

BADGER METER INC
Form 10-Q
April 30, 2019
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 10-Q

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

For the quarterly period ended March 31, 2019

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 No. 001-06706

BADGER METER, INC.

(Exact name of registrant as specified in its charter)

| | |
|--|---|
| Wisconsin (State or other jurisdiction of incorporation or organization) | 39-0143280 (I.R.S. Employer Identification No.) |
|--|---|

4545 W. Brown Deer Road

| | |
|----------------------|-------|
| Milwaukee, Wisconsin | 53233 |
|----------------------|-------|

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(Address of principal executive offices) (Zip code)

(414) 355-0400

(Registrant's telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

| Trading | | |
|---------------------|-----------|--|
| Title of each class | Symbol(s) | Name of each exchange where registered |
| Common Stock | BMI | New York Stock Exchange |

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

Indicate by check mark whether the registrant has submitted electronically 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 No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See 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 | Smaller reporting company |
| Accelerated filer | Emerging growth company |
| Non accelerated filer | |

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes No

As of April 11, 2019, there were 29,114,760 shares of Common stock outstanding with a par value of \$1 per share.

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BADGER METER, INC.

Quarterly Report on Form 10-Q for the Period Ended March 31, 2019

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Special Note Regarding Forward Looking Statements

Certain statements contained in this Quarterly Report on Form 10-Q, as well as other information provided from time to time by Badger Meter, Inc. (the “Company” or “Badger Meter”) or its employees, may contain forward looking statements that involve risks and uncertainties that could cause actual results to differ materially from those in the forward looking statements. The words “anticipate,” “believe,” “estimate,” “expect,” “think,” “should,” “could” and “objective” and similar expressions are intended to identify forward looking statements. All such forward looking statements are based on the Company’s then current views and assumptions and involve risks and uncertainties. Some risks and uncertainties that could cause actual results to differ materially from those expressed or implied in forward looking statements include those described in Item 1A of the Company’s Annual Report on Form 10-K for the year ended December 31, 2018 and include, among other things:

- the continued shift in the Company’s business from lower cost, manually read meters toward more expensive, value-added automatic meter reading (AMR) systems, advanced metering infrastructure (AMI) systems and advanced metering analytics (AMA) systems that offer more comprehensive solutions to customers’ metering needs;
- the success or failure of newer Company products;
- changes in competitive pricing and bids in both the domestic and foreign marketplaces, and particularly in continued intense price competition on government bid contracts for lower cost, manually read meters;
- the actions (or lack thereof) of the Company’s competitors;
- changes in the general conditions of the United States and foreign economies, including to some extent such things as the length and severity of global economic downturns, international or civil conflicts that affect international trade, the ability of municipal water utility customers to authorize and finance purchases of the Company’s products, the Company’s ability to obtain financing, housing starts in the United States, and overall industrial activity;
- unusual weather, weather patterns or other natural phenomena, including related economic and other ancillary effects of any such events;
- economic policy changes, including but not limited to, trade policy and corporate taxation;
- the timing and impact of government funding programs that stimulate national and global economies, as well as the impact of government budget cuts or partial shutdowns of governmental operations;
- changes in the cost and/or availability of needed raw materials and parts, such as volatility in the cost of brass castings as a result of fluctuations in commodity prices, particularly for copper and scrap metal at the supplier level, foreign-sourced electronic components as a result of currency exchange fluctuations and/or lead times, and plastic resin as a result of changes in petroleum and natural gas prices;
- the Company’s ability to successfully integrate acquired businesses or products;
- changes in foreign economic conditions, particularly currency fluctuations in the United States dollar, the Euro and the Mexican peso;
- the inability to develop technologically advanced products;
- the failure of the Company’s products to operate as intended;
- the inability to protect the Company’s proprietary rights to its products;
- the Company’s expanded role as a prime contractor for providing complete technology systems to governmental entities, which brings with it added risks, including but not limited to, the Company’s responsibility for subcontractor performance, additional costs and expenses if the Company and its subcontractors fail to meet the timetable agreed to with the governmental entity, and the Company’s expanded warranty and performance obligations;
- disruptions and other damages to information technology, other networks, operations and property (Company or third party owned) due to breaches in data security or any other cybersecurity attack;

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- transportation delays or interruptions;
- violations or alleged violations of the U.S. Foreign Corrupt Practices Act (FCPA) or other anti-corruption laws;
- the loss of or disruption in certain single-source suppliers; and
- changes in laws and regulations, particularly laws dealing with the content or handling of materials used in the Company's products.

All of these factors are beyond the Company's control to varying degrees. Shareholders, potential investors and other readers are urged to consider these factors carefully in evaluating the forward looking statements contained in this Quarterly Report on Form 10-Q and are cautioned not to place undue reliance on such forward looking statements. The forward looking statements made in this document are made only as of the date of this document and the Company assumes no obligation, and disclaims any obligation, to update any such forward looking statements to reflect subsequent events or circumstances.

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Part I – Financial Information

Item 1 Financial Statements

BADGER METER, INC.

Consolidated Condensed Balance Sheets

| | December | |
|--|----------------|-----------|
| | March 31, | 31, |
| | (Unaudited) | |
| | (In thousands) | |
| | 2019 | 2018 |
| Assets | | |
| Current assets: | | |
| Cash | \$ 15,033 | \$ 13,086 |
| Receivables | 68,095 | 66,300 |
| Inventories: | | |
| Finished goods | 21,811 | 23,476 |
| Work in process | 16,076 | 17,097 |
| Raw materials | 42,667 | 40,231 |
| Total inventories | 80,554 | 80,804 |
| Prepaid expenses and other current assets | 7,541 | 4,469 |
| Total current assets | 171,223 | 164,659 |
| Property, plant and equipment, at cost | 215,098 | 213,722 |
| Less accumulated depreciation | (125,816) | (123,401) |
| Net property, plant and equipment | 89,282 | 90,321 |
| Intangible assets, at cost less accumulated amortization | 53,534 | 55,418 |
| Other assets | 15,810 | 8,872 |
| Deferred income taxes | 2,142 | 2,163 |
| Goodwill | 71,258 | 71,258 |
| Total assets | \$403,249 | \$392,691 |
| Liabilities and shareholders' equity | | |
| Current liabilities: | | |
| Short-term debt | \$ 10,980 | \$ 18,060 |
| Payables | 25,983 | 22,469 |
| Accrued compensation and employee benefits | 9,583 | 13,768 |
| Warranty and after-sale costs | 4,318 | 4,206 |
| Other current liabilities | 7,060 | 1,512 |
| Total current liabilities | 57,924 | 60,015 |
| Other long-term liabilities | 21,494 | 13,972 |
| Deferred income taxes | 3,217 | 3,332 |
| Accrued non-pension postretirement benefits | 5,214 | 5,184 |
| Other accrued employee benefits | 6,787 | 6,685 |
| Commitments and contingencies (Note 6) | | |
| Shareholders' equity: | | |
| Common stock | 37,200 | 37,198 |

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| | | |
|--|-----------|-----------|
| Capital in excess of par value | 38,756 | 38,082 |
| Reinvested earnings | 263,777 | 257,313 |
| Accumulated other comprehensive income | 311 | 580 |
| Less: Employee benefit stock | (306) | (306) |
| Treasury stock, at cost | (31,125) | (29,364) |
| Total shareholders' equity | 308,613 | 303,503 |
| Total liabilities and shareholders' equity | \$403,249 | \$392,691 |

See accompanying notes to unaudited consolidated condensed financial statements.

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BADGER METER, INC.

Consolidated Condensed Statements of Operations

| | Three Months Ended | |
|---|--|------------|
| | March 31, (Unaudited) | |
| | (In thousands except share and per share amounts) | |
| | 2019 | 2018 |
| Net sales | \$ 104,881 | \$ 105,041 |
| Cost of sales | 64,424 | 68,293 |
| Gross margin | 40,457 | 36,748 |
| Selling, engineering and administration | 26,130 | 26,774 |
| Operating earnings | 14,327 | 9,974 |
| Interest expense, net | 129 | 290 |
| Other pension and postretirement costs (benefits) | 47 | (19) |
| Earnings before income taxes | 14,151 | 9,703 |
| Provision for income taxes | 3,327 | 2,157 |
| Net earnings | \$ 10,824 | \$ 7,546 |
| Earnings per share: | | |
| Basic | \$ 0.37 | \$ 0.26 |
| Diluted | \$ 0.37 | \$ 0.26 |
| Dividends declared per common share | \$ 0.15 | \$ 0.13 |
| Shares used in computation of earnings per share: | | |
| Basic | 29,028,964 | 28,932,787 |
| Impact of dilutive securities | 209,660 | 217,259 |
| Diluted | 29,238,624 | 29,150,046 |

See accompanying notes to unaudited consolidated condensed financial statements.

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BADGER METER, INC.

Consolidated Condensed Statements of Comprehensive Income

| | Three Months Ended | |
|---|--------------------------|---------|
| | March 31, (Unaudited) | |
| | (In thousands) | |
| | 2019 | 2018 |
| Net earnings | \$10,824 | \$7,546 |
| Other comprehensive income: | | |
| Foreign currency translation adjustments | (257) | 421 |
| Pension and postretirement benefits, net of tax | (12) | 61 |
| Comprehensive income | \$10,555 | \$8,028 |

See accompanying notes to unaudited consolidated condensed financial statements.

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BADGER METER, INC.

Consolidated Condensed Statements of Cash Flows

| | Three Months Ended | |
|---|--------------------------|-----------|
| | March 31, (Unaudited) | |
| | (In thousands) | |
| | 2019 | 2018 |
| Operating activities: | | |
| Net earnings | \$ 10,824 | \$ 7,546 |
| Adjustments to reconcile net earnings to net cash provided by operations: | | |
| Depreciation | 2,978 | 3,175 |
| Amortization | 3,264 | 3,537 |
| Deferred income taxes | (1) | 1 |
| Noncurrent employee benefits | 117 | 94 |
| Stock-based compensation expense | 265 | 471 |
| Changes in: | | |
| Receivables | (1,943) | (4,919) |
| Inventories | 166 | 265 |
| Payables | 4,540 | (4,479) |
| Prepaid expenses and other current assets | (2,101) | (1,586) |
| Other liabilities | (294) | 2,670 |
| Total adjustments | 6,991 | (771) |
| Net cash provided by operations | 17,815 | 6,775 |
| Investing activities: | | |
| Property, plant and equipment expenditures | (2,160) | (3,043) |
| Net cash used for investing activities | (2,160) | (3,043) |
| Financing activities: | | |
| Net (decrease) increase in short-term debt | (7,000) | 3,500 |
| Payment of contingent acquisition consideration | (1,000) | - |
| Dividends paid | (4,357) | (3,770) |
| Proceeds from exercise of stock options | 471 | 231 |
| Repurchase of treasury stock | (1,873) | (1,619) |
| Issuance of treasury stock | 52 | 65 |
| Net cash used for financing activities | (13,707) | (1,593) |
| Effect of foreign exchange rates on cash | (1) | 229 |
| Increase in cash | 1,947 | 2,368 |
| Cash – beginning of period | 13,086 | 11,164 |
| Cash – end of period | \$ 15,033 | \$ 13,532 |

See accompanying notes to unaudited consolidated condensed financial statements.

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BADGER METER, INC.

Consolidated Condensed Statements of Shareholders' Equity

| | Quarters ended March 31, | | | Accumulated | | | |
|---|---|----------|------------|---------------|-----------|------------|-----------|
| | Capital | | | other | | | |
| | Common | excess | | comprehensive | Employee | Treasury | |
| | Stock at \$1 | of | Reinvested | income | benefit | stock (at | Total |
| | par | par | earnings | (loss) | stock | cost) | |
| | value* | value | | | | | |
| | (Unaudited) | | | | | | |
| | (In thousands except share and per share amounts) | | | | | | |
| Balance, December 31, 2017 | \$37,165 | \$32,182 | \$244,224 | \$ (10,893) | \$ (461) | \$(24,766) | \$277,451 |
| Net earnings | — | — | 7,546 | — | — | — | 7,546 |
| ASU 2014-09 adoption impact | — | — | (128) | — | — | — | (128) |
| Pension and postretirement benefits | | | | | | | |
| (net of \$21 tax effect) | — | — | — | 61 | — | — | 61 |
| Foreign currency translation | — | — | — | 421 | — | — | 421 |
| Cash dividends of \$0.13 per share | — | — | (3,777) | — | — | — | (3,777) |
| Stock options exercised | 12 | 219 | — | — | — | — | 231 |
| Stock-based compensation | — | 471 | — | — | — | — | 471 |
| Purchase of common stock for treasury stock | — | — | — | — | — | (1,619) | (1,619) |
| Issuance of treasury stock (21 shares) | — | (1) | — | — | — | 66 | 65 |
| Balance, March 31, 2018 | \$37,177 | \$32,871 | \$247,865 | \$ (10,411) | \$ (461) | \$(26,319) | \$280,722 |
| Balance, December 31, 2018 | \$37,198 | \$38,082 | \$257,313 | \$ 580 | \$ (306) | \$(29,364) | \$303,503 |
| Net earnings | — | — | 10,824 | — | — | — | 10,824 |
| Pension and postretirement benefits | | | | | | | |
| (net of \$4 tax effect) | — | — | — | (12) | — | — | (12) |
| Foreign currency translation | — | — | — | (257) | — | — | (257) |
| Cash dividends of \$0.15 per share | — | — | (4,360) | — | — | — | (4,360) |
| Stock options exercised | 2 | 397 | — | — | — | 72 | 471 |
| Stock-based compensation | — | 265 | — | — | — | — | 265 |
| Purchase of common stock for treasury stock | — | — | — | — | — | (1,873) | (1,873) |
| Issuance of treasury stock (9 shares) | — | 12 | — | — | — | 40 | 52 |

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| | | | | | | | |
|-------------------------|----------|----------|-----------|--------|-----------|------------|-----------|
| Balance, March 31, 2019 | \$37,200 | \$38,756 | \$263,777 | \$ 311 | \$ (306) | \$(31,125) | \$308,613 |
|-------------------------|----------|----------|-----------|--------|-----------|------------|-----------|

* Each common share of stock equals \$1 par value; therefore, the number of common shares is the same as the dollar value.

See accompanying notes to unaudited consolidated condensed financial statements.

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BADGER METER, INC.

Notes to Unaudited Consolidated Condensed Financial Statements

Note 1 Basis of Presentation

In the opinion of management, the accompanying unaudited consolidated condensed financial statements of Badger Meter contain all adjustments (consisting only of normal recurring accruals except as otherwise discussed) necessary to present fairly the Company's consolidated condensed financial position at March 31, 2019, results of operations, comprehensive income, cash flows and statements of shareholders' equity for the three-month periods ended March 31, 2019 and 2018. The results of operations for any interim period are not necessarily indicative of the results to be expected for the full year.

The preparation of financial statements in conformity with United States generally accepted accounting principles ("GAAP") requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

Note 2 Additional Financial Information Disclosures

The consolidated condensed balance sheet at December 31, 2018 was derived from amounts included in the Company's Annual Report on Form 10-K for the year ended December 31, 2018. Refer to the notes to the financial statements included in that report for a description of the Company's accounting policies and for additional details of the Company's financial condition. The details in those notes have not changed except as discussed below and as a result of normal adjustments in the interim.

Warranty and After-Sale Costs

The Company estimates and records provisions for warranties and other after-sale costs in the period in which the sale is recorded, based on a lag factor and historical warranty claim experience. After-sale costs represent a variety of activities outside of the written warranty policy, such as investigation of unanticipated problems after the customer has installed the product, or analysis of water quality issues. Changes in the Company's warranty and after-sale costs reserve are as follows:

| | Three months ended | |
|--|-----------------------|---------|
| (In thousands) | March 31, | |
| | 2019 | 2018 |
| Balance at beginning of period | \$4,206 | \$3,367 |
| Net additions charged to earnings | 465 | 1,041 |
| Adjustments to pre-existing warranties | - | (53) |
| Costs incurred | (353) | (653) |
| Balance at end of period | \$4,318 | \$3,702 |

Note 3 Employee Benefit Plans

Historically, the Company maintained a non-contributory defined benefit pension plan that covered substantially all U.S. employees who were employed at December 31, 2011. After that date, no further benefits were accrued in this plan. For the frozen pension plan, benefits were based primarily on years of service and, for certain individuals, levels of compensation. In 2018, the Company completed the termination of the non-contributory defined benefit pension plan.

The Company maintains supplemental non-qualified plans for certain officers and other key employees, and an Employee Savings and Stock Ownership Plan for the majority of the U.S. employees.

The Company additionally has a postretirement healthcare benefit plan that provides medical benefits for certain U.S. retirees and eligible dependents hired prior to November 1, 2004. Employees are eligible to receive postretirement healthcare benefits upon meeting certain age and service requirements. No employees hired after October 31, 2004 are eligible to receive these benefits. This plan requires employee contributions to offset benefit costs.

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The following table sets forth the components of net periodic benefit cost (income) for the three months ended March 31, 2019 and 2018 based on December 31, 2018 and 2017 actuarial measurement dates, respectively:

| | Defined | | Other | |
|--|----------|---------|----------------|------|
| | pension | | postretirement | |
| | benefits | | benefits | |
| (In thousands) | 2019 | 2018 | 2019 | 2018 |
| Service cost – benefits earned during the year | \$37 | \$29 | \$29 | \$34 |
| Interest cost on projected benefit obligations | 9 | 95 | 53 | 48 |
| Expected return on plan assets | - | (244) | - | - |
| Amortization of prior service benefit | - | - | (25) | (6) |
| Amortization of net loss | 9 | 88 | - | - |
| Net periodic benefit cost (income) | \$55 | \$(32) | \$57 | \$76 |

The Company disclosed in its financial statements for the year ended December 31, 2018 that it estimated it would pay \$0.4 million in other postretirement benefits in 2019 based on actuarial estimates. As of March 31, 2019, \$52,000 of such benefits have been paid. The Company continues to believe that its estimated payments for the full year are reasonable. However, such estimates contain inherent uncertainties because cash payments can vary significantly depending on the timing of postretirement medical claims and the collection of the retirees' portion of certain costs. The amount of benefits paid in calendar year 2019 will not impact the expense for postretirement benefits for 2019.

Note 4 Accumulated Other Comprehensive Income (Loss)

Components of and changes in accumulated other comprehensive income (loss) at March 31, 2019 are as follows:

| | Unrecognized | | |
|--|----------------|----------|---------|
| | pension and | | |
| | postretirement | | Foreign |
| (In thousands) | benefits | currency | Total |
| Balance at beginning of period | \$ 360 | \$ 220 | \$580 |
| Other comprehensive income (loss) before reclassifications | - | (257) | (257) |
| Amounts reclassified from accumulated other comprehensive income | | | |
| (loss), net of tax of \$4 thousand | (12) | - | (12) |
| Net current period other comprehensive income (loss), net of tax | (12) | (257) | (269) |
| Accumulated other comprehensive income (loss) | \$ 348 | \$(37) | \$311 |

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Details of reclassifications out of accumulated other comprehensive income (loss) during the three months ended March 31, 2019 are as follows:

| (In thousands) | Amount |
|---|--|
| | reclassified from accumulated other comprehensive income (loss) |
| Amortization of pension and postretirement benefits items: | |
| Prior service benefit (1) | \$ (25) |
| Actuarial loss (1) | 9 |
| Total before tax | (16) |
| Income tax | 4 |
| Amount reclassified out of accumulated other comprehensive loss | \$ (12) |

(1) These accumulated other comprehensive income (loss) components are included in the computation of net periodic benefit cost (income) in Note 3 "Employee Benefit Plans."

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Components of and changes in accumulated other comprehensive income (loss) at March 31, 2018 are as follows:

| (In thousands) | Unrecognized pension and postretirement benefits | Foreign currency | Total |
|---|---|---------------------|------------|
| Balance at beginning of period | \$ (11,597) | \$ 704 | \$(10,893) |
| Other comprehensive income (loss) before reclassifications | - | 421 | 421 |
| Amounts reclassified from accumulated other comprehensive income (loss), net of tax of \$21 thousand | 61 | - | 61 |
| Net current period other comprehensive income (loss), net of tax | 61 | 421 | 482 |
| Accumulated other comprehensive income (loss) | \$ (11,536) | \$ 1,125 | \$(10,411) |

Details of reclassifications out of accumulated other comprehensive income (loss) during the three months ended March 31, 2018 are as follows:

| (In thousands) | Amount reclassified from accumulated other comprehensive income (loss) |
|---|--|
| Amortization of pension and postretirement benefits items: | |
| Prior service benefit (1) | \$ (6) |
| Amortization of actuarial loss (1) | 88 |
| Total before tax | 82 |
| Income tax | (21) |
| Amount reclassified out of accumulated other comprehensive income | \$ 61 |

(1) These accumulated other comprehensive income (loss) components are included in the computation of net periodic benefit cost (income) in Note 3 "Employee Benefit Plans."

Note 5 Acquisition

On April 2, 2018, the Company acquired 100% of the outstanding stock of Innovative Metering Solutions, Inc. ("IMS") of Odessa, Florida, which was one of the Company's distributors serving Florida. Acquisitions are accounted for under the purchase method, and accordingly, the results of operations were included in the Company's financial statements from the date of acquisition. The IMS acquisition did not have a material impact on the Company's consolidated financial statements or the notes thereto.

The total purchase consideration was approximately \$12.0 million, which included \$7.7 million in cash, a \$0.3 million working capital adjustment, a balance sheet holdback of \$0.7 million and settlement of \$3.3 million of pre-existing Company receivables. The working capital adjustment was settled in the second quarter of 2018 and the balance sheet holdback is recorded in payables on the Company's Consolidated Balance Sheet as it is anticipated to be paid in the next twelve months. The Company's allocation of the purchase price at March 31, 2019 included \$3.8 million of receivables, \$0.8 million of inventories, \$0.1 million of machinery and equipment, \$3.6 million of intangibles and \$3.7 million of goodwill. The intangible assets acquired are customer relationships with an estimated average useful life of 10 years. The allocation of the purchase price to the assets acquired was based upon the estimated fair values at the date of acquisition. As of March 31, 2019, the Company had completed its analysis for estimating the fair value of the assets acquired with no additional adjustments.

In the first quarter of 2019, the Company made a contingent payment of \$1.0 million related to the May 1, 2017 acquisition of 100% of the outstanding common stock of D-Flow Technology AB ("D-Flow"). There is an additional \$2.0 million of contingent payments related to the D-Flow acquisition that is anticipated to be made in 2019 which is recorded in payables on the Company's Consolidated Balance Sheet at March 31, 2019.

Note 6 Contingencies, Litigation and Commitments

In the normal course of business, the Company is named in legal proceedings. There are currently no material legal proceedings pending with respect to the Company.

The Company is subject to contingencies related to environmental laws and regulations. A future change in circumstances with respect to specific matters or with respect to sites formerly or currently owned or operated by the Company, off-site disposal locations used by the Company, and property owned by third parties that is near such sites, could result in

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future costs to the Company and such amounts could be material. Expenditures for compliance with environmental control provisions and regulations during 2018 and the first quarter of 2019 were not material.

The Company relies on single suppliers for most brass castings, certain resins and electronic subassemblies in several of its product lines. The Company believes these items would be available from other sources, but that the loss of certain suppliers would result in a higher cost of materials, delivery delays, short-term increases in inventory and higher quality control costs in the short term. The Company attempts to mitigate these risks by working closely with key suppliers, purchasing minimal amounts from alternative suppliers and by purchasing business interruption insurance where appropriate.

The Company reevaluates its exposures on a periodic basis and makes adjustments to reserves as appropriate.

Note 7 Income Taxes

The Company is subject to income taxes in the United States and numerous foreign jurisdictions. The Company's income tax positions are based on interpretations of income tax laws and rulings in each of the jurisdictions that the Company operates. Significant judgment is required in determining the worldwide provision for income taxes and recording the related deferred tax assets and liabilities. The Company's deferred tax assets and liabilities are measured using the currently enacted tax rates that apply to taxable income for the years in which the assets or liabilities are expected to be realized or settled. Interim provisions are tied to an estimate of the overall annual rate which can vary due to the relationship of foreign and domestic earnings, state taxes and available deductions, credits and discrete items.

The Company's earnings before incomes taxes, income tax expense and effective income tax rate are as follows:

| | Three Months Ended March 31, 2019 | Three Months Ended March 31, 2018 |
|------------------------------|--|--|
| | (In thousands) | |
| Earnings before income taxes | \$ 14,151 | \$ 9,703 |
| Income tax expense | \$ 3,327 | \$ 2,157 |
| Effective income tax rate | 23.5 % | 22.2 % |

Note 8 Fair Value Measurements of Financial Instruments

The Company applies the accounting standards for fair value measurements and disclosures for its financial assets and financial liabilities. The carrying amounts of cash, receivables and payables in the financial statements approximate their fair values due to the short-term nature of these financial instruments. Short-term debt is comprised of notes

payable drawn against the Company's lines of credit and commercial paper. Because of its short-term nature, the carrying amount of the short-term debt also approximates fair value. Included in other assets are insurance policies on various individuals who were previously employed by the Company. The carrying amounts of these insurance policies approximate their fair value.

Note 9 Subsequent Events

The Company evaluates subsequent events at the date of the balance sheet as well as conditions that arise after the balance sheet date but before the financial statements are issued. The effects of conditions that existed at the balance sheet date are recognized in the financial statements. Events and conditions arising after the balance sheet date but before the financial statements are issued are evaluated to determine if disclosure is required to keep the financial statements from being misleading. To the extent such events and conditions exist, if any, disclosures are made regarding the nature of events and the estimated financial effects for those events and conditions. For purposes of preparing the accompanying consolidated financial statements and the notes to these financial statements, the Company evaluated subsequent events through the date that the accompanying financial statements were issued, and has determined that no material subsequent events exist through the date of this filing.

Note 10 New Pronouncements

In August 2018, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2018-14 "Compensation - Retirement Benefits - Defined Benefit Plans - General (Subtopic 715-20)," which modifies the annual disclosure requirements for defined benefit pension and other postretirement benefit plans. This ASU as modified added and deleted specific disclosures in an effort to improve the usefulness for financial statement users while also reducing unnecessary costs for companies. The ASU is effective for annual periods beginning after December 15, 2020 with early adoption being permitted in any interim reporting period within the annual reporting period. The Company is currently assessing the impact of adopting ASU No. 2018-14.

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In August 2018, the FASB issued ASU No. 2018-13 “Fair Value Measurement (Topic 820),” which is designed to improve the effectiveness of disclosures related to fair value measurements. This ASU is effective for annual periods beginning after December 15, 2019 and early adoption is allowed in any interim reporting period within the annual reporting period. The Company is currently assessing the impact of adopting ASU No. 2018-13.

In January 2017, the FASB issued ASU No. 2017-04 “Intangibles - Goodwill and Other (Topic 350).” The update requires a single-step quantitative test to measure potential impairment based on the excess of a reporting unit's carrying amount over its fair value. A qualitative assessment can still be completed first for an entity to determine if a quantitative impairment test is necessary. The ASU is effective on a prospective basis for annual periods beginning after December 15, 2019 and interim periods thereafter. Early adoption is permitted for interim or annual goodwill impairment tests performed on testing dates after January 1, 2017. The Company adopted ASU No. 2017-04 on January 1, 2019. The adoption of this standard did not have any impact on the Company's financial statements.

In June 2016, the FASB issued ASU No. 2016-13 “Financial Instruments - Credit Losses (Topic 326),” which amends the accounting for credit losses on purchased financial assets and available-for-sale debt securities with credit deterioration. This ASU requires the measurement of all expected credit losses for financial assets, including accounts receivables, held at the reporting date based upon current conditions, historical experience and reasonable forecasts. This ASU is effective for annual reporting periods beginning after December 15, 2019, and early adoption is allowed in any interim reporting period within the annual reporting period. The Company is currently assessing the impact of adopting ASU No. 2016-13.

In February 2016, the FASB issued ASU No. 2016-02 “Leases (Topic 842),” which requires lessees to record most leases on their balance sheets. Lessees initially recognize a lease liability (measured at the present value of the lease payments over the lease term) and a right-of-use asset (measured at the lease liability amount, adjusted for lease prepayments, lease incentives received and the lessee's initial direct costs). Lessees can make an accounting policy election not to recognize ROU assets and lease liabilities for leases with a lease term of 12 months or less as long as the leases do not include options to purchase the underlying assets that the lessee is reasonably certain to exercise. The standard includes the use of a modified retrospective approach for leases that exist or are entered into after the beginning of the earliest comparative period in the financial statements. Full retrospective application is prohibited. In July 2018, the FASB issued ASU No. 2018-11 “Targeted Improvements (Topic 842).” This ASU provides for an optional method of transition which allows companies to adopt the new leasing standard with a cumulative effect adjustment to reinvested earnings. The Company adopted the new leasing standard with the optional transition methodology as of January 1, 2019. For a complete discussion of the adoption of ASU No. 2016-02 and ASU No. 2018-11, see Note 12 “Leases.”

Note 11 Revenue Recognition

Revenue for sales of products and services is derived from contracts with customers. The products and services promised in contracts include the sale of municipal water and flow instrumentation products, such as flow meters and radios, software access and other ancillary services. Contracts generally state the terms of sale, including the description, quantity and price of each product or service. Since the customer typically agrees to a stated rate and price in the contract that does not vary over the life of the contract, the majority of the Company's contracts do not contain variable consideration. The Company establishes a provision for estimated warranty and returns as well as

certain after sale costs as discussed in Note 2 "Additional Financial Information Disclosures."

In accordance with ASU No. 2016-10 "Revenue from Contracts with Customers" ("Topic 606"), the Company disaggregates revenue from contracts with customers into geographical regions and by the timing of when goods and services are transferred. The Company determined that disaggregating revenue into these categories meets the disclosure objective in Topic 606 which is to depict how the nature, amount, timing and uncertainty of revenue and cash flows are affected by regional economic factors.

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Information regarding revenues disaggregated by geographic area is as follows:

| | Three Months | Three Months |
|------------------|------------------|------------------|
| | Ended | Ended |
| | March 31, | March 31, |
| | 2019 | 2018 |
| | (In thousands) | |
| Revenues: | | |
| United States | \$91,499 | \$91,153 |
| Foreign: | | |
| Asia | 1,452 | 1,700 |
| Canada | 3,497 | 3,260 |
| Europe | 5,352 | 5,047 |
| Mexico | 834 | 623 |
| Middle East | 1,584 | 2,152 |
| Other | 663 | 1,106 |
| Total | \$104,881 | \$105,041 |

Information regarding revenues disaggregated by the timing of when goods and services are transferred is as follows:

| | Three Months | Three Months |
|---------------------------------------|------------------|------------------|
| | Ended | Ended |
| | March 31, | March 31, |
| | 2019 | 2018 |
| | (In thousands) | |
| Revenue recognized over time | \$3,753 | 2,687 |
| Revenue recognized at a point in time | 101,128 | 102,354 |
| Total | \$104,881 | \$105,041 |

The Company performs its obligations under a contract by shipping products or performing services in exchange for consideration. The Company typically invoices its customers as soon as control of an asset is transferred and a receivable to the Company is established. The Company, however, recognizes a contract liability when a customer prepaids for goods or services and the Company has not transferred control of the goods or services.

The opening and closing balances of the Company's receivables and contract liabilities are as follows:

| | March 31, | December 31, |
|----------------------|----------------|-----------------|
| | 2019 | 2018 |
| | (In thousands) | |
| Receivables | \$68,095 | \$ 66,300 |
| Contract liabilities | \$ 16,686 | \$ 15,793 |

The balance of contract assets was immaterial as the Company did not have a significant amount of uninvoiced receivables at March 31, 2019 and December 31, 2018. The difference between the opening and closing balances of the Company's contract liabilities was the result of a timing difference between the Company's performance and the customers' prepayments.

As of March 31, 2019, the Company had certain contracts where there were unsatisfied performance obligations. For contracts recorded as contract liabilities, \$16.7 million was the aggregate amount of the transaction price allocated to performance obligations that were unsatisfied or partially unsatisfied as of the end of the reporting period. The Company estimates that revenue recognized from satisfying those performance obligations will be approximately \$3.3 million in 2019, \$1.5 million in each year from 2020 through 2024 and \$5.9 million thereafter.

A performance obligation is a promise in a contract to transfer a distinct good or service to the customer, and is the unit of measurement in Topic 606. At contract inception, the Company assesses the products and services promised in its contracts with customers. The Company then identifies performance obligations to transfer distinct products or services to the customer. In order to identify performance obligations, the Company considers all of the products or services promised in the contract regardless of whether they are explicitly stated or are implied by customary business practices.

The Company's performance obligations are satisfied at a point in time or over time as work progresses. Revenue from products and services transferred to customers at a single point in time accounted for 96.4% and 97.4% of net sales for the three-month periods ended March 31, 2019 and 2018, respectively. The majority of the Company's revenue recognized at a

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point in time is for the sale of municipal and flow instrumentation products. Revenue from these contracts is recognized when the customer is able to direct the use of and obtain substantially all of the benefits from the product which generally coincides with title transfer during the shipping process.

Revenue from services transferred to customers over time accounted for 3.6% and 2.6% of sales of net sales for the three-month periods ended March 31, 2019 and 2018, respectively. The majority of the Company's revenue that is recognized over time relates to the BEACON AMA software as a service.

Note 12 Leases

On January 1, 2019, the Company adopted ASU No. 2016-02 and ASU No. 2018-11 using the optional transition method. Under this transition method, comparative periods will continue to be reported in accordance with prior lease guidance under ASC 840 Leases. The Company has elected certain practical expedients permitted under the transition guidance, which, among other things, allows the Company to carry forward historical lease classifications.

The Company rents facilities, equipment and vehicles under operating leases, some of which contain renewal options. Upon inception of a rent agreement, the Company determines whether the arrangement contains a lease based on the unique conditions present. Leases that have a term over a year are recognized on the balance sheet as right-of-use assets and lease liabilities. Right-of-use assets are included in prepaid expenses and other current assets and other assets on the Company's Consolidated Balance Sheet. Lease liabilities are included in other current liabilities and other long-term liabilities on the Company's Consolidated Balance Sheet. The Company has elected not to recognize leases that have terms of one year or less on the Consolidated Balance Sheet. Information regarding the Company's right-of-use assets and the corresponding lease liabilities are as follows:

| | March 31, 2019 | January 1, 2019 |
|---------------------|----------------------|-----------------------|
| | (In thousands) | |
| Right-of-use assets | \$ 10,077 | \$ 10,745 |
| Lease liabilities | \$ 10,428 | \$ 11,087 |

The Company's operating lease agreements have lease and non-lease components that require payments for common area maintenance, property taxes and insurance. The Company has elected to account for both lease and non-lease components as one lease component. The fixed and in-substance fixed consideration in the Company's rent agreements constitute operating lease expense that is included in the capitalized right-of-use assets and lease liabilities. The variable and short-term lease expense payments are not included in the present value of the right-of-use-assets and lease liabilities on the Consolidated Balance Sheet. The Company's rent expense is as follows:

Three
Months

Ended

March 31,

2019
(In
thousands)

| | |
|---------------------------------------|--------|
| Operating lease expense | \$ 801 |
| Variable and short-term lease expense | 72 |
| Rent expense | \$ 873 |

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The Company records right-of-use assets and lease liabilities based upon the present value of lease payments over the expected lease term. The Company's rent agreements typically do not have implicit interest rates that are readily determinable. As a result, the Company utilizes an incremental borrowing rate that would be incurred to borrow on a collateralized basis over a similar term in a comparable economic environment. As of March 31, 2019 and January 1, 2019, the remaining lease term on the Company's leases was 5.0 years and 5.3 years, respectively. As of March 31, 2019 and January 1, 2019, the discount rate was 5.00%. The future minimum lease payments to be paid under operating leases are as follows:

| | Three Months Ended March 31, 2019 (In thousands) |
|---|--|
| 2019 (remaining nine months) | \$ 2,328 |
| 2020 | \$ 2,703 |
| 2021 | \$ 2,113 |
| 2022 | \$ 1,247 |
| 2023 | \$ 1,184 |
| Thereafter | \$ 2,189 |
| Total future lease payments | \$ 11,764 |
| (Present value adjustment) | \$ (1,336) |
| Present value of future lease payments | \$ 10,428 |

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Item 2 Management's Discussion and Analysis of Financial Condition and Results of Operations

BUSINESS DESCRIPTION AND OVERVIEW

Badger Meter is an innovator in flow measurement, control and related communication solutions, serving water utilities, municipalities, and commercial and industrial customers worldwide. The Company's products measure water, oil, chemicals and other fluids, and are known for accuracy, long-lasting durability and for providing valuable and timely measurement data through various methods. The Company's product lines fall into two categories: sales of water meters, radios and related technologies to municipal water utilities (municipal water) and sales of meters, valves and other products for industrial applications in water, wastewater, and other industries (flow instrumentation). The Company estimates that over 85% of its products are used in water related applications.

Municipal water, the largest sales category, is comprised of either mechanical or static (ultrasonic) water meters along with the related radio and software technologies and services used by municipal water utilities as the basis for generating their water and wastewater revenues. The largest geographic market for the Company's municipal water products is North America, primarily the United States, because most of the Company's meters are designed and manufactured to conform to standards promulgated by the American Water Works Association. The majority of water meters sold by the Company continue to be mechanical in nature; however, ultrasonic meters are gaining in penetration due to a variety of factors, including their ability to maintain near absolute measurement accuracy over their useful life. Providing ultrasonic water meter technology, combined with advanced radio technology, provides the Company with the opportunity to sell into other geographical markets, for example the Middle East and Europe.

Flow instrumentation includes meters and valves sold worldwide to measure and control fluids going through a pipe or pipeline including water, air, steam, oil, and other liquids and gases. These products are used in a variety of industries and applications, with the Company's primary market focus being water/wastewater; heating, ventilating and air conditioning (HVAC); oil and gas, and chemical and petrochemical. Flow instrumentation products are generally sold to original equipment manufacturers as the primary flow measurement device within a product or system, as well as through manufacturers' representatives.

Municipal water meters (both residential and commercial) are generally classified as either manually read meters or remotely read meters via radio technology. A manually read meter consists of a water meter and a register that provides a visual totalized meter reading. Meters equipped with radio technology (endpoints) receive flow measurement data from battery-powered encoder registers attached to the water meter, which is encrypted and transmitted via radio frequency to a receiver that collects and formats the data appropriately for water utility usage and billing systems. These remotely read systems are classified as either automatic meter reading (AMR) systems, where a vehicle equipped for meter reading purposes, including a radio receiver, computer and reading software, collects the data from utilities' meters; or advanced metering infrastructure (AMI) systems, where data is gathered utilizing a network (either fixed or cellular) of data collectors or gateway receivers that are able to receive radio data transmission from the utilities' meters. AMI systems eliminate the need for utility personnel to drive through service territories to collect data from the meters. These systems provide the utilities with more frequent and diverse data from their meters at specified intervals.

The ORION branded family of radio endpoints provides water utilities with a range of industry-leading options for meter reading. These include ORION Migratable (ME) for AMR meter reading, ORION (SE) for traditional fixed network applications, and ORION Cellular for an infrastructure-free meter reading solution. ORION Migratable makes the migration to fixed network easier for utilities that prefer to start with mobile reading and later adopt fixed network communications, allowing utilities to choose a solution for their current needs and be positioned for their future operational changes. ORION Cellular eliminates the need for utility-owned fixed network infrastructure, allows for gradual or full deployment, and decreases ongoing maintenance.

Critical to the water metering ecosystem is information and analytics. The Company's BEACON Advanced Metering Analytics (AMA) software suite improves the utilities' visibility of their water and water usage. BEACON AMA is a secure, cloud-hosted software suite that includes a customizable dashboard, and has the ability to establish alerts for specific conditions. It also allows for consumer engagement tools that permit end water users (such as homeowners) to view and manage their water usage activity. Benefits to the utility include improved customer service, increased visibility through faster leak detection, the ability to promote and quantify the effects of its water conservation efforts, and easier compliance reporting.

Water meter replacement and the adoption and deployment of new technology comprise the majority of water meter product sales, including radio products. To a much lesser extent, housing starts also contribute to the new product sales base. Over the last decade, there has been a growing trend in the conversion from manually read water meters to meters with radio technology. This conversion rate is accelerating, with the Company estimating that approximately 60% of water meters installed in the United States have been converted to a radio solution technology.

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The Company's net sales and corresponding net earnings depend on unit volume and product mix, with the Company generally earning higher average selling prices and margins on meters equipped with radio technology, and higher margins on ultrasonic compared to mechanical meters. The Company's proprietary radio products (i.e. ORION) generally result in higher margins than the remarketed, non-proprietary technology products. The Company also sells registers and endpoints separately to customers who wish to upgrade their existing meters in the field.

Flow instrumentation products are used in flow measurement and control applications across a broad industrial spectrum, occasionally leveraging the same technologies used in the municipal water category. Specialized communication protocols that control the entire flow measurement process and mandatory certifications drive these markets. The Company provides both standard and customized flow instrumentation solutions.

The industries served by the Company's flow instrumentation products face accelerating demands to contain costs, reduce product variability, and meet ever-changing safety, regulatory and sustainability requirements. To address these challenges, customers must reap more value from every component in their systems. This system-wide scrutiny has heightened the focus on flow instrumentation in industrial process, manufacturing, commercial fluid, building automation and precision engineering applications where flow measurement and control are critical.

A leader in both mechanical and static (ultrasonic) flow metering technologies for industrial markets, the Company offers one of the broadest flow measurement, control and communication portfolios in the market. This portfolio carries respected brand names including Recordall®, Hedland®, Dynasonics®, Blancett®, and Research Control®, and includes eight of the ten major flow meter technologies. Customers rely on the Company for application-specific solutions that deliver accurate, timely and dependable flow data and control essential for product quality, cost control, safer operations, regulatory compliance and more sustainable operations.

The Company's products are sold throughout the world through employees, resellers and representatives. Depending on the customer mix, there can be a moderate seasonal impact on sales, primarily relating to higher sales of certain municipal water products during the spring and summer months. No single customer accounts for more than 10% of the Company's sales.

Business Trends

Across the globe, increasing regulations and a focus on sustainability are driving companies and utilities to better manage critical resources like water, monitor their use of hazardous materials and reduce exhaust gases. Some customers measure fluids to identify leaks and/or misappropriation for cost control or add measurement points to help automate manufacturing. Other customers employ measurement to comply with government mandates and laws. The Company provides flow measurement technology to measure water, hydrocarbon-based fluids, chemicals, gases and steams. This technology is critical to provide baseline usage data and to quantify reductions as customers' attempt to reduce consumption. For example, once water usage metrics are better understood, a strategy for water-use reduction can be developed with specific water-reduction initiatives targeted to those areas where it is most viable. With the Company's technology, customers have found costly leaks, pinpointed equipment in need of repair, and identified areas for process improvements.

Increasingly, customers in the water utility market are interested in more frequent and diverse data collection. Specifically, AMI technology enables water utilities to capture readings from each meter at more frequent and variable intervals. There are approximately 52,000 water utilities in the United States and the Company estimates that approximately 60% of them have converted to a radio solution. The Company believes it is well positioned to meet this continuing conversion trend with its comprehensive radio and software solutions.

In addition, the water utility industry is beginning the conversion from mechanical to static (ultrasonic) meters. Ultrasonic water metering maintains measurement accuracy over the life of the meter, reducing a utility's non-revenue water. The Company has nearly a decade of proven reliability in the market with its ultrasonic meters and will be launching its next generation of ultrasonic metering with its D-Flow technology in 2019, which the Company believes will increase its competitive differentiation. While ultrasonic technology migration in North America could affect the competitive landscape, it also opens up further geographic penetration opportunities for the Company as previously described.

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Finally, the concept of “Smart Cities” is beginning to take hold as one avenue to affect efficient city operations, conserve resources and improve service and delivery. Smart water solutions (“Smart Water”) are those that provide actionable information through data analytics from an interconnected and interoperable network of sensors and devices that help people and organizations efficiently use and conserve one of the world’s most precious resources. Badger Meter is well positioned to benefit from the advancement of Smart Water applications within the Smart Cities framework. Cities have a keen interest in Smart Water as it provides both a revenue base and conservation outcome. Badger Meter is one of approximately a dozen firms, and the only water metering company, that participates in the AT&T Smart City Alliance. By leveraging this alliance, the Company expects to be able to gain access and sell its broad smart water solutions to higher level decision makers within a city such as the mayor’s office. In addition, it allows Badger Meter to keep abreast of emerging cellular technology changes which the Company believes is the premier AMI solution.

Acquisition

On April 2, 2018, the Company acquired 100% of the outstanding stock of Innovative Metering Solutions, Inc. (“IMS”) of Odessa, Florida, which was one of the Company's distributors serving Florida.

The total purchase consideration was approximately \$12.0 million, which included \$7.7 million in cash, a \$0.3 million working capital adjustment, a balance sheet holdback of \$0.7 million and settlement of \$3.3 million of pre-existing Company receivables. The working capital adjustment was settled in the second quarter of 2018 and the balance sheet holdback is recorded in payables on the Company's Consolidated Balance Sheet as it is anticipated to be paid in the next twelve months. The Company's allocation of the purchase price at June 30, 2018 included \$3.8 million of receivables, \$0.8 million of inventories, \$0.1 million of machinery and equipment, \$3.6 million of intangibles and \$3.7 million of goodwill. The intangible assets acquired are customer relationships with an estimated average useful life of 10 years. As of March 31, 2019, the Company had completed its analysis for estimating the fair value of the assets acquired with no additional adjustments. This acquisition is further described in Note 5 "Acquisition" in the Unaudited Notes to Consolidated Condensed Financial Statements.

In the first quarter of 2019, the Company made a contingent payment of \$1.0 million related to the May 1, 2017 acquisition of 100% of the outstanding common stock of D-Flow. There is an additional \$2.0 million of contingent payments related to the D-Flow acquisition that is anticipated to be made in 2019 which is recorded in payables on the Company’s Consolidated Balance Sheet at March 31, 2019.

Revenue and Product Mix

As the industry continues to evolve, the Company has been at the forefront of innovation across metering, radio and software technologies in order to meet its customers’ increasing expectations for accurate and actionable data. As technologies such as ORION Cellular and BEACON AMA managed solutions have become more readily adopted, the Company’s revenue from Software as a Service (SaaS) has increased significantly, albeit from a small base, and is margin accretive.

The Company also seeks opportunities for additional revenue enhancement. For instance, the Company has made inroads into the Middle East market with its ultrasonic meter technology and is pursuing other geographic expansion opportunities. The Company is periodically asked to oversee and perform field installation of its products for certain customers. The Company assumes the role of general contractor and either performs the installation or hires installation subcontractors and supervises their work.

Results of Operations - Three Months Ended March 31, 2019 and 2018

Net Sales

The Company's net sales for the three months ended March 31, 2019 were \$104.9 million, level with the prior year comparable quarter of \$105.0 million. Sales into the municipal water market were \$81.2 million, an increase of approximately 1% over the prior year's \$80.5 million. Municipal water sales benefitted from higher commercial sales in the US, partially offset by lower residential volumes in both the US and international markets. The company did benefit from continued positive sales mix reflecting a higher percentage of meters with radios, ultrasonic meters and SaaS revenue associated with data collection and software analytics. Sales of products into the global flow instrumentations end markets were \$23.7 million, approximately 3% lower than the prior year's \$24.5 million. The majority of the decline was due to the unfavorable foreign currency exchange rate fluctuations year-over-year. While sales in the general industrial and water/wastewater market increased year-over-year, this was offset by lower oil & gas and certain other de-emphasized end markets.

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Earnings

Total operating earnings for the three months ended March 31, 2019 were \$14.3 million, or 13.7% of sales, compared to \$10.0 million, or 9.5% of sales, in the comparable prior year quarter. Gross profit increased \$3.7 million and improved as a percent of sales from 35.0% to 38.6%. The improvement was largely the result of the nonrecurrence of facility relocation charges incurred in the prior year, improved municipal water sales mix and the benefit of pricing and lower year-over-year commodity costs, including brass. Selling, engineering and administration (“SEA”) expenses decreased \$0.6 million year-over-year with normal salary and wage inflation more than offset by spending controls.

The provision for income taxes as a percentage of earnings before income taxes for the first quarter of 2019 was 23.5% compared to 22.2% in the first quarter of 2018. Interim provisions are based on an estimate of the overall annual rate that can vary due to state taxes, the relationship of foreign and domestic earnings, other credits available and tax reform provisions.

As a result of the above-mentioned items, net earnings for the three months ended March 31, 2019 were \$10.8 million, or \$0.37 per diluted share, compared to \$7.5 million, or \$0.26 per diluted share, for the same period in 2018.

LIQUIDITY AND CAPITAL RESOURCES

The main sources of liquidity for the Company are cash from operations and borrowing capacity. In addition, depending on market conditions, the Company may access the capital markets to strengthen its capital position and to provide additional liquidity for general corporate purposes.

Primary Working Capital

The Company uses primary working capital (PWC) as a percentage of sales as a key metric for working capital efficiency. The Company defines this metric as the sum of Receivables and Inventories less Payables, divided by trailing twelve month net sales. The following table shows the components of our PWC (in millions):

| | March 31, 2019 | | December 31, 2018 | |
|-------------------------|----------------|--------|-------------------|--------|
| | \$ | PWC% | \$ | PWC% |
| Receivables | \$68,095 | 15.7 % | \$66,300 | 15.3 % |
| Inventories | 80,554 | 18.6 % | 80,804 | 18.6 % |
| Payables | (25,983) | -6.0 % | (22,469) | -5.2 % |
| Primary Working Capital | \$122,666 | 28.3 % | \$124,635 | 28.7 % |

Overall, PWC declined \$2.0 million compared to the prior quarter on flat sales activity. Receivables at March 31, 2019 were \$68.1 million compared to \$66.3 million at the end of 2018. The increase was due to a modest increase in days sales outstanding associated with international receivables due to their regionally higher payment terms. Inventories at March 31, 2019 were \$80.6 million, in line with the \$80.8 million at December 31, 2018. Payables at March 31, 2019 were \$26.0 million, up from \$22.5 million at the end of 2018 due to the timing of payments.

Cash Provided by Operations

Cash provided by operations in the first three months of 2019 was \$17.8 million compared to \$6.8 million in the same period of 2018. The increase between years is due primarily to higher net earnings and PWC changes between years.

Capital expenditures for the first three months of 2019 were \$2.2 million compared to \$3.0 million in the first three months of 2018.

Short-term debt decreased \$7.1 million to \$11.0 million at March 31, 2019 from \$18.1 million at December 31, 2018 due to the strong cash flow from operations, partially offset by the payment of dividends. At the end of the first quarter of 2019, the Company is in a net cash (cash less short-term debt) position of approximately \$4.1 million.

The Company's financial condition remains strong. In June 2018, the Company amended its May 2012 credit agreement with its primary lender and extended its term until September 2021. The credit agreement includes a \$125.0 million line of credit that supports commercial paper (up to \$70.0 million) and includes \$5.0 million of a Euro line of credit. While the facility is unsecured, there are a number of financial covenants with which the Company must comply, and the Company was in compliance as of March 31, 2019. The Company believes that its operating cash flows, available borrowing capacity, and its ability to raise capital provide adequate resources to fund ongoing operating requirements, future capital expenditures and the development of new products. The Company continues to take advantage of its local commercial paper market and carefully monitors the current borrowing market. The Company had \$121.8 million of unused credit lines available at March 31, 2019.

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Other Matters

The Company is subject to contingencies related to environmental laws and regulations. A future change in circumstances with respect to these specific matters or with respect to sites formerly or currently owned or operated by the Company, off-site disposal locations used by the Company, and property owned by third parties that is near such sites, could result in future costs to the Company and such amounts could be material. Expenditures for compliance with environmental control provisions and regulations during 2018 and the first quarter of 2019 were not material.

See the “Special Note Regarding Forward Looking Statements” at the front of this Quarterly Report on Form 10-Q and Part I, Item 1A “Risk Factors” in the Company’s Annual Report on Form 10-K for the year ended December 31, 2018 for a discussion of risks and uncertainties that could impact the Company’s financial performance and results of operations.

Off-Balance Sheet Arrangements and Contractual Obligations

The Company’s off-balance sheet arrangements and contractual obligations are discussed in Part II, Item 7 “Management’s Discussion and Analysis of Financial Condition and Results of Operations” under the headings “Off-Balance Sheet Arrangements” and “Contractual Obligations” in the Company’s Annual Report on Form 10-K for the year ended December 31, 2018 and have not materially changed since that report was filed unless otherwise indicated in this Form 10-Q.

Item 3 Quantitative and Qualitative Disclosures about Market Risk

The Company’s quantitative and qualitative disclosures about market risk are included in Part II, Item 7 “Management’s Discussion and Analysis of Financial Condition and Results of Operations” under the heading “Market Risks” in the Company’s Annual Report on Form 10-K for the year ended December 31, 2018 and have not materially changed since that report was filed.

Item 4 Controls and Procedures

Evaluation of Disclosure Controls and Procedures

In accordance with Rule 13a-15(b) of the Securities Exchange Act of 1934 (the “Exchange Act”), the Company’s management evaluated, with the participation of the Company’s President and Chief Executive Officer and the Company’s Vice President - Finance, Chief Financial Officer and Treasurer, the effectiveness of the design and operation of the Company’s disclosure controls and procedures (as defined in Rule 13a-15(e) under the Exchange Act) as of the end of the quarter ended March 31, 2019. Based upon their evaluation of these disclosure controls and procedures, the Company’s President and Chief Executive Officer and the Company’s Vice President - Finance, Chief Financial Officer and Treasurer concluded that, as of the date of such evaluation, the Company’s disclosure controls and procedures were effective.

Changes in Internal Control over Financial Reporting

There was no change in the Company’s internal control over financial reporting that occurred during the quarter ended March 31, 2019 that has materially affected, or is reasonably likely to materially affect, the Company’s internal control over financial reporting.

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Part II – Other Information

Item 6 Exhibits

EXHIBIT INDEX

Exhibit No. Description

- 10 Retirement Agreement, dated as of December 28, 2018, by and between Badger Meter, Inc. and Ms. Beverly L.P. Smiley.
- 31.1 Certification by the Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification by the Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32 Certification of Periodic Financial Report by the Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 101 The following materials from the Company’s Quarterly Report on Form 10-Q for the quarter ended March 31, 2019 formatted in Extensible Business Reporting Language (XBRL): (i) the Consolidated Condensed Balance Sheets, (ii) the Consolidated Statements of Operations, (iii) the Consolidated Statements of Comprehensive Income, (iv) the Consolidated Condensed Statements of Cash Flows, (v) Consolidated Condensed Statements of Shareholders’ Equity (vi) Notes to Unaudited Consolidated Condensed Financial Statements, tagged as blocks of text and (vii) document and entity information.

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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.

BADGER METER, INC.

Dated: April 30, 2019 By /s/ Kenneth C. Bockhorst
Kenneth C. Bockhorst
President and Chief Executive Officer

By /s/ Robert A. Wrocklage
Robert A. Wrocklage
Vice President – Finance, Chief Financial Officer and Treasurer

By /s/ Daniel R. Weltzien
Daniel R. Weltzien
Vice President – Controller