

MODINE MANUFACTURING CO

Form 10-K

May 29, 2015

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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D. C. 20549

FORM 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 or 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended March 31, 2015

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 1-1373

MODINE MANUFACTURING COMPANY

(Exact name of registrant as specified in its charter)

WISCONSIN

(State or other jurisdiction of incorporation or organization) 39-0482000 (I.R.S. Employer Identification No.)

1500 DeKoven Avenue, Racine, Wisconsin 53403

(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code (262) 636 1200

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

<u>Title of each class</u>	<u>Name of each exchange on which registered</u>
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Common Stock, \$0.625 par value	New York Stock Exchange
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Securities Registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.

Yes No

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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 such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes    No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes    No

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Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large Accelerated Filer

Accelerated Filer

Non-accelerated Filer (Do not check if a smaller reporting company) Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act).

Yes No

Approximately 97 percent of the outstanding shares are held by non-affiliates. The aggregate market value of these shares was approximately \$550 million based upon the market price of \$11.87 per share on September 30, 2014, the last day of our most recently completed second fiscal quarter. Shares of common stock held by each executive officer and director and by each person known to beneficially own more than 10 percent of the outstanding common stock have been excluded in that such persons may be deemed to be affiliates. The determination of affiliate status is not necessarily a conclusive determination for other purposes.

The number of shares outstanding of the registrant's common stock, \$0.625 par value, was 47,895,824 at May 22, 2015.

An Exhibit Index appears at pages 77-79 herein.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the following documents are incorporated by reference into the parts of this Form 10-K designated to the right of the document listed.

<u>Incorporated Document</u>	<u>Location in Form 10-K</u>
Proxy Statement for the 2015 Annual Meeting of Shareholders	Part III of Form 10-K (Items 10, 11, 12, 13, 14)

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PART I

ITEM 1. BUSINESS.

Modine Manufacturing Company specializes in thermal management systems and components, bringing heating and cooling technologies and solutions to diversified global markets. We are a leading global developer, manufacturer and marketer of heat exchangers and systems for use in on-highway and off-highway original equipment manufacturer (“OEM”) vehicular applications, and to a wide array of building, industrial and refrigeration markets. Products include radiators and radiator cores, condensers, oil coolers, charge air coolers, heat-transfer modules and assemblies, exhaust gas recirculation (“EGR”) coolers, and building heating, ventilating and air conditioning (“HVAC”) equipment. Our primary customers across the globe are:

- Automobile, truck, bus, and specialty vehicle OEMs;
- Agricultural, industrial and construction equipment OEMs;
- Heating, ventilation and cooling OEMs;
- Construction architects and contractors; and
- Wholesalers of heating equipment.

We focus our development efforts on solutions that meet the ever-increasing heat transfer needs of OEMs and other customers within the automobile, commercial vehicle, construction, agricultural, industrial and commercial HVAC industries. Our products and systems typically are aimed at solving complex heat transfer challenges requiring effective thermal management. Typical customer and market demands include products and systems that are lighter weight, more compact, more efficient and more durable to meet customer standards as they work to ensure compliance with increasingly stringent global emissions, fuel economy and energy efficiency requirements. Our heritage provides a depth and breadth of expertise in thermal management, which, when combined with our global manufacturing presence, standardized processes, and state-of-the-art technical resources, enables us to rapidly bring highly valued, customized solutions to our customers.

### History

Modine was incorporated under the laws of the State of Wisconsin on June 23, 1916 by its founder, Arthur B. Modine. Mr. Modine’s “Turbotube” radiators became standard equipment on the famous Ford Motor Company Model T. When he died at the age of 95, A.B. Modine had personally been granted a total of 120 U.S. patents for his heat transfer innovations. The standard of innovation exemplified by A.B. Modine remains the cornerstone of Modine today.

### Terms and Year References

When we use the terms “Modine,” “we,” “us,” the “Company,” or “our” in this report, unless the context otherwise requires, we are referring to Modine Manufacturing Company. Our fiscal year ends on March 31 and, accordingly, all references to a particular year mean the fiscal year ended March 31 of that year, unless indicated otherwise.

### Business Strategy and Results

We focus on thermal management leadership and highly engineered product and service innovations for diversified, global markets and customers. We are committed to enhancing our presence around the world and serving our customers where they are located. We create value by focusing on customer partnerships and providing innovative solutions for our customers' thermal management problems.

Our strategy for improved profitability is grounded in diversifying our markets and customer base, differentiating our products and services, both technically and commercially, and partnering with customers to deliver the right products

in the right markets. Our top five customers are in three different markets – automotive, commercial vehicle, and off-highway – and our ten largest customers accounted for 63 percent of our fiscal 2015 sales. In fiscal 2015, 64 percent of our total sales were generated from customers outside of the U.S., with 55 percent of total sales generated by foreign operations and 9 percent generated by exports from the U.S. In fiscal 2014, 66 percent of our total sales were generated from customers outside of the U.S., with 56 percent of total sales generated by foreign operations and 10 percent generated by exports from the U.S. In fiscal 2013, 61 percent of our total sales were generated from customers outside of the U.S., with 54 percent of total sales generated by foreign operations and 7 percent generated by exports from the U.S.



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During fiscal 2015, our consolidated sales were \$1.50 billion, a 1 percent increase from \$1.48 billion in fiscal 2014. Sales volume increases to our HVAC and commercial vehicle customers were partially offset by lower sales volume to our off-highway customers and a \$42.5 million unfavorable impact of foreign currency exchange rate changes, primarily associated with the strengthening of the U.S. dollar. Gross profit increased \$8.3 million to \$246.5 million in fiscal 2015 compared with the prior year, primarily due to sales volume improvements and lower warranty costs. Selling, general and administrative (“SG&A”) expenses increased slightly to \$184.5 million in fiscal 2015, compared with \$181.7 million in fiscal 2014.

In an effort to optimize our cost structure and improve efficiency of our operations, we have engaged in restructuring activities in our Europe, North America, and South America segments. As a result, we recorded \$4.7 million of restructuring expenses during fiscal 2015. In addition, we recorded a \$7.8 million goodwill impairment charge related to our South America segment in fiscal 2015, primarily caused by a decline in the financial outlook for the segment due to the weak economic environment in Brazil. We also sold a wind tunnel in our Europe segment in fiscal 2015, an asset which we no longer considered to be a core asset. As a result of this sale, we recorded a gain of \$3.2 million.

Operating income improved \$15.5 million in fiscal 2015 compared with the prior year, primarily due to lower restructuring expenses, higher gross profit on increased sales volume, and the gain on the sale of the wind tunnel, partially offset by the goodwill impairment charge.

A key metric by which we measure our performance is return on average capital employed (“ROACE”). We define ROACE as operating income, less restructuring expenses, impairment charges, certain other adjustments, income tax at a 30 percent rate, and earnings attributable to noncontrolling interest; divided by the average of debt plus Modine shareholders’ equity. We have established a long-term goal of achieving ROACE of 15 percent. ROACE was 7.8 percent in fiscal 2015 compared with 8.7 percent in fiscal 2014. The lower ROACE in fiscal 2015 was primarily due to higher capital employed in fiscal 2015. Capital employed was negatively impacted by the \$119 million reversal of U.S. income tax valuation allowances on March 31, 2014. See Note 8 of the Notes to Consolidated Financial Statements for further information.

ROACE is not a measure derived under generally accepted accounting principles (“GAAP”) and should not be considered as a substitute for any measure derived in accordance with GAAP. We believe that ROACE provides investors with helpful information about our performance, our ability to provide an acceptable return on capital, and our ability to fund future growth. This measure may not be comparable with similar measures presented by other companies. The following schedule provides a reconciliation of ROACE to the most directly comparable financial measures calculated and presented in accordance with GAAP:

	Fiscal 2015	Fiscal 2014
Operating income	\$52.7	\$37.2
Restructuring expenses	4.7	16.1
Impairment charges	7.8	3.2
Gain on sale of wind tunnel	(3.2 )	-
Other adjustments (a)	3.2	4.8
Subtotal	65.2	61.3
Tax applied at 30% rate	(19.6 )	(18.4 )
Noncontrolling interest	(1.0 )	(1.5 )
Operating income - adjusted	\$44.6	\$41.4
Average capital employed (see calculation below)	\$570.5	\$475.5
ROACE	7.8 %	8.7 %

Capital employed (debt + Modine shareholders' equity):

Beginning of fiscal year	\$589.2	\$429.3
June 30	604.5	440.0
September 30	582.0	460.0
December 31	572.0	459.2
End of fiscal year	504.7	589.2
Average capital employed (b)	\$570.5	\$475.5

In fiscal 2015, other adjustments consisted of a \$3.2 million charge in our South America segment associated with a legal matter in Brazil; see Note 19 of the Notes to Consolidated Financial Statements for further information. In (a) fiscal 2014, other adjustments primarily consisted of \$4.3 million of accelerated depreciation related to production equipment that is no longer used in Germany due to manufacturing process changes.

(b) Average capital employed represents the sum of capital employed for the five most recent quarter-end dates, divided by five.

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## Products

We offer a broad line of products that are categorized as a percentage of net sales as follows:

	Fiscal 2015		Fiscal 2014	
Modules/Assemblies*	25	%	26	%
Oil coolers	16	%	15	%
HVAC equipment	13	%	11	%
EGR coolers	12	%	12	%
Charge air coolers	10	%	11	%
Condensers	10	%	9	%
Radiators	8	%	9	%
Other	6	%	7	%

\*Typically include components such as radiators, oil coolers, charge air coolers, condensers and other purchased components.

## Competitive Position

We compete with many manufacturers of heat transfer and HVAC products, some of which are divisions of larger companies. The markets for our products are increasingly competitive and have changed significantly in the past few years. Our traditional OEM customers are faced with dramatically increased international competition and have expanded their global manufacturing footprint to compete in local markets. Some of these market changes have caused us to experience competition from suppliers in other parts of the world that enjoy economic advantages such as lower labor costs, lower healthcare costs, and lower tax rates. As a result, we have expanded and continue to expand our geographic footprint, in part to provide more flexibility to serve our customers around the globe. Our customers also continue to ask us, as well as their other primary suppliers, to provide research and development (“R&D”), design, and validation support for new potential projects. This combined work effort often results in stronger customer relationships and more partnership opportunities for us. It can also introduce risk, to the extent that these requests come at a time when actual business awards are pending.

## Business Segments

We have assigned specific businesses to segments based principally on defined markets and geographic locations. Each operating segment is managed by a vice president or managing director and has separate financial results reviewed by our chief operating decision maker. These results are used by management in evaluating the performance of each business segment and in making decisions on the allocation of resources among our various businesses. During fiscal 2015, we changed the name of our Commercial Products segment to Building HVAC in order to better reflect the nature of the segment’s product lines. There were no changes to the operations or reported financial results of the segment as a result. Financial information related to our operating segments is included in Note 21 of the Notes to Consolidated Financial Statements.

## North America, South America, Europe, and Asia Segments

The continued globalization of our OEM customer base has led to the necessity of viewing our strategic approach, product offerings and competitors on a global basis. This trend offers significant opportunities for us with our market positioning, including our presence in key global markets (U.S., Europe, Brazil, China, India, South Korea, Japan, Russia, and Mexico) and a global product-based organization with expertise to solve technical challenges. We are recognized for having strong technical support, product breadth and the ability to support global standard designs for

our customers.

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Our main vehicular competitors, AKG Group, BorgWarner, Dana Corporation, Delphi Corporation, Denso Corporation, Mahle Behr, Tata Toyo, TitanX, T. Rad Co. Ltd., Valeo SA, Visteon Corporation and Zhejiang Yinlun Machinery Co. Ltd., have a multi-regional or worldwide presence. Increasingly, we face heightened competition as these competitors expand their product offerings and manufacturing footprints through expansion into low-cost countries or low-cost sourcing initiatives. In addition, competitors from some of the low-cost regions are aligning their presence for OEM market expansion.

The North America, South America, Europe, and Asia segments represent our original equipment segments and serve the following markets:

## Commercial Vehicle

Market Overview – During fiscal 2015, the North America commercial vehicle market experienced significant volume improvements, particularly in heavy-duty trucks, and we expect the market to remain relatively strong in fiscal 2016. Favorable economic conditions and freight fundamentals suggest solid underlying freight demand and improved profits for truck fleets, although these gains may be offset by the introduction of new government regulations. In recent years, new trucks in the U.S., Canada, and the Eurozone have become more expensive due to enhanced vehicle technology, but the enhancements have resulted in improved fuel economy. Truck buyers making initial capital outlays can expect to experience improved fuel economy and reduced fuel expenses. These market conditions, coupled with older truck fleets and tight shipping capacity, are expected to result in year-over-year increases in North America truck production. In Europe, we anticipate Euro 6 commercial vehicle orders to remain relatively slow in the near term, an effect persisting from the pre-buy of Euro 5 truck platforms during fiscal 2014 and compounded by recent unfavorable economic conditions in certain European countries. Despite these recent challenges, we expect commercial vehicle demand in Europe to improve in fiscal 2016 compared with fiscal 2015.

Other trends influencing the commercial vehicle market include a call by global commercial vehicle manufacturers to standardize U.S., Canada, and Eurozone emission regulations. If global truck OEMs are successful, this likely would lead to further consolidation of our customer base and competitors, as they leverage higher volumes, consolidate development costs, and rationalize distribution channels. Additionally, truck makers are evaluating alternative powertrains and fuels, electrification, waste heat recovery and other technologies aimed to improve vehicle efficiency.

OEMs continue to expect greater supplier support and seek new technology solutions at lower prices for their thermal management needs. In general, this creates a challenge to the supply base, but also an opportunity for suppliers who develop innovative solutions at a competitive cost. Global standardization, fuel economy and emissions regulations are driving the advancement of product development worldwide and are creating demand for incremental thermal transfer products that we are well positioned to support.

Products – Powertrain cooling (engine cooling modules, radiators, charge air coolers, condensers, oil coolers, fan shrouds, and surge tanks); on-engine cooling (EGR coolers, engine oil coolers, fuel coolers, charge air coolers and intake air coolers); and auxiliary coolers (transmission and retarder oil coolers and power steering coolers).

Customers – Commercial, medium- and heavy-duty truck and engine manufacturers; bus and specialty vehicle manufacturers.

Primary Competitors – Mahle Behr; TitanX; T. Rad Co. Ltd.; BorgWarner; and Tata Toyo.

## Off-Highway

Market Overview – The global off-highway markets declined during fiscal 2015. The U.S. agricultural market has been under pressure from low commodity prices and associated demand, a trend that we expect to continue in fiscal

2016. We expect these markets will continue to be negatively impacted by higher used equipment inventories, which could suppress new equipment sales, the absence of tax benefits available to customers, and the uncertain interest rate environment. We expect modest improvements in the European construction and agricultural equipment markets, as we expect Eurozone economic conditions to slowly improve, aided by recent monetary stimulus efforts. Many mining equipment buyers continued to cut capital investment plans as it appears this market is progressing through a multiple-year cycle of demand declines. The mining equipment markets remained depressed during fiscal 2015 and are showing little signs of improving in fiscal 2016, especially in the U.S. The construction market was mixed in fiscal 2015, as some regions began to show signs of improvement during the year, while others remained depressed. In South America, we anticipate a decline in the agricultural market during fiscal 2016. In Asia, we expect that the China and Korea excavator markets will remain depressed.

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Overall, off-highway market trends include a migration toward global machine platforms, where economically feasible, driving the multi-region assembly of a common design platform. OEMs often prefer global suppliers with local production capabilities. We are recognized as having strong technical support capabilities, product breadth, and the ability to support global standard designs and local manufacturing operations for our customers.

Products – Powertrain cooling (engine cooling modules, radiators, condensers, charge air coolers, fuel coolers and oil coolers); auxiliary coolers (power steering coolers and transmission oil coolers); and on-engine cooling (EGR coolers, engine oil coolers, fuel coolers, charge air coolers and intake air coolers).

Customers – Construction, agricultural, and mining equipment and engine manufacturers, and industrial manufacturers of material handling equipment, generator sets and compressors.

Primary Competitors – Adams Thermal Systems Inc.; AKG Group; Denso Corporation; Zhejiang Yinlun Machinery Co., Ltd.; ThermaSys Corp.; Doowon; Donghwan; T. Rad Co. Ltd.; Mahle Industrial Thermal Systems; KALE OTO RADYATÖR; and RAAL.

### Automotive

Market Overview – The global automotive market improved in most regions during fiscal 2015, and we expect this trend to continue in fiscal 2016, supported by favorable oil prices and accommodative monetary policies. Structurally, albeit slowly, the automotive market is beginning to move away from traditional internal combustion engines towards alternative powertrains, such as electric, hybrid, or fuel cell. This shift is expected to increase the thermal requirements for these vehicles and we are capitalizing on this trend by applying our base heat transfer components to new applications. We expect our global automotive market production to increase in fiscal 2016, with modest improvements in both North America and Europe and new product launches driving sales volume growth in Asia.

Products – Powertrain cooling (engine cooling assemblies, radiators, condensers and charge air coolers); auxiliary cooling (power steering coolers and transmission oil coolers); component assemblies; radiators for special applications; on-engine cooling (EGR coolers, engine oil coolers, fuel coolers, charge air coolers and intake air coolers); and battery cooling (layered core battery chillers).

Customers – Automobile, light truck, and power sports vehicle and engine manufacturers.

Primary Competitors – Mahle Behr; Dana Corporation; Delphi Corporation; Denso Corporation; Visteon Corporation; BorgWarner; and Valeo SA.

### Building HVAC Segment

Market Overview – The North American heating market has experienced significant volume increases over the past two years. We expect modest improvement in the North American heating market in fiscal 2016, given the significant market growth seen in the past two fiscal years. We anticipate market demand for our data center cooling, ventilation, and geothermal heat pump products to increase in fiscal 2016. Continued growth in global computing power, coupled with increasing requirements for energy-efficient and green solutions, will continue to drive increased demand for our data center cooling products, especially our high-density and free-cooling solutions. Likewise, a steadily-improving economy, improvement in construction markets, and energy efficiency legislation is expected to drive increased demand for our ventilation and geothermal products.

Products – Unit heaters (gas-fired, hydronic, electric and oil-fired); duct furnaces (indoor and outdoor); infrared units (high- and low-intensity); hydronic products (commercial fin-tube radiation, cabinet unit heaters, and convectors); roof-mounted direct- and indirect-fired makeup air units; commercial packaged rooftop ventilation units; unit

ventilators; single packaged vertical units; geothermal and water-source heat pumps; precision air conditioning units for data center applications; air-handling units; chillers; ceiling cassettes; and condensing units.

Customers – Mechanical contractors; HVAC wholesalers; installers; and end users in a variety of commercial and industrial applications, including banking and finance, data center management, education, hospitality, telecommunications, entertainment arenas, hotels, restaurants, hospitals, warehousing, manufacturing, and food and beverage processing.



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Primary Competitors – Lennox International Inc. (ADP); CES (Reznor); Mestek Inc. (Sterling); Emerson Electric Company (Liebert); Stulz; Schneider Electric (APC / Uniflair); Johnson Controls, Inc. (York); Daikin (McQuay International); System Air (ChangeAir); Bard Manufacturing; and Aon, Inc.

Geographical Areas

We maintain administrative organizations in four geographical regions - North America, South America, Europe, and Asia - to facilitate customer support, development and testing, and other administrative functions. We operate in the following countries:

North America South America Europe Asia/Pacific