 2018 and December 31, 2017 consisted of the following:

	September 30, 2018	December 31, 2017
Long-Term Debt:		
Senior unsecured notes	$ 300,000	$ 300,000
Credit facility borrowings	50,000	80,000
Capital lease obligations	2,955	3,279
Total Long-Term Debt	352,955	383,279
Less: unamortized debt issuance costs	(5,020)	(6,440)
Less: current maturities of credit facility borrowings, net of debt issuance costs[1]	(29,704)	(29,413)
Less: current maturities of capital lease obligations[1]	(1,294)	(1,470)
Long-term portion	$ 316,937	$ 345,956

(1) Current maturities of long-term debt include $30,000 of current maturities, less $296 of unamortized debt issuance costs, under our 2017 Credit Agreement and $1,294 of current maturities of capital lease obligations.

As of September 30, 2018, we had outstanding borrowings under our Senior Unsecured Notes of $300,000. We had outstanding borrowings under our 2017 Credit Agreement, totaling $30,000 under our term loan facility and $20,000 under our revolving facility, leaving $180,000 of unused borrowing capacity on our revolving facility. Although we are only required to make a minimum principal payment of $6,250 during the next year, we have both the intent and the ability to pay an additional $23,750 during the next year on our term loan facility. As such, we have classified $30,000 as current maturities of long-term debt. In addition, we had letters of credit and bank guarantees outstanding in the amount of $5,724, leaving approximately $174,276 of unused borrowing capacity on our revolving facility. Commitment fees on unused lines of credit for the nine months ended September 30, 2018 were $455. The overall weighted average cost of debt is approximately 5.4% and net of a related cross-currency swap instrument is approximately 4.5%. Further details regarding the cross-currency swap instrument are discussed in Note 10.

9. Warranty

We record a liability for warranty claims at the time of sale. The amount of the liability is based on the trend in the historical ratio of claims to sales, the historical length of time between the sale and resulting warranty claim, new product introductions and other factors. Warranty terms on machines generally range from one to four years. However, the majority of our claims are paid out within the first six to nine months following a sale. The majority of the liability for estimated warranty claims represents amounts to be paid out in the near term for qualified warranty issues, with immaterial amounts reserved to be paid for older equipment warranty issues.

The changes in warranty reserves for the nine months ended September 30, 2018 and 2017 were as follows:

	Nine Months Ended September 30	
	2018	2017
Beginning balance	$12,676	$10,960
Additions charged to expense	10,883	8,879
Acquired warranty obligations	—	384
Foreign currency fluctuations	(193)	225
Claims paid	(9,805)	(8,912)
Ending balance	$13,561	$11,536

10. Derivatives

Hedge Accounting and Hedging Programs

We recognize all derivative instruments as either assets or liabilities in our Condensed Consolidated Balance Sheets and measure them at fair value. Gains and losses resulting from changes in fair value are accounted for depending on the use of the derivative and whether it is designated and qualifies for hedge accounting.

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Balance Sheet Hedging

Hedges of Foreign Currency Assets and Liabilities

We hedge portions of our net recognized foreign currency denominated assets and liabilities with foreign exchange forward contracts to reduce the risk that the value of these assets and liabilities will be adversely affected by changes in exchange rates. At September 30, 2018 and December 31, 2017, the notional amounts of foreign currency forward exchange contracts outstanding not designated as hedging instruments were $47,614 and $60,858, respectively.

Cash Flow Hedging

Hedges of Forecasted Foreign Currency Transactions

In countries outside the U.S., we transact business in U.S. dollars and in various other currencies. We may use foreign exchange option contracts or forward contracts to hedge certain cash flow exposures resulting from changes in these foreign currency exchange rates. These foreign exchange contracts, carried at fair value, have maturities of up to one year. We enter into these foreign exchange contracts to hedge a portion of our forecasted foreign currency denominated revenue in the normal course of business, and accordingly, they are not speculative in nature. The notional amounts of outstanding foreign currency forward contracts designated as cash flow hedges were $2,952 and $2,928 as of September 30, 2018 and December 31, 2017, respectively. The notional amounts of outstanding foreign currency option contracts designated as cash flow hedges were $8,737 and $8,619 as of September 30, 2018 and December 31, 2017, respectively.

Foreign Currency Derivatives

We use foreign currency exchange rate derivatives to hedge our exposure to fluctuations in exchange rates for anticipated intercompany cash transactions between Tennant Company and its subsidiaries. We entered into Euro to U.S. dollar foreign exchange cross currency swaps for all of the anticipated cash flows associated with an intercompany loan from a wholly owned European subsidiary. We enter into these foreign exchange cross currency swaps to hedge the foreign currency denominated cash flows associated with this intercompany loan, and accordingly, they are not speculative in nature. These cross currency swaps are designated as cash flow hedges. The hedged cash flows as of September 30, 2018 and December 31, 2017 included €175,800 and €181,200 of total notional values, respectively. As of September 30, 2018, the aggregate scheduled interest payments over the course of the loan and related swaps amounted to €25,800. The scheduled maturity and principal payment of the loan and related swaps of €150,000 are due in April 2022.

The fair value of derivative instruments on our Condensed Consolidated Balance Sheets as of September 30, 2018 and December 31, 2017 was as follows:

	September 30, 2018		December 31, 2017	
	Fair Value Asset Derivatives	Fair Value Liability Derivatives	Fair Value Asset Derivatives	Fair Value Liability Derivatives
Derivatives designated as hedging instruments:				
Foreign currency option contracts[(1)]	$ 113	$ —	$ 86	$ —
Foreign currency forward contracts[(1)]	7,038	29,868	7,218	34,961
Derivatives not designated as hedging instruments:				
Foreign currency forward contracts[(1)]	$ 653	$ 358	$ 442	$ 425

(1) Contracts that mature within the next 12 months are included in Other Current Assets and Other Current Liabilities for asset derivatives and liability derivatives, respectively, on our Condensed Consolidated Balance Sheets. Contracts with maturities greater than 12 months are included in Other Assets and Other Liabilities for asset derivatives and liability derivatives, respectively, in our Condensed Consolidated Balance Sheets. Amounts included in our Condensed Consolidated Balance Sheets are recorded net where a right of offset exists with the same derivative counterparty.

As of September 30, 2018, we anticipate reclassifying approximately $2,129 of gains from Accumulated Other Comprehensive Loss to net earnings during the next 12 months.

The effect of foreign currency derivative instruments designated as cash flow hedges and of foreign currency derivative instruments not designated as hedges in our Condensed Consolidated Statements of Operations for the three and nine months ended September 30, 2018 was as follows:

	Three Months Ended September 30, 2018		Nine Months Ended September 30, 2018	
	Foreign Currency Option Contracts	Foreign Currency Forward Contracts	Foreign Currency Option Contracts	Foreign Currency Forward Contracts
Derivatives in cash flow hedging relationships:				
Net (loss) gain recognized in Other Comprehensive (Loss) Income, net of tax[1]	$(89)	$ 1,253	$(40)	$ 4,929
Net loss reclassified from Accumulated Other Comprehensive Loss into earnings, net of tax, effective portion to Net Sales	(7)	(33)	(91)	(34)
Net gain reclassified from Accumulated Other Comprehensive Loss into earnings, net of tax, effective portion to Interest Income	—	487	—	1,345
Net gain reclassified from Accumulated Other Comprehensive Loss into earnings, net of tax, effective portion to Net Foreign Currency Transaction Losses	—	739	—	4,724
Net (loss) gain recognized in earnings[2]	(5)	2	3	8
Derivatives not designated as hedging instruments:				
Net (loss) gain recognized in earnings[3]	$—	$ (658)	$—	$ 1,174

The effect of foreign currency derivative instruments designated as cash flow hedges and of foreign currency derivative instruments not designated as hedges in our Condensed Consolidated Statements of Operations for the three and nine months ended September 30, 2017 was as follows:

	Three Months Ended September 30, 2017		Nine Months Ended September 30, 2017	
	Foreign Currency Option Contracts	Foreign Currency Forward Contracts	Foreign Currency Option Contracts	Foreign Currency Forward Contracts
Derivatives in cash flow hedging relationships:				
Net loss recognized in Other Comprehensive (Loss) Income, net of tax[1]	$(40)	$(4,492)	$(177)	$(14,026)
Net (loss) gain reclassified from Accumulated Other Comprehensive Loss into earnings, net of tax, effective portion to Net Sales	(141)	26	(140)	(76)
Net gain reclassified from Accumulated Other Comprehensive Loss into earnings, net of tax, effective portion to Interest Income	—	374	—	823
Net loss reclassified from Accumulated Other Comprehensive Loss into earnings, net of tax, effective portion to Net Foreign Currency Transaction Losses	—	(3,705)	—	(10,853)
Net (loss) gain recognized in earnings[2]	(7)	3	(12)	8
Derivatives not designated as hedging instruments:				
Net loss recognized in earnings[3]	$—	$(2,062)	$(1,132)	$(7,369)

(1) Net change in the fair value of the effective portion classified in Other Comprehensive (Loss) Income.

(2) Ineffective portion and amount excluded from effectiveness testing classified in Net Foreign Currency Transaction Losses.

(3) Classified in Net Foreign Currency Transaction Losses.

11. Fair Value Measurements

Estimates of fair value for financial assets and financial liabilities are based on the framework established in the accounting guidance for fair value measurements. The framework defines fair value, provides guidance for measuring fair value and requires certain disclosures. The framework discusses valuation techniques, such as the market approach (comparable market prices), the income approach (present value of future income or cash flow) and the cost approach (cost to replace the service capacity of an asset or replacement cost). The framework utilizes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value into three broad levels. The following is a brief description of those three levels:

- Level 1: Observable inputs such as quoted prices (unadjusted) in active markets for identical assets or liabilities.
- Level 2: Inputs other than quoted prices that are observable for the asset or liability, either directly or indirectly. These include quoted prices for similar assets or liabilities in active markets and quoted prices for identical or similar assets or liabilities in markets that are not active.
- Level 3: Unobservable inputs that reflect the reporting entity's own assumptions.

Our population of assets and liabilities subject to fair value measurements at September 30, 2018 is as follows:

	Fair Value	Level 1	Level 2	Level 3
Assets:				
Foreign currency forward exchange contracts	$7,691	$ —	$7,691	$ —
Foreign currency option contracts	113	—	113	—
Total Assets	$7,804	$ —	$7,804	$ —
Liabilities:				
Foreign currency forward exchange contracts	$30,226	$ —	$30,226	$ —
Total Liabilities	$30,226	$ —	$30,226	$ —

Our population of assets and liabilities subject to fair value measurements at December 31, 2017 is as follows:

	Fair Value	Level 1	Level 2	Level 3
Assets:				
Foreign currency forward exchange contracts	$7,660	$ —	$7,660	$ —
Foreign currency option contracts	86	—	86	—
Total Assets	$7,746	$ —	$7,746	$ —
Liabilities:				
Foreign currency forward exchange contracts	$35,386	$ —	$	