

BRADY CORP
Form 10-Q
November 15, 2018
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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 October 31, 2018

OR

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

For the Transition Period from _____ to _____

Commission File Number 1-14959

BRADY CORPORATION
(Exact name of registrant as specified in its charter)

Wisconsin 39-0178960
(State or other jurisdiction of (I.R.S. Employer
incorporation or organization) Identification No.)
6555 West Good Hope Road, Milwaukee, Wisconsin 53223
(Address of principal executive offices) (Zip Code)
(414) 358-6600
(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted every Interactive Data File required to be submitted 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 such files). Yes No

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

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

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

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

APPLICABLE ONLY TO CORPORATE ISSUERS

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

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As of November 13, 2018, there were 48,937,041 outstanding shares of Class A Nonvoting Common Stock and 3,538,628 shares of Class B Voting Common Stock. The Class B Voting Common Stock, all of which is held by affiliates of the Registrant, is the only voting stock.

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

BRADY CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS

(Dollars in Thousands)

| | October 31, 2018 | July 31, 2018 |
|---|---------------------|------------------|
| | (Unaudited) | |
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 192,176 | \$ 181,427 |
| Accounts receivable—net | 169,327 | 161,282 |
| Inventories: | | |
| Finished products | 71,092 | 73,133 |
| Work-in-process | 20,734 | 19,903 |
| Raw materials and supplies | 22,190 | 20,035 |
| Total inventories | 114,016 | 113,071 |
| Prepaid expenses and other current assets | 18,497 | 15,559 |
| Total current assets | 494,016 | 471,339 |
| Other assets: | | |
| Goodwill | 415,129 | 419,815 |
| Other intangible assets | 41,033 | 42,588 |
| Deferred income taxes | 7,770 | 7,582 |
| Other | 17,621 | 17,662 |
| Property, plant and equipment: | | |
| Cost: | | |
| Land | 7,250 | 6,994 |
| Buildings and improvements | 95,386 | 96,245 |
| Machinery and equipment | 270,192 | 270,989 |
| Construction in progress | 7,492 | 4,495 |
| | 380,320 | 378,723 |
| Less accumulated depreciation | 282,263 | 280,778 |
| Property, plant and equipment—net | 98,057 | 97,945 |
| Total | \$ 1,073,626 | \$ 1,056,931 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Current liabilities: | | |
| Accounts payable | \$ 64,735 | \$ 66,538 |
| Wages and amounts withheld from employees | 48,945 | 67,619 |
| Taxes, other than income taxes | 8,377 | 8,318 |
| Accrued income taxes | 4,937 | 3,885 |
| Other current liabilities | 54,582 | 44,567 |
| Total current liabilities | 181,576 | 190,927 |
| Long-term obligations | 54,408 | 52,618 |
| Other liabilities | 64,699 | 61,274 |
| Total liabilities | 300,683 | 304,819 |
| Stockholders' equity: | | |
| Class A nonvoting common stock—Issued 51,261,487 shares, and outstanding 48,918,974 and 48,393,617 shares, respectively | 513 | 513 |

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| | | |
|---|-------------|-------------|
| Class B voting common stock—Issued and outstanding, 3,538,628 shares | 35 | 35 |
| Additional paid-in capital | 326,182 | 325,631 |
| Retained earnings | 570,858 | 553,454 |
| Treasury stock—2,342,513 and 2,867,870 shares, respectively, of Class A nonvoting common stock, at cost | (58,414) | (71,120) |
| Accumulated other comprehensive loss | (66,231) | (56,401) |
| Total stockholders' equity | 772,943 | 752,112 |
| Total | \$1,073,626 | \$1,056,931 |

See Notes to Condensed Consolidated Financial Statements.

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BRADY CORPORATION AND SUBSIDIARIES
 CONDENSED CONSOLIDATED STATEMENTS OF EARNINGS
 (Dollars in Thousands, Except Per Share Amounts, Unaudited)

| | Three months ended October 31, | |
|--|-----------------------------------|-----------|
| | 2018 | 2017 |
| Net sales | \$293,196 | \$290,151 |
| Cost of products sold | 146,657 | 144,086 |
| Gross margin | 146,539 | 146,065 |
| Operating expenses: | | |
| Research and development | 11,326 | 10,520 |
| Selling, general and administrative | 94,591 | 100,134 |
| Total operating expenses | 105,917 | 110,654 |
| Operating income | 40,622 | 35,411 |
| Other (expense) income: | | |
| Investment and other (expense) income | (17 |) 216 |
| Interest expense | (712 |) (863 |
| Earnings before income taxes | 39,893 | 34,764 |
| Income tax expense | 9,256 | 8,928 |
| Net earnings | \$30,637 | \$25,836 |
| Net earnings per Class A Nonvoting Common Share: | | |
| Basic | \$0.59 | \$0.50 |
| Diluted | \$0.58 | \$0.49 |
| Dividends | \$0.21 | \$0.21 |
| Net earnings per Class B Voting Common Share: | | |
| Basic | \$0.57 | \$0.49 |
| Diluted | \$0.56 | \$0.48 |
| Dividends | \$0.20 | \$0.19 |
| Weighted average common shares outstanding (in thousands): | | |
| Basic | 52,201 | 51,440 |
| Diluted | 52,958 | 52,383 |

See Notes to Condensed Consolidated Financial Statements.

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BRADY CORPORATION AND SUBSIDIARIES
 CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
 (Dollars in Thousands, Unaudited)

| | Three months ended October 31, | | | |
|--|--------------------------------|--------|--------|--------|
| | 2018 | | 2017 | |
| Net earnings | \$ | 30,637 | \$ | 25,836 |
| Other comprehensive loss: | | | | |
| Foreign currency translation adjustments | (5,395 |) | (5,383 |) |
| Net investment hedge and long-term intercompany loan translation adjustments | (3,395 |) | (1,172 |) |
| Cash flow hedges: | | | | |
| Net loss recognized in other comprehensive loss | (380 |) | (234 |) |
| Reclassification adjustment for (gains) losses included in net earnings | (47 |) | 24 |) |
| | (427 |) | (210 |) |
| Pension and other post-retirement benefits actuarial gain amortization | (155 |) | (130 |) |
| Other comprehensive loss, before tax | (9,372 |) | (6,895 |) |
| Income tax expense related to items of other comprehensive loss | (458 |) | (485 |) |
| Other comprehensive loss, net of tax | (9,830 |) | (7,380 |) |
| Comprehensive income | \$ | 20,807 | \$ | 18,456 |

See Notes to Condensed Consolidated Financial Statements.

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BRADY CORPORATION AND SUBSIDIARIES
 CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
 (Dollars in Thousands, Unaudited)

| | Three months ended October 31, | |
|---|--------------------------------|-----------|
| | 2018 | 2017 |
| Operating activities: | | |
| Net earnings | \$ 30,637 | \$ 25,836 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | 5,960 | 6,564 |
| Non-cash portion of stock-based compensation expense | 4,965 | 3,744 |
| Deferred income taxes | 2,164 | (1,168) |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | (6,709) | (4,807) |
| Inventories | (3,125) | (3,571) |
| Prepaid expenses and other assets | (2,197) | (2,005) |
| Accounts payable and accrued liabilities | (14,070) | 7,799 |
| Income taxes | 1,193 | 2,327 |
| Net cash provided by operating activities | 18,818 | 34,719 |
| Investing activities: | | |
| Purchases of property, plant and equipment | (6,009) | (3,802) |
| Other | 337 | 974 |
| Net cash used in investing activities | (5,672) | (2,828) |
| Financing activities: | | |
| Payment of dividends | (11,096) | (10,639) |
| Proceeds from exercise of stock options | 12,138 | 3,249 |
| Proceeds from borrowing on credit facilities | 5,737 | 10,901 |
| Repayment of borrowing on credit facilities | (2,269) | (22,894) |
| Income tax on equity-based compensation, and | (3,846) | (2,280) |

| | | | |
|---|------------|------------|--------|
| other | | | |
| Net cash provided by (used in) financing activities | 664 | (21,663 |) |
| Effect of exchange rate changes on cash | (3,061 |) | (1,935 |
| | | |) |
| Net increase in cash and cash equivalents | 10,749 | 8,293 | |
| Cash and cash equivalents, beginning of period | 181,427 | 133,944 | |
| Cash and cash equivalents, end of period | \$ 192,176 | \$ 142,237 | |

See Notes to Condensed Consolidated Financial Statements

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BRADY CORPORATION AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Three Months Ended October 31, 2018

(Unaudited)

(In thousands, except share and per share amounts)

NOTE A — Basis of Presentation

The condensed consolidated financial statements included herein have been prepared by Brady Corporation and subsidiaries (the "Company," "Brady," "we," or "our") without audit, pursuant to the rules and regulations of the Securities and Exchange Commission. In the opinion of the Company, the foregoing statements contain all adjustments, consisting only of normal recurring adjustments necessary to present fairly the financial position of the Company as of October 31, 2018 and July 31, 2018, its results of operations and comprehensive income for the three months ended October 31, 2018 and 2017, and cash flows for the three months ended October 31, 2018 and 2017. The consolidated balance sheet as of July 31, 2018 has been derived from the audited consolidated financial statements as of that date. The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America ("GAAP") requires management to make estimates and assumptions that affect the reported amounts therein. Due to the inherent uncertainty involved in making estimates, actual results in future periods may differ from the estimates.

Certain information and footnote disclosures normally included in financial statements prepared in accordance with GAAP have been omitted pursuant to rules and regulations of the Securities and Exchange Commission. Accordingly, the condensed consolidated financial statements do not include all of the information and footnotes required by GAAP for complete financial statement presentation. It is suggested that these condensed consolidated financial statements be read in conjunction with the consolidated financial statements and the notes thereto included in the Company's annual report on Form 10-K for the year ended July 31, 2018.

NOTE B — New Accounting Pronouncements

In August 2017, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2017-12 "Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities," which simplifies and reduces the complexity of the hedge accounting requirements and better aligns an entity's financial reporting for hedging relationships with its risk management activities. The guidance is effective for interim periods in fiscal years beginning after December 15, 2018, with early adoption permitted. This new guidance will require a modified retrospective adoption approach to existing hedging relationships as of the adoption date. The Company is currently evaluating the impact of this update on its consolidated financial statements and disclosures.

In March 2017, the FASB issued ASU 2017-07, "Compensation-Retirement Benefits (Topic 715): Improving the presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost," which requires entities to present the service cost component of net periodic pension cost and net periodic postretirement benefit cost in the income statement line items where they report compensation cost. Entities will present all other components of net benefit cost outside operating income, if this subtotal is presented. The amendment only impacts where those costs are reflected within the income statement. In addition, only the service cost component of net benefit cost is eligible for capitalization. The Company adopted ASU 2017-07 effective August 1, 2018 and elected the practical expedient to use the components of cost disclosed in prior years as a basis for the retrospective application of the new income statement presentation. The impact of the adoption on the Company's condensed consolidated financial statements was not significant for the three months ended October 31, 2018 and 2017. Refer to Note 4 "Employee Benefit Plans" in our annual report on Form 10-K for the year ended July 31, 2018.

In January 2017, the FASB issued ASU 2017-04, "Goodwill and Other, Simplifying the Test for Goodwill Impairment," which simplifies the accounting for goodwill impairment. The new guidance removes Step 2 of the goodwill impairment test, which requires a hypothetical purchase price allocation. A goodwill impairment will now be the amount by which a reporting unit's carrying value exceeds its fair value, not to exceed the carrying amount of goodwill. All other goodwill impairment guidance will remain largely unchanged. This guidance is effective for

annual periods beginning after December 15, 2019, and interim periods thereafter; however, early adoption is permitted for any impairment tests performed after January 1, 2017. This guidance will only impact the Company's consolidated financial statements if there is a future impairment of goodwill.

In February 2016, the FASB issued ASU 2016-02, "Leases," which replaces the current lease accounting standards. The update requires, among other items, lessees to recognize the assets and liabilities that arise from most leases on the balance sheet. This guidance is effective for annual periods beginning after December 15, 2018, and interim periods within those annual periods. The ASU allows for either a full retrospective or a modified retrospective approach and early adoption is permitted. The Company expects the new lease standard to increase its total assets and liabilities; however, it is evaluating the magnitude of the impact on

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its consolidated financial statements. The Company has formed a team to implement the new lease standard, has selected a third-party software program to track and store its leases, and has accumulated data pertaining to its global lease obligations.

In May 2014, the FASB issued ASU 2014-09, "Revenue from Contracts with Customers" ("Topic 606"), which eliminates the transaction and industry-specific revenue recognition guidance under current GAAP and replaces it with a principles-based approach for determining revenue recognition. The new guidance requires revenue recognition when control of the goods or services transfers to the customer, replacing the existing guidance which requires revenue recognition when the risks and rewards transfer to the customer. The Company adopted ASU 2014-09 (and related updates) effective August 1, 2018 using the modified retrospective method to apply this guidance to all contracts at the date of initial application. Results for reporting periods beginning after August 1, 2018 are presented under Topic 606, while comparative prior period amounts have not been restated and continue to be presented under accounting standards in effect in those periods.

The results of applying Topic 606 were insignificant and did not have a material impact on the Company's consolidated financial condition, results of operations, cash flows, business processes, controls, or systems. Upon adoption, the Company recorded a cumulative adjustment to the opening balance of retained earnings as of August 1, 2018, which resulted in a decrease to retained earnings of \$2,137, net of tax. The adjustment was primarily due to a change in timing of when revenue and the related costs for certain extended service-type warranties are recognized, as required per Topic 606.

Refer to Note C "Revenue Recognition" for additional information and required disclosures under the new standard.

NOTE C — Revenue Recognition

The Company's revenues are primarily from the sale of identification solutions and workplace safety products that are shipped and billed to customers. All revenue is from contracts with customers and is included in "Net sales" on the consolidated statements of earnings. The Company considers the purchase orders, which in some cases are governed by master sales or distributor agreements, to be its contracts with the customers. For each contract, the Company considers the commitment to transfer products, each of which is distinct, to be its identified performance obligations.

Timing

The majority of the Company's revenue is earned and recognized at a point in time through ship-and-bill performance obligations, when control of the product is transferred to the customer, which typically occurs upon shipment or delivery to the customer, depending on freight terms. To determine when control has transferred, the Company considers if there is a present right to payment; and if legal title, physical possession, and the significant risks and rewards of ownership of the asset has transferred to the customer. Once a product has shipped or has been delivered, the customer is able to direct the use of, and obtain substantially all of the remaining benefits from, the asset.

Measurement

Revenue is measured as the amount of consideration the Company expects to be entitled to in exchange for the transfer of product, which is generally the price stated in the contract specific for each item sold, adjusted for the value of expected returns, discounts, rebates, or other allowances offered to the Company's customers as a reduction of the transaction price. Certain discounts and price assurances are fixed and known at the time of sale. Expected returns and other allowances are variable and are estimated using the expected value method based upon historical experience. Rebates offered to customers are retrospective and typically defined in the master sales or distributor agreements, and therefore are recorded using the most likely amount method based on the terms of the contract. Estimated amounts are included in the transaction price to the extent it is probable that a significant reversal of cumulative revenue recognized will not occur when the uncertainty associated with the variable consideration is resolved.

Payment Terms

While the Company's standard payment terms are net 30 days, the specific payment terms and conditions in its customer contracts vary. In some cases, customers pay for their goods at time of shipment or upon delivery; in other cases, after appropriate credit evaluation, an open credit line is granted and payment is due in arrears. Contracts with payment in arrears are recognized in the condensed consolidated balance sheet as accounts receivable.

Warranties

The Company offers standard warranty coverage on substantially all products that it sells, and accounts for this standard warranty coverage as an assurance warranty. As such, no transaction price is allocated to the standard warranty, and the Company records a liability for product warranty obligations at the time of sale to a customer based upon historical warranty experience.

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The Company also sells extended warranty coverage for certain products, which it accounts for as service warranties. In most cases, the extended service warranty is included with the purchase of the product. In applying Topic 606, the Company considers the extended service warranty to be a separate performance obligation in the contract and allocates a portion of the transaction price to the service warranty based on the estimated stand-alone selling price. Under Topic 606, the extended warranty transaction price is initially recorded as deferred revenue on the consolidated balance sheet and recognized on a straight-line basis over the life of the service warranty period. The deferred revenue is considered a contract liability as the Company has a right to payment at the time the product with the related extended service warranty is shipped or delivered and therefore, payment is received in advance of the Company's performance. The balance of contract liabilities as of October 31, 2018, was \$2,800. This also represents the amount of unsatisfied performance obligations related to contracts that extend beyond one year. Of this amount, the Company expects to recognize 34% as revenue by the end of fiscal 2019, an additional 37% by the end of fiscal 2020, and the balance thereafter. Upon adoption of Topic 606, at the beginning of fiscal 2019, the contract liability balance was \$2,796. The current portion of contract liabilities and the non-current portion are included in "Other current liabilities" and "Other liabilities," respectively, on the consolidated balance sheet. During the three months ended October 31, 2018, the Company recognized revenue of \$308 that was included in the contract liability balance at the beginning of the period, which was from the amortization of extended service warranties.

Practical Expedients

With the exception of the performance obligations related to the extended service warranties, the Company's contracts have an original expected duration of one year or less. As a result, the Company has elected to use the practical expedient to not disclose its remaining performance obligations for contracts that have an original expected length of one year or less.

The Company applied the portfolio approach to its ship-and-bill contracts that have similar characteristics as it reasonably expects that the effects on the financial statements of applying this guidance to the portfolio of contracts would not differ materially from applying this guidance to the individual contracts within the portfolio.

As the Company's product sale contracts and standard payment terms have a duration of less than one year, it uses the practical expedient applicable to such contracts and does not consider the time value of money.

Sales, use, value-add and other similar taxes assessed by governmental authorities and collected concurrent with revenue-producing activities are excluded from revenue.

The Company accounts for shipping and handling activities that occur after control of the related products transfers to the customer as fulfillment activities and are therefore recognized as revenue at time of shipping.

The Company expenses incremental direct costs of obtaining a contract (e.g., sales commissions) when incurred because the amortization period is generally twelve months or less. Contract costs are expensed in "Selling, general, and administrative expenses" on the consolidated statements of earnings.

Refer to Note G, "Segment Information," for the Company's disaggregated revenue disclosure.

NOTE D — Goodwill and Other Intangible Assets

Changes in the carrying amount of goodwill for the three months ended October 31, 2018, were as follows:

| | IDS | WPS | Total |
|--------------------------------|-----------|----------|-----------|
| Balance as of July 31, 2018 | \$385,524 | \$34,291 | \$419,815 |
| Translation adjustments | (3,569) | (1,117) | (4,686) |
| Balance as of October 31, 2018 | \$381,955 | \$33,174 | \$415,129 |

Goodwill is presented net of accumulated impairment losses, with the most recent impairment charge being incurred in fiscal 2015. There were no impairment charges recorded during the three months ended October 31, 2018.

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Other intangible assets include patents, trademarks, and customer relationships with finite lives being amortized in accordance with the accounting guidance for other intangible assets. The Company also has unamortized indefinite-lived trademarks that are classified as other intangible assets. The net book value of these assets was as follows:

| | October 31, 2018 | | | | July 31, 2018 | | | |
|--------------------------------------|--|-----------------------------|-----------------------------|----------------------|--|-----------------------------|-----------------------------|----------------------|
| | Weighted Average Amortization Period (Years) | Gross Carrying Amount | Accumulated Amortization | Net Book Value | Weighted Average Amortization Period (Years) | Gross Carrying Amount | Accumulated Amortization | Net Book Value |
| Amortized other intangible assets: | | | | | | | | |
| Patents | 5 | \$ 1,448 | \$ (1,069) | \$ 379 | 5 | \$ 1,448 | \$ (942) | \$ 506 |
| Trademarks and other | 9 | 4,416 | (4,332) | 84 | 9 | 4,497 | (4,395) | 102 |
| Customer relationships | 9 | 55,559 | (34,418) | 21,141 | 9 | 55,999 | (33,535) | 22,464 |
| Unamortized other intangible assets: | | | | | | | | |
| Trademarks | N/A | 19,429 | — | 19,429 | N/A | 19,516 | — | 19,516 |
| Total | | \$ 80,852 | \$ (39,819) | \$ 41,033 | | \$ 81,460 | \$ (38,872) | \$ 42,588 |

The decrease in the gross carrying amount of other intangible assets as of October 31, 2018 compared to July 31, 2018 was due to the effects of currency fluctuations during the three-month period.

Amortization expense on intangible assets was \$1,436 and \$1,693 for the three months ended October 31, 2018 and 2017, respectively. Amortization expense over each of the next five fiscal years is projected to be \$5,713, \$5,187, \$5,148, \$5,004 and \$2,025 for the fiscal years ending July 31, 2019, 2020, 2021, 2022 and 2023, respectively.

NOTE E — Other Comprehensive Loss

Other comprehensive loss consists of foreign currency translation adjustments, unrealized gains and losses from cash flow hedges and net investment hedges, and the unamortized gain on post-retirement plans, net of their related tax effects.

The following table illustrates the changes in the balances of each component of accumulated other comprehensive loss, net of tax, for the three months ended October 31, 2018:

| | Unrealized gain on cash flow hedges | Unamortized gain on post-retirement plans | Foreign currency translation adjustments | Accumulated other comprehensive loss |
|--|--|--|---|---|
| Beginning balance, July 31, 2018 | \$ 863 | \$ 3,302 | \$ (60,566) | \$ (56,401) |
| Other comprehensive loss before reclassification | (491) | — | (9,149) | (9,640) |
| Amounts reclassified from accumulated other comprehensive loss | (35) | (155) | — | (190) |
| Ending balance, October 31, 2018 | \$ 337 | \$ 3,147 | \$ (69,715) | \$ (66,231) |

The increase in the accumulated other comprehensive loss as of October 31, 2018, compared to July 31, 2018, was primarily due to the appreciation of the U.S. dollar against certain other currencies. The foreign currency translation adjustments column in the table above includes the impact of foreign currency translation, foreign currency translation on intercompany notes, and the settlements of net investment hedges, net of tax. Of the total \$190 in amounts reclassified from accumulated other comprehensive loss, the \$35 gain on cash flow hedges was reclassified into cost of goods sold and the \$155 gain on post-retirement plans was reclassified into selling, general and administrative expenses ("SG&A") on the Condensed Consolidated Statements of Earnings for the three months ended October 31, 2018.

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The changes in accumulated other comprehensive loss by component, net of tax, for the three months ended October 31, 2017, were as follows:

| | Unrealized gain (loss) on cash flow hedges | Unamortized gain on post-retirement plans | Foreign currency translation adjustments | Accumulated other comprehensive loss |
|--|--|--|---|---|
| Beginning balance, July 31, 2017 | \$ 109 | \$ 2,620 | \$ (47,411) | \$ (44,682) |
| Other comprehensive loss before reclassification | (419) | — | (6,846) | (7,265) |
| Amounts reclassified from accumulated other comprehensive loss | 15 | (130) | — | (115) |
| Ending balance, October 31, 2017 | \$ (295) | \$ 2,490 | \$ (54,257) | \$ (52,062) |

The increase in accumulated other comprehensive loss as of October 31, 2017, compared to July 31, 2017, was primarily due to the appreciation of the U.S. dollar against certain other currencies. The foreign currency translation adjustments column in the table above includes the impact of foreign currency translation, foreign currency translation on intercompany notes, and the settlements of net investment hedges, net of tax. Of the total \$115 in amounts reclassified from accumulated other comprehensive loss, the \$15 loss on cash flow hedges was reclassified into cost of goods sold and the \$130 gain on post-retirement plans was reclassified into SG&A on the Condensed Consolidated Statements of Earnings for the three months ended October 31, 2017.

The following table illustrates the income tax expense on the components of other comprehensive loss for the three months ended October 31, 2018 and 2017:

| | Three months ended October 31, 2018 2017 | |
|--|---|---------|
| Income tax expense related to items of other comprehensive loss: | | |
| Net investment hedge translation adjustments | \$(405) | \$(301) |
| Cash flow hedges | (100) | (195) |
| Other income tax adjustments and currency translation | 47 | 11 |
| Income tax expense related to items of other comprehensive loss | \$(458) | \$(485) |

NOTE F — Net Earnings per Common Share

Reconciliations of the numerator and denominator of the basic and diluted per share computations for the Company's Class A and Class B common stock are summarized as follows:

| | Three months ended October 31, 2018 2017 | |
|---|--|----------|
| Numerator: | | |
| Earnings (Numerator for basic and diluted Class A Nonvoting Common Share) | \$30,637 | \$25,836 |
| Less: | | |
| Preferential dividends | (815) | (799) |
| Preferential dividends on dilutive stock options | (13) | (16) |
| Numerator for basic and diluted earnings per Class B Voting Common Share | \$29,809 | \$25,021 |
| Denominator: (in thousands) | | |
| Denominator for basic earnings for both Class A and Class B | 52,201 | 51,440 |
| Plus: Effect of dilutive stock options | 757 | 943 |
| Denominator for diluted earnings per share for both Class A and Class B | 52,958 | 52,383 |
| Net earnings per Class A Nonvoting Common Share: | | |
| Basic | \$0.59 | \$0.50 |
| Diluted | \$0.58 | \$0.49 |

Net earnings per Class B Voting Common Share:

| | | |
|---------|--------|--------|
| Basic | \$0.57 | \$0.49 |
| Diluted | \$0.56 | \$0.48 |

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Options to purchase 679,902 and 737,132 shares of Class A Nonvoting Common Stock for the three months ended October 31, 2018 and 2017, respectively, were not included in the computation of diluted net earnings per share because the option exercise price was greater than the average market price of the common shares and, therefore, the effect would have been anti-dilutive.

NOTE G — Segment Information

The Company is organized and managed on a global basis within three operating segments, Identification Solutions ("IDS"), Workplace Safety ("WPS"), and People Identification ("People ID"), which aggregate into two reportable segments that are organized around businesses with consistent products and services: IDS and WPS. The Identification Solutions and People ID operating segments aggregate into the IDS reporting segment, while the WPS reporting segment is comprised solely of the Workplace Safety operating segment. The Company evaluates short-term segment performance based on segment profit and customer sales. Interest expense, investment and other income (expense), income taxes, and certain corporate administrative expenses are excluded when evaluating segment performance.

The following is a summary of net sales by segment and geographic region for the three months ended October 31, 2018 and 2017:

| | Three months ended October 31, | |
|------------------|-----------------------------------|------------|
| | 2018 | 2017 |
| Net sales: | | |
| ID Solutions | | |
| Americas | \$ 145,791 | \$ 139,404 |
| Europe | 48,828 | 47,131 |
| Asia | 23,481 | 23,170 |
| Total | \$ 218,100 | \$ 209,705 |
| Workplace Safety | | |
| Americas | \$ 24,751 | \$ 26,488 |
| Europe | 37,655 | 41,384 |
| Australia | 12,690 | 12,574 |
| Total | \$ 75,096 | \$ 80,446 |
| Total Company | | |
| Americas | \$ 170,542 | \$ 165,892 |
| Europe | 86,483 | 88,515 |
| Asia-Pacific | 36,171 | 35,744 |
| Total | \$ 293,196 | \$ 290,151 |

Segment profit for the three months ended October 31, 2018 and 2017 is as follows:

| | Three months ended October 31, | |
|------------------|--------------------------------------|-----------|
| | 2018 | 2017 |
| Segment profit: | | |
| ID Solutions | \$ 41,562 | \$ 35,837 |
| Workplace Safety | 5,541 | 6,445 |
| Total Company | \$ 47,103 | \$ 42,282 |

The following is a reconciliation of segment profit to earnings before income taxes for the three months ended October 31, 2018 and 2017:

| | Three months ended October 31, | |
|--|-----------------------------------|------|
| | 2018 | 2017 |

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| | | |
|---------------------------------------|----------|----------|
| Total profit from reportable segments | \$47,103 | \$42,282 |
| Unallocated amounts: | | |
| Administrative costs | (6,481) | (6,871) |
| Investment and other (expense) income | (17) | 216 |
| Interest expense | (712) | (863) |
| Earnings before income taxes | \$39,893 | \$34,764 |

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NOTE H – Stock-Based Compensation

The Company has an incentive stock plan under which the Board of Directors may grant nonqualified stock options to purchase shares of Class A Nonvoting Common Stock, restricted stock units ("RSUs"), or restricted and unrestricted shares of Class A Nonvoting Common Stock to employees and non-employee directors. Certain awards may be subject to pre-established performance goals.

The options issued under the plan have an exercise price equal to the fair market value of the underlying stock at the date of grant and generally vest over a three-year service period, with one-third becoming exercisable one year after the grant date and one-third additional in each of the succeeding two years. Options issued under the plan, referred to herein as "service-based" stock options, generally expire 10 years from the date of grant.

Restricted and unrestricted shares and RSUs issued under the plan have a grant date fair value equal to the fair market value of the underlying stock at the date of grant or as determined using a Monte Carlo simulation. Shares issued under the plan are referred to herein as either "service-based" or "performance-based" restricted shares and RSUs. The service-based RSUs granted under the plan generally vest over a three-year service period, with one-third becoming exercisable one year after the grant date and one-third additional in each of the succeeding two years. The performance-based RSUs granted under the plan vest at the end of a three-year service period provided specified financial performance metrics are met.

As of October 31, 2018, the Company has reserved 2,682,634 shares of Class A Nonvoting Common Stock for outstanding stock options, RSUs, and restricted shares and 3,655,246 shares of Class A Nonvoting Common Stock remain for future issuance of stock options, RSUs, and restricted and unrestricted shares under the active plan. The Company uses treasury stock or will issue new Class A Nonvoting Common Stock to deliver shares under the plan. The Company recognizes the compensation cost of all share-based awards at the time it is deemed probable the award will vest. This cost is recognized on a straight-line basis over the vesting period of the award. If it is determined that it is unlikely the award will vest, the expense recognized to date for the award is reversed in the period in which this is evident and the remaining expense is not recorded. Total stock-based compensation expense recognized by the Company during the three months ended October 31, 2018 and 2017, was \$4,965 (\$4,319 net of taxes) and \$3,744 (\$2,321 net of taxes), respectively.

As of October 31, 2018, total unrecognized compensation cost related to stock-based compensation awards was \$16,245 pre-tax, net of estimated forfeitures, which the Company expects to recognize over a weighted-average period of 2.1 years.

The Company has estimated the fair value of its service-based stock option awards granted during the three months ended October 31, 2018 and 2017, using the Black-Scholes option valuation model. The weighted-average assumptions used in the Black-Scholes valuation model are reflected in the following table:

| Black-Scholes Option Valuation Assumptions | Three months ended October 31, | |
|--|-----------------------------------|---------|
| | 2018 | 2017 |
| Expected term (in years) | 6.20 | 6.07 |
| Expected volatility | 25.83 % | 28.19 % |
| Expected dividend yield | 2.71 % | 2.72 % |
| Risk-free interest rate | 3.01 % | 1.96 % |
| Weighted-average market value of underlying stock at grant date | \$43.96 | \$36.85 |
| Weighted-average exercise price | \$43.96 | \$36.85 |
| Weighted-average fair value of options granted during the period | \$9.70 | \$7.96 |

The Company uses historical data regarding stock option exercise behaviors to estimate the expected term of options granted based on the period of time that options granted are expected to be outstanding. Expected volatilities are based on the historical volatility of the Company's stock. The expected dividend yield is based on the Company's historical dividend payments and historical yield. The risk-free interest rate is based on the U.S. Treasury yield curve in effect

on the grant date for the length of time corresponding to the expected term of the option. The market value is calculated as the average of the high and the low stock price on the date of the grant.

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A summary of stock option activity under the Company's share-based compensation plans for the three months ended October 31, 2018, is presented below:

| Service-Based Options | Shares | Weighted Average Exercise Price | Weighted Average Remaining Contractual Term | Aggregate Intrinsic Value |
|---------------------------------|-----------|--|---|---------------------------------|
| Outstanding at July 31, 2018 | 2,504,633 | \$ 28.23 | | |
| New grants | 276,238 | 43.96 | | |
| Exercised | (551,919) | 26.88 | | |
| Forfeited or expired | (5,407) | 36.24 | | |
| Outstanding at October 31, 2018 | 2,223,545 | \$ 30.50 | 6.5 | \$ 23,842 |
| Exercisable at October 31, 2018 | 1,621,317 | \$ 27.06 | 5.6 | \$ 22,340 |

There were 1,621,317 and 2,229,350 options exercisable with a weighted average exercise price of \$27.06 and \$27.39 at October 31, 2018 and 2017, respectively. The total fair value of stock options vested during the three months ended October 31, 2018 and 2017, was \$2,798 and \$2,974, respectively.

The cash received from the exercise of options during the three months ended October 31, 2018 and 2017, was \$12,138 and \$3,249. The tax benefit from the exercise of options during the three months ended October 31, 2018 and 2017, was \$2,356 and \$478, respectively. The total intrinsic value of options exercised during the three months ended October 31, 2018 and 2017, based upon the average market price at the time of exercise during the period, was \$9,423 and \$1,257, respectively.

The following tables summarize the RSU activity under the Company's share-based compensation plans for the three months ended October 31, 2018:

| Service-Based RSUs | Shares | Weighted Average Grant Date Fair Value |
|---------------------------------|-----------|--|
| Outstanding at July 31, 2018 | 342,856 | \$ 29.05 |
| New grants | 76,356 | 44.04 |
| Vested | (111,194) | 28.15 |
| Forfeited | (7,339) | 29.97 |
| Outstanding at October 31, 2018 | 300,679 | \$ 33.16 |

The service-based RSUs granted during the three months ended October 31, 2017, had a weighted-average grant date fair value of \$35.14. The total fair value of service-based RSUs vested during the three months ended October 31, 2018 and 2017, was \$4,795 and \$4,736, respectively.

| Performance-Based RSUs | Shares | Weighted Average Grant Date Fair Value |
|---------------------------------|---------|--|
| Outstanding at July 31, 2018 | 108,097 | \$ 32.57 |
| New grants | 50,313 | 50.70 |
| Vested | — | — |
| Forfeited | — | — |
| Outstanding at October 31, 2018 | 158,410 | \$ 38.33 |

The performance-based RSUs granted during the three months ended October 31, 2017, had a weighted-average grant date fair value of \$33.12. The aggregate intrinsic value of unvested service-based and performance-based RSUs outstanding at October 31, 2018 and expected to vest was \$18,497.

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NOTE I — Fair Value Measurements

In accordance with fair value accounting guidance, the Company's assets and liabilities measured at fair market value are classified in one of the following categories:

Level 1 — Assets or liabilities for which fair value is based on unadjusted quoted prices in active markets for identical instruments that are accessible as of the reporting date.

Level 2 — Assets or liabilities for which fair value is based on other significant pricing inputs that are either directly or indirectly observable.

Level 3 — Assets or liabilities for which fair value is based on significant unobservable pricing inputs to the extent little or no market data is available, which result in the use of management's own assumptions.

The following tables set forth by level within the fair value hierarchy our financial assets and liabilities that were accounted for at fair value on a recurring basis at October 31, 2018 and July 31, 2018, according to the valuation techniques the Company used to determine their fair values.

| | Inputs Considered As Quoted Prices in Significant Active Other Markets for Observable Identical Inputs (Level Assets 2) (Level 1) | | Fair Values | Balance Sheet Classifications |
|----------------------------|---|----------|----------------|--|
| October 31, 2018 | | | | |
| Trading securities | \$ 14,060 | \$ — | \$ 14,060 | Other assets |
| Foreign exchange contracts | — | 891 | 891 | Prepaid expenses and other current assets |
| Total Assets | \$ 14,060 | \$ 891 | \$ 14,951 | |
| Foreign exchange contracts | \$ — | \$ 505 | \$ 505 | Other current liabilities |
| Total Liabilities | \$ — | \$ 505 | \$ 505 | |
| July 31, 2018 | | | | |
| Trading securities | \$ 14,383 | \$ — | \$ 14,383 | Other assets |
| Foreign exchange contracts | — | 1,077 | 1,077 | Prepaid expenses and other current assets |
| Total Assets | \$ 14,383 | \$ 1,077 | \$ 15,460 | |
| Foreign exchange contracts | \$ — | \$ 3 | \$ 3 | Other current liabilities |
| Total Liabilities | \$ — | \$ 3 | \$ 3 | |

The following methods and assumptions were used to estimate the fair value of each class of financial instrument:

Trading securities: The Company's deferred compensation investments consist of investments in mutual funds. These investments were classified as Level 1 as the shares of these investments trade with sufficient frequency and volume to enable us to obtain pricing information on an ongoing basis.

Foreign exchange contracts: The Company's foreign exchange contracts were classified as Level 2 as the fair value was based on the present value of the future cash flows using external models that use observable inputs, such as interest rates, yield curves and foreign exchange rates. See Note J, "Derivatives and Hedging Activities," for additional information.

There have been no transfers of assets or liabilities between the fair value hierarchy levels, outlined above, during the three months ended October 31, 2018. In addition, the Company had no significant measurements of assets or liabilities at fair value on a nonrecurring basis subsequent to their initial recognition during the three months ended October 31, 2018.

The Company's financial instruments, other than those presented in the disclosures above, include cash and cash equivalents, accounts receivable, notes payable, accounts payable, accrued liabilities and short-term and long-term

debt. The fair values of cash and cash equivalents, accounts receivable, accounts payable, and accrued liabilities approximated carrying values because of the short-term nature of these instruments.

The estimated fair value of the Company's short-term and long-term debt obligations based on the quoted market prices for similar issues and on the current rates offered for debt of similar maturities was \$57,047 and \$55,707 at October 31, 2018 and July 31, 2018, respectively, as compared to the carrying value of \$54,408 and \$52,618 at October 31, 2018 and July 31, 2018, respectively.

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NOTE J — Derivatives and Hedging Activities

The Company utilizes forward foreign exchange currency contracts to reduce the exchange rate risk of specific foreign currency denominated transactions. These contracts typically require the exchange of a foreign currency for U.S. dollars at a fixed rate at a future date, with maturities of less than 18 months, which qualify as cash flow hedges or net investment hedges under the accounting guidance for derivative instruments and hedging activities. The primary objective of the Company's foreign currency exchange risk management program is to minimize the impact of currency movements due to transactions in other than the respective subsidiaries' functional currency and to minimize the impact of currency movements on the Company's net investment denominated in a currency other than the U.S. dollar. To achieve this objective, the Company hedges a portion of known exposures using forward foreign exchange currency contracts. As of October 31, 2018 and July 31, 2018, the notional amount of outstanding forward exchange contracts was \$23,619 and \$32,667, respectively.

The Company hedges a portion of known exposures using forward exchange contracts. Main exposures are related to transactions denominated in the Euro, Canadian dollar, and Mexican peso. Generally, these risk management transactions will involve the use of foreign currency derivatives to minimize the impact of currency movements on non-functional currency transactions.

Hedge effectiveness is determined by how closely the changes in fair value of the hedging instrument offset the changes in the fair value or cash flows of the hedged item. Hedge accounting is permitted only if the hedging relationship is expected to be highly effective at the inception of the hedge and on an on-going basis. Gains or losses on the derivative related to hedge ineffectiveness are recognized in current earnings.

Cash Flow Hedges

The Company has designated a portion of its forward foreign exchange contracts as cash flow hedges and recorded these contracts at fair value on the Condensed Consolidated Balance Sheets. For these instruments, the effective portion of the gain or loss on the derivative is reported as a component of other comprehensive income ("OCI") and reclassified into earnings in the same period or periods during which the hedged transaction affects earnings. As of October 31, 2018 and 2017, unrealized gains of \$590 and losses of \$710 were included in OCI, respectively. Balances are reclassified from OCI to earnings when the hedged transactions impact earnings. For the three months ended October 31, 2018 and 2017, the Company reclassified gains of \$47 and losses of \$24 from OCI into earnings, respectively. At October 31, 2018, the U.S. dollar equivalent of these outstanding forward foreign exchange contracts totaled \$20,398, including contracts to sell Euros and Canadian dollars, and contracts to buy Mexican pesos.

Net Investment Hedges

As of April 30, 2017, €45 million of Euro-denominated senior unsecured notes were designated as net investment hedges to hedge portions of the Company's net investment in European operations. The Company's foreign denominated debt obligations are valued under a market approach using publicized spot prices.

Non-Designated Hedges

For the three months ended October 31, 2018 and 2017, the Company recognized losses of \$33 and gains of \$22, respectively, in "Investment and other (expense) income" on the Condensed Consolidated Statements of Earnings related to non-designated hedges.

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Fair values of derivative instruments in the Condensed Consolidated Balance Sheets were as follows:

| | Asset Derivatives | | | | Liability Derivatives | | | |
|---|---|------------|---|------------|--|------------|--|------------|
| | October 31, 2018 | | July 31, 2018 | | October 31, 2018 | | July 31, 2018 | |
| | Balance Sheet Location | Fair Value | Balance Sheet Location | Fair Value | Balance Sheet Location | Fair Value | Balance Sheet Location | Fair Value |
| Derivatives designated as hedging instruments | | | | | | | | |
| Cash flow hedges | | | | | | | | |
| Foreign exchange contracts | Prepaid expenses and other current assets | \$ 871 | Prepaid expenses and other current assets | \$ 1,076 | Other current liabilities | \$ 452 | Other current liabilities | \$— |
| Net investment hedges | | | | | | | | |
| Foreign currency denominated debt | Prepaid expenses and other current assets | — | Prepaid expenses and other current assets | — | Long term obligations, less current maturities | 51,048 | Long term obligations, less current maturities | 52,668 |
| Total derivatives designated as hedging instruments | | \$ 871 | | \$ 1,076 | | \$ 51,500 | | \$ 52,668 |
| Derivatives not designated as hedging instruments | | | | | | | | |
| Foreign exchange contracts | Prepaid expenses and other current assets | \$ 20 | Prepaid expenses and other current assets | \$ 1 | Other current liabilities | \$ 52 | Other current liabilities | \$ 3 |
| Total derivatives not designated as hedging instruments | | \$ 20 | | \$ 1 | | \$ 52 | | \$ 3 |

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NOTE K – Stockholders' Equity

The following table illustrates the changes in the balances of each component of stockholders' equity for the three months ended October 31, 2018:

| | Common Stock | Additional Paid-In Capital | Retained Earnings | Treasury Stock | Accumulated Other Comprehensive Loss | Total Stockholders' Equity |
|--|-----------------|----------------------------------|----------------------|-------------------|---|----------------------------------|
| Balances at July 31, 2018 | \$ 548 | \$325,631 | \$553,454 | \$(71,120) | \$ (56,401) | \$ 752,112 |
| Net earnings | — | — | 30,637 | — | — | 30,637 |
| Other comprehensive loss, net of tax | — | — | — | — | (9,830) | (9,830) |
| Issuance of shares of Class A Common Stock under stock plan | — | (4,505) | — | 14,569 | — | 10,064 |
| Tax benefit and withholdings from deferred compensation distributions | — | 91 | — | — | — | 91 |
| Stock-based compensation expense (Note H) | — | 4,965 | — | — | — | 4,965 |
| Purchase of shares of Class A Common Stock | — | — | — | (1,863) | — | (1,863) |
| Cumulative adjustment for ASU 2014-09, net of tax (Note B) | — | — | (2,137) | — | — | (2,137) |
| Cash dividends on Common Stock | | | | | | |
| Class A — \$0.21 per share | — | — | (10,403) | — | — | (10,403) |
| Class B — \$0.20 per share | — | — | (693) | — | — | (693) |
| Balances at October 31, 2018 | \$ 548 | \$326,182 | \$570,858 | \$(58,414) | \$ (66,231) | \$ 772,943 |

The following table illustrates the changes in the balances of each component of stockholders' equity for the three months ended October 31, 2017:

| | Common Stock | Additional Paid-In Capital | Retained Earnings | Treasury Stock | Accumulated Other Comprehensive Loss | Total Stockholders' Equity |
|--|-----------------|----------------------------------|----------------------|-------------------|---|----------------------------------|
| Balances at July 31, 2017 | \$ 548 | \$322,608 | \$507,136 | \$(85,470) | \$ (44,682) | \$ 700,140 |
| Net earnings | — | — | 25,836 | — | — | 25,836 |
| Other comprehensive loss, net of tax | — | — | — | — | (7,380) | (7,380) |
| Issuance of shares of Class A Common Stock under stock plan | — | (3,863) | — | 5,086 | — | 1,223 |
| Tax benefit and withholdings from deferred compensation distributions | — | 168 | — | (422) | — | (254) |
| Stock-based compensation expense (Note H) | — | 3,744 | — | — | — | 3,744 |
| Cash dividends on Common Stock | | | | | | |
| Class A — \$0.21 per share | — | — | (9,964) | — | — | (9,964) |
| Class B — \$0.19 per share | — | — | (675) | — | — | (675) |
| Balances at October 31, 2017 | \$ 548 | \$322,657 | \$522,333 | \$(80,806) | \$ (52,062) | \$ 712,670 |

NOTE L – Income Taxes

The effective income tax rate for the three months ended October 31, 2018 and 2017 was 23.2% and 25.7%, respectively. The decrease in the income tax rate was primarily due to a reduction of the U.S. federal corporate tax rate as a result of the Tax Cuts and Jobs Act (the "Tax Reform Act") passed in December 2017 and tax benefits from equity-based compensation activity in the current period.

The U.S. Securities and Exchange Commission has issued rules that would allow for a measurement period of up to one year after the enactment date of the Tax Reform Act to finalize the recording of the related tax impacts. Provisional adjustments have been recorded in the Company's consolidated financial statements; however, the final enactment impacts of the Tax Reform Act may differ from the estimate due to changes in interpretation, legislative action to address questions that arise, changes in accounting

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standards for income taxes or related interpretations in response to the Tax Reform Act, or any updates or changes to information the Company has utilized to develop the estimates, including impacts from changes to earnings estimates and foreign exchange rates of foreign subsidiaries. No significant adjustments to the provisional amounts recorded during the year ended July 31, 2018, have been recognized for the three months ended October 31, 2018. For further discussion on the impact of the Tax Reform Act, refer to Note 5 “Income Taxes” of the Annual Report on Form 10-K for the year ended July 31, 2018.

NOTE M — Subsequent Events

On November 13, 2018, the Board of Directors declared a quarterly cash dividend to shareholders of the Company’s Class A and Class B Common Stock of \$0.2125 per share payable on January 31, 2019, to shareholders of record at the close of business on January 10, 2019.

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

Overview

Brady Corporation is a global manufacturer and supplier of identification solutions and workplace safety products that identify and protect premises, products and people. The IDS segment is primarily involved in the design, manufacture, and distribution of high-performance and innovative identification and healthcare products. The WPS segment provides workplace safety and compliance products, half of which are internally manufactured and half of which are externally sourced.

The long-term sales growth and profitability of our segments will depend not only on improved demand in end markets and the overall economic environment, but also on our ability to continuously improve operational excellence, focus on the customer, develop and market innovative new products, and to advance our digital capabilities. In our Identification Solutions ("ID Solutions" or "IDS") business, our strategy for growth includes an increased focus on certain industries and products, a focus on improving the customer buying experience, and increasing investment in research and development ("R&D") to develop new products. In our Workplace Safety ("WPS") business, our strategy for growth includes a focus on workplace safety critical industries, innovative new product offerings, compliance expertise, and improving our digital capabilities.

The following are key initiatives supporting the strategy in fiscal 2019:

- Enhancing our innovation development process and the speed to deliver high-value, innovative products in alignment with our target markets.
- Driving operational excellence and providing our customers with the highest level of customer service.
- Executing sustainable efficiency gains within our selling, general, and administrative structures as well as throughout our global operations by making investments in equipment and machinery to drive automation.
- Expanding and enhancing our digital presence.
- Growing through focused sales and marketing actions in selected vertical markets and strategic accounts.
- Enhancing our global employee development process to attract and retain key talent.

Results of Operations

A comparison of results of Operating Income for the three months ended October 31, 2018 and 2017 is as follows:

| (Dollars in thousands) | Three months ended October 31, | | | |
|-------------------------------------|--------------------------------|------------|-----------|------------|
| | 2018 | % Sales | 2017 | % Sales |
| Net Sales | \$293,196 | | \$290,151 | |
| Gross Margin | 146,539 | 50.0% | 146,065 | 50.3% |
| Operating Expenses: | | | | |
| Research and Development | 11,326 | 3.9 % | 10,520 | 3.6 % |
| Selling, General and Administrative | 94,591 | 32.3 % | 100,134 | 34.5 % |
| Total operating expenses | 105,917 | 36.1 % | 110,654 | 38.1 % |
| Operating Income | \$40,622 | 13.9 % | \$35,411 | 12.2 % |

References in this Form 10-Q to "organic sales" refer to sales calculated in accordance with U.S. GAAP, excluding the impact of foreign currency translation and divestitures. The Company's organic sales disclosures exclude the effects of foreign currency translation as foreign currency translation is subject to volatility that can obscure underlying business trends. Management believes that the non-GAAP financial measure of organic sales is meaningful to investors as it provides them with useful information to aid in identifying underlying sales trends in our businesses and facilitating

comparisons of our sales performance with prior periods.

Sales for the three months ended October 31, 2018, increased 1.0% to \$293.2 million, compared to \$290.2 million in the same period of the prior year. The increase in sales consisted of organic sales growth of 4.7%, partially offset by a negative foreign currency impact of 2.0% and a sales decline of 1.7% due to the divestiture of a business. Organic sales grew by 5.7% in the IDS segment and 2.2% in the WPS segment during the three months ended October 31, 2018, compared to the same period in the prior year. The IDS segment realized sales growth in the Product ID, Wire ID, Safety and Facility ID, and Healthcare ID product lines. Both digital and traditional catalog channel sales in the WPS segment improved.

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Gross margin for the three months ended October 31, 2018, increased 0.3% to \$146.5 million, compared to \$146.1 million in the same period of the prior year. As a percentage of net sales, gross margin decreased to 50.0% for the three months ended October 31, 2018, from 50.3% in the same period of the prior year. The decrease in gross margin as a percentage of net sales was primarily due to increased material, supplies, and freight costs which were partially mitigated by our on-going efforts to streamline manufacturing processes and drive operational efficiencies, including increased automation in our manufacturing facilities.

Research and development ("R&D") expenses for the three months ended October 31, 2018, increased 7.7% to \$11.3 million, compared to \$10.5 million in the same period of the prior year. As a percentage of sales, R&D expenses were 3.9% for the three months ended October 31, 2018, compared to 3.6% in the same period of the prior year. The increase in R&D expenses was primarily due to an increased number of R&D personnel and investment in new product development supporting our focus on increasing new product sales within our IDS and WPS businesses.

Selling, general and administrative expenses ("SG&A") include selling and administrative costs directly attributed to the IDS and WPS segments, as well as certain other corporate administrative expenses including finance, information technology, human resources, and other administrative expenses. SG&A decreased 5.5% to \$94.6 million for the three months ended October 31, 2018, compared to \$100.1 million in the same period of the prior year. As a percentage of sales, SG&A was 32.3% for the three months ended October 31, 2018, compared to 34.5% in the same period of the prior year. Approximately half of the decrease in SG&A was due to a favorable impact of foreign currency translation and the impact of the sale of a business in the prior year. The remainder of the decrease was due to ongoing efficiency gains in SG&A.

Operating income was \$40.6 million and \$35.4 million for three months ended October 31, 2018 and 2017, respectively. The increase was primarily due to increased segment profit in the IDS segment and reduced SG&A in both segments.

OPERATING INCOME TO NET EARNINGS

| (Dollars in thousands) | Three months ended October 31, | | | |
|---------------------------------------|--------------------------------|------------|----------|------------|
| | 2018 | % Sales | 2017 | % Sales |
| Operating income | \$40,622 | 13.9 % | \$35,411 | 12.2 % |
| Other (expense) income: | | | | |
| Investment and other (expense) income | (17) | — % | 216 | 0.1 % |
| Interest expense | (712) | (0.2)% | (863) | (0.3)% |
| Earnings before income tax | 39,893 | 13.6 % | 34,764 | 12.0 % |
| Income tax expense | 9,256 | 3.2 % | 8,928 | 3.1 % |
| Net earnings | \$30,637 | 10.4 % | \$25,836 | 8.9 % |

Investment and other expense was \$0.0 million for the three months ended October 31, 2018, compared to investment and other income of \$0.2 million for the same period in the prior year. The decrease was primarily due to a reduction in the market value of securities held in deferred compensation plans partially offset by increased interest income in the current period.

Interest expense decreased to \$0.7 million for the three months ended October 31, 2018, from \$0.9 million for the same period in the prior year. This decrease was due to the Company's declining principal balance under its outstanding debt agreements.

The Company's income tax rate was 23.2% for the three months ended October 31, 2018, compared to 25.7% in the same period in the prior year. Refer to Note L "Income Taxes" for additional information on the Company's effective income tax rate.

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Business Segment Operating Results

The Company is organized and managed on a global basis within three operating segments, Identification Solutions, Workplace Safety, and People Identification ("People ID"), which aggregate into two reportable segments that are organized around businesses with consistent products and services: IDS and WPS. The Identification Solutions and People ID operating segments aggregate into the IDS reporting segment, while the WPS reporting segment is comprised solely of the Workplace Safety operating segment. The Company evaluates short-term segment performance based on segment profit and customer sales. Interest expense, investment and other (expense) income, income taxes, and certain corporate administrative expenses are excluded when evaluating segment performance.

The following is a summary of segment information for the three months ended October 31, 2018 and 2017:

| | Three months ended October 31, | | | |
|---|--------------------------------------|--------|--|--|
| | 2018 | 2017 | | |
| SALES GROWTH INFORMATION | | | | |
| ID Solutions | | | | |
| Organic | 5.7 % | 2.9 % | | |
| Currency | (1.7)% | 1.3 % | | |
| Total | 4.0 % | 4.2 % | | |
| Workplace Safety | | | | |
| Organic | 2.2 % | (1.4)% | | |
| Currency | (2.6)% | 3.3 % | | |
| Divestitures | (6.2)% | — % | | |
| Total | (6.6)% | 1.9 % | | |
| Total Company | | | | |
| Organic | 4.7 % | 1.7 % | | |
| Currency | (2.0)% | 1.9 % | | |
| Divestitures | (1.7)% | — % | | |
| Total | 1.0 % | 3.6 % | | |
| SEGMENT PROFIT AS A PERCENT OF NET SALES | | | | |
| ID Solutions | 19.1 % | 17.1 % | | |
| Workplace Safety | 7.4 % | 8.0 % | | |
| Total | 16.1 % | 14.6 % | | |

ID Solutions

IDS sales increased 4.0% to \$218.1 million for the three months ended October 31, 2018, compared to \$209.7 million in the same period in the prior year. Organic sales increased 5.7% and foreign currency fluctuations decreased sales by 1.7% for the three months ended October 31, 2018, compared to the same period in the prior year.

Organic sales in the Americas increased in the mid-single digits for the three months ended October 31, 2018, as compared to the same period in the prior year. The IDS Americas region realized organic sales growth in the Product ID, Wire ID, Safety and Facility ID, and Healthcare ID product lines. Organic sales grew in the mid-single digits in the United States and the rest of the Americas grew in the high-single digits. Most end markets realized organic sales growth with the industrial sector realizing the strongest growth.

Organic sales in Europe grew in the mid-single digits for the three months ended October 31, 2018, as compared to the same period in the prior year. The IDS Europe region realized organic sales growth in the Product ID, Wire ID, and Safety and Facility ID product lines. Organic sales growth was led by businesses in emerging geographies and

supplemented by businesses based in Western Europe; in particular, increased printer sales throughout the region drove the organic sales growth.

Organic sales in Asia grew in the low-single digits for the three months ended October 31, 2018, as compared to the same period in the prior year. The IDS Asia region realized organic sales growth in the Product ID and Wire ID product lines, partially offset by a decline in the Safety and Facility ID product line. Organic sales were led by our businesses outside of China. Within China, organic sales were approximately flat when compared to the same period in the prior year.

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Segment profit increased 16.0% to \$41.6 million for the three months ended October 31, 2018, compared to \$35.8 million in the same period of the prior year. As a percentage of net sales, segment profit was 19.1% for the three months ended October 31, 2018, compared to 17.1% in the same period of the prior year. The increase in segment profit was primarily driven by increased organic sales and operational efficiencies in our SG&A structure in all regions.

Workplace Safety

WPS sales decreased 6.6% to \$75.1 million from \$80.4 million for the three months ended October 31, 2018 and 2017, respectively, which consists of organic sales growth of 2.2%, a negative foreign currency impact of 2.6%, and a sales decline of 6.2% due to the impact of divestitures. Both catalog and digital channel sales in the WPS segment realized low-single digit sales growth.

Europe realized mid-single digit organic sales growth for the three months ended October 31, 2018, compared to the same period in the prior year. This growth was driven primarily by the U.K., Germany, and France due to improvements in website functionality, growth in new customers, and key account management. WPS Europe experienced over 10% growth in digital channel sales and low-single digit growth in traditional catalog channel sales.

Organic sales in the Americas declined in the mid-single digits for the three months ended October 31, 2018, compared to the same period in the prior year. This decrease was primarily in the U.S. due to lower response rates to catalog promotions. Catalog channel sales declined in the low-single digits. Additionally, we continue to experience the negative impact of transitioning to a new digital sales platform in the prior fiscal period resulting in a decline in digital channel sales.

Organic sales in Australia grew more than 10% in both the digital and traditional catalog channel for the three months ended October 31, 2018, as compared to the same period of the prior year. The Australian business is expanding its customer base and has diversified its product offering into many different industries and target markets. WPS Australia continues to focus on enhancing its expertise in these industries to drive sales growth, while addressing its cost structure to improve profitability.

Segment profit decreased to \$5.5 million for the three months ended October 31, 2018, compared to \$6.4 million in the same period of the prior year. As a percentage of net sales, segment profit decreased to 7.4% for the three months ended October 31, 2018, compared to 8.0% in the same period of the prior year. The decrease in segment profit was due to a combination of the divestiture of a business in the prior period, foreign currency translation, and the decrease in sales volumes in the North American business.

Financial Condition

Cash and cash equivalents were \$192.2 million at October 31, 2018, an increase of \$10.7 million from July 31, 2018. The significant changes were as follows:

| (Dollars in thousands) | Three months ended October 31, | |
|---|-----------------------------------|-----------|
| | 2018 | 2017 |
| Net cash flow provided by (used in): | | |
| Operating activities | \$18,818 | \$34,719 |
| Investing activities | (5,672) | (2,828) |
| Financing activities | 664 | (21,663) |
| Effect of exchange rate changes on cash | (3,061) | (1,935) |
| Net increase in cash and cash equivalents | \$10,749 | \$8,293 |

Net cash provided by operating activities was \$18.8 million for the three months ended October 31, 2018, compared to \$34.7 million in the same period of the prior year. The change was driven by an increase in net earnings adjusted for

non-cash items which was offset by the timing of incentive compensation payments and an increase in cash used by working capital in support of growth when compared to the same period in the prior year.

Net cash used in investing activities was \$5.7 million for the three months ended October 31, 2018, compared to \$2.8 million used in the same period of the prior year. The increase in cash used in investing activities was primarily driven by an increase in capital expenditures for the purchase of manufacturing equipment and facility upgrades in the United States and Europe.

Net cash provided by financing activities was \$0.7 million during the three months ended October 31, 2018, compared to \$21.7 million used in the same period of the prior year. The change was primarily due to a decrease of \$15.5 million in net credit

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facility repayments and an increase of \$8.9 million in proceeds from stock option exercises when compared to the same period in the prior year.

The effect of fluctuations in exchange rates decreased cash balances by \$3.1 million primarily due to cash balances held in currencies that depreciated against the U.S. dollar during three months ended October 31, 2018.

On May 13, 2010, the Company completed a private placement of €75.0 million aggregate principal amount of senior unsecured notes to accredited institutional investors. The €75.0 million of senior notes consisted of €30.0 million aggregate principal amount of 3.71% Series 2010-A Senior Notes, which were repaid during fiscal 2017, and €45.0 million aggregate principal amount of 4.24% Series 2010-A Senior Notes, due May 13, 2020, with interest payable on the notes semiannually. This private placement was exempt from the registration requirements of the Securities Act of 1933. The notes have been fully and unconditionally guaranteed on an unsecured basis by the Company's domestic subsidiaries.

On September 25, 2015, the Company and certain of its subsidiaries entered into an unsecured \$300 million multi-currency revolving loan agreement with a group of six banks. At the Company's option, and subject to certain conditions, the available amount under the revolving loan agreement may be increased from \$300 million to \$450 million. As of October 31, 2018, the outstanding balance on the credit facility was \$3.4 million, and the maximum outstanding balance during the three months ended October 31, 2018 was \$5.7 million. The Company also had letters of credit outstanding under the loan agreement of \$3.0 million as of October 31, 2018 and there was \$293.6 million available for future borrowing, which can be increased to \$443.6 million at the Company's option, subject to certain conditions. The revolving loan agreement has a final maturity date of September 25, 2020. As such, the borrowing is included in "Long-term obligations, less current maturities" on the Condensed Consolidated Balance Sheets.

The Company's debt agreements require it to maintain certain financial covenants, including a ratio of debt to the trailing 12 months EBITDA, as defined in the debt agreements, of not more than a 3.25 to 1.0 ratio (leverage ratio) and the trailing 12 months EBITDA to interest expense of not less than a 3.0 to 1.0 ratio (interest expense coverage). As of October 31, 2018, the Company was in compliance with these financial covenants, with the ratio of debt to EBITDA, as defined by the agreements, equal to 0.3 to 1.0 and the interest expense coverage ratio equal to 63.5 to 1.0.

The Company's cash balances are generated and held in numerous locations throughout the world. At October 31, 2018, approximately 58% of the Company's cash and cash equivalents were held outside the United States. The Company's growth has historically been funded by a combination of cash provided by operating activities and debt financing. The Company believes that its cash flow from operating activities and its borrowing capacity are sufficient to fund its anticipated requirements for working capital, capital expenditures, common stock repurchases, scheduled debt repayments, and dividend payments for the next 12 months.

Off-Balance Sheet Arrangements

The Company does not have material off-balance sheet arrangements. The Company is not aware of factors that are reasonably likely to adversely affect liquidity trends, other than the risk factors described in this and other Company filings. However, the following additional information is provided to assist those reviewing the Company's financial statements.

Operating Leases - The leases generally are entered into for investments in facilities such as manufacturing facilities, warehouses and office space, computer equipment and Company vehicles.

Purchase Commitments - The Company has purchase commitments for materials, supplies, services, and property, plant and equipment as part of the ordinary conduct of its business. In the aggregate, such commitments are not in excess of current market prices and are not material to the financial position of the Company. Due to the proprietary nature of many of the Company's materials and processes, certain supply contracts contain penalty provisions for early termination. The Company does not believe a material amount of penalties will be incurred under these contracts based upon historical experience and current expectations.

Other Contractual Obligations - The Company does not have material financial guarantees or other contractual commitments that are reasonably likely to adversely affect liquidity.

Forward-Looking Statements

In this quarterly report on Form 10-Q, statements that are not reported financial results or other historic information are “forward-looking statements.” These forward-looking statements relate to, among other things, the Company's future financial position, business strategy, targets, projected sales, costs, earnings, capital expenditures, debt levels and cash flows, and plans and objectives of management for future operations.

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The use of words such as “may,” “will,” “expect,” “intend,” “estimate,” “anticipate,” “believe,” “should,” “project” or “plan” or terminology are generally intended to identify forward-looking statements. These forward-looking statements by their nature address matters that are, to different degrees, uncertain and are subject to risks, assumptions, and other factors, some of which are beyond Brady's control, that could cause actual results to differ materially from those expressed or implied by such forward-looking statements. For Brady, uncertainties arise from:

- Brady's ability to compete effectively or to successfully execute our strategy
 - Brady's ability to develop technologically advanced products that meet customer demands
 - Difficulties in protecting our sites, networks, and systems against security breaches
 - Decreased demand for the Company's products
 - Brady's ability to retain large customers
 - Extensive regulations by U.S. and non-U.S. governmental and self regulatory entities
 - Risks associated with the loss of key employees
 - Divestitures, contingent liabilities from divestitures and the failure to identify, integrate, and grow acquired companies
 - Litigation, including product liability claims
 - Brady's ability to execute facility consolidations and maintain acceptable operational service metrics
 - Foreign currency fluctuations
 - The impact of the U.S. Tax Reform Act and any other changes in tax legislation and tax rates
 - Potential write-offs of Brady's substantial intangible assets
 - Differing interests of voting and non-voting shareholders
 - Brady's ability to meet certain financial covenants required by our debt agreements
- Numerous other matters of national, regional and global scale, including those of a political, economic, business, competitive, and regulatory nature contained from time to time in Brady's U.S. Securities and Exchange Commission filings, including, but not limited to, those factors listed in the “Risk Factors” section within Item 1A of Part I of Brady's Form 10-K for the year ended July 31, 2018.

These uncertainties may cause Brady's actual future results to be materially different than those expressed in its forward-looking statements. Brady does not undertake to update its forward-looking statements except as required by law.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Refer to the Company's annual report on Form 10-K for the year ended July 31, 2018. There has been no material change in this information since July 31, 2018.

ITEM 4. CONTROLS AND PROCEDURES

Brady Corporation maintains a set of disclosure controls and procedures that are designed to ensure that information required to be disclosed by the Company in the reports filed by the Company under the Securities Exchange Act of 1934, as amended (the “Exchange Act”), is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by the Company in the reports the Company files under the Exchange Act is accumulated and communicated to the Company's management, including the Company's principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure. The Company carried out an evaluation, under the supervision and with the participation of its management, including its President and Chief Executive Officer and its Chief Financial Officer and Treasurer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures pursuant to Rule 13a-15 of the Exchange Act. Based on that evaluation, the Company's President & Chief Executive Officer and Chief Financial Officer and Treasurer concluded that the Company's disclosure controls and procedures are effective as of the end of the period covered by this report.

There were no changes in the Company's internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) that occurred during the Company's most recently completed fiscal quarter that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

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PART II. OTHER INFORMATION

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

The Company has a share repurchase program for the Company's Class A Nonvoting Common Stock. The plan may be implemented by purchasing shares in the open market or in privately negotiated transactions, with repurchased shares available for use in connection with the Company's stock-based plans and for other corporate purposes. On February 16, 2016, the Company's Board of Directors authorized a share repurchase program of 2,000,000 shares. The Company repurchased 47,317 shares at an average price of \$39.37 per share during the three months ended October 31, 2018. As of October 31, 2018, there were 1,911,989 shares authorized to purchase in connection with this share repurchase program.

The following table provides information with respect to the purchase of Class A Nonvoting Common Stock during the three months ended October 31, 2018:

| Period | Total Number of Shares Purchased | Average Price paid per share | Total Number of Shares Purchased As Part of Publicly Announced Plans | Maximum Number of Shares That May Yet Be Purchased Under the Plans |
|--|---|---------------------------------------|---|---|
| August 1, 2018 - August 31, 2018 | — | \$ — | — | 1,959,306 |
| September 1, 2018 - September 30, 2018 | — | — | — | 1,959,306 |
| October 1, 2018 - October 31, 2018 | 47,317 | 39.37 | 47,317 | 1,911,989 |
| Total | 47,317 | \$ 39.37 | 47,317 | 1,911,989 |

ITEM 6. EXHIBITS

(a) Exhibits

31.1 Rule 13a-14(a)/15d-14(a) Certification of J. Michael Nauman31.2 Rule 13a-14(a)/15d-14(a) Certification of Aaron J. Pearce32.1 Section 1350 Certification of J. Michael Nauman32.2 Section 1350 Certification of Aaron J. Pearce

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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.

SIGNATURES

BRADY CORPORATION

Date: November 15, 2018 /s/ J. MICHAEL NAUMAN
J. Michael Nauman
President and Chief Executive Officer
(Principal Executive Officer)

Date: November 15, 2018 /s/ AARON J. PEARCE
Aaron J. Pearce
Chief Financial Officer and Treasurer
(Principal Financial Officer)