CHART INDUSTRIES INC
Form 10-Q
October 27, 2016
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)
x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended September 30, 2016
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 1-11442

CHART INDUSTRIES, INC.
(Exact Name of Registrant as Specified in its Charter)

Delaware	34-1712937
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)

One Infinity Corporate Centre Drive, Suite 300, Garfield Heights, Ohio 44125
(Address of Principal Executive Offices) (ZIP Code)
Registrant's Telephone Number, Including Area Code: (440) 753-1490
NOT APPLICABLE
(Former Name, Former Address and Former Fiscal Year, if Changed Since Last Report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x 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 (§232.405 of this Chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No ¨
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 the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer	x	Accelerated filer	¨
Non-accelerated filer	¨	Smaller reporting company	¨

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No x
At October 24, 2016, there were 30,596,345 outstanding shares of the Company's Common Stock, par value $0.01 per share.

CHART INDUSTRIES, INC.
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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements
CHART INDUSTRIES, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
(Dollars in thousands, except per share amounts)

	September 30, 2016 (Unaudited)	December 31, 2015
ASSETS		
Current Assets		
Cash and cash equivalents	$ 267,276	$ 123,708
Accounts receivable, less allowances of $7,890 and $6,965	132,556	183,514
Inventories, net	182,227	199,302
Unbilled contract revenue	19,621	59,283
Prepaid expenses	11,230	8,494
Other current assets	14,832	12,929
Total Current Assets	627,742	587,230
Property, plant and equipment, net	258,081	266,277
Goodwill	219,091	218,390
Identifiable intangible assets, net	96,913	106,714
Other assets	16,038	21,529
TOTAL ASSETS	$ 1,217,865	$ 1,200,140
LIABILITIES AND EQUITY		
Current Liabilities		
Accounts payable	$ 65,737	$ 97,413
Customer advances and billings in excess of contract revenue	72,563	71,030
Accrued salaries, wages and benefits	35,993	33,886
Current portion of warranty reserve	13,523	15,341
Short-term debt and current portion of long-term debt	6,739	6,160
Other current liabilities	30,045	38,209
Total Current Liabilities	224,600	262,039
Long-term debt	232,079	213,798
Long-term deferred tax liabilities	8,723	5,146
Long-term portion of warranty reserve	3,732	5,634
Accrued pension liabilities	15,776	17,283
Other long-term liabilities	20,624	20,504
Total Liabilities	505,534	524,404
Equity		
Common stock, par value $0.01 per share – 150,000,000 shares authorized, 30,595,086 and 30,545,657 shares issued and outstanding at September 30, 2016 and December 31, 2015, respectively	306	305
Additional paid-in capital	394,459	387,100
Retained earnings	339,618	308,091
Accumulated other comprehensive loss	(24,127)	(24,904)
Total Chart Industries, Inc. Shareholders' Equity	710,256	670,592
Noncontrolling interests	2,075	5,144

Total Equity	712,331	675,736
TOTAL LIABILITIES AND EQUITY	$ 1,217,865	$ 1,200,140

The balance sheet at December 31, 2015 has been derived from the audited financial statements at that date, but does not include all of the information and notes required by U.S. generally accepted accounting principles for complete financial statements.

See accompanying notes to these unaudited condensed consolidated financial statements.

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CHART INDUSTRIES, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME (LOSS)
(UNAUDITED)
(Dollars and shares in thousands, except per share amounts)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2016	2015	2016	2015
Sales	$203,930	$264,047	$644,782	$779,404
Cost of sales	134,307	195,758	435,507	563,712
Gross profit	69,623	68,289	209,275	215,692
Selling, general and administrative expenses	45,430	48,108	143,862	146,898
Amortization	2,912	4,572	9,156	13,099
Asset impairment	1,217	—	1,217	—
Operating expenses	49,559	52,680	154,235	159,997
Operating income	20,064	15,609	55,040	55,695
Other expenses:				
Interest expense, net	4,291	4,073	12,556	11,994
Financing costs amortization	321	322	963	969
Foreign currency loss	4	848	117	771
Other expenses, net	4,616	5,243	13,636	13,734
Income before income taxes	15,448	10,366	41,404	41,961
Income tax expense	1,764	6,095	12,829	15,333
Net income	13,684	4,271	28,575	26,628
Noncontrolling interests, net of taxes	(1,341)	(489)	(2,952)	(535)
Net income attributable to Chart Industries, Inc.	$15,025	$4,760	$31,527	$27,163
Net income attributable to Chart Industries, Inc. per common share:				
Basic	$0.49	$0.16	$1.03	$0.89
Diluted	$0.48	$0.15	$1.02	$0.88
Weighted-average number of common shares outstanding:				
Basic	30,585	30,498	30,578	30,487
Diluted	31,064	30,745	30,940	30,693
Comprehensive income (loss), net of taxes	$13,932	$(1,964)	$29,235	$15,243
Less: Comprehensive loss attributable to noncontrolling interests, net of taxes	(1,364)	(762)	(3,069)	(803)
Comprehensive income (loss) attributable to Chart Industries, Inc., net of taxes	$15,296	$(1,202)	$32,304	$16,046

See accompanying notes to these unaudited condensed consolidated financial statements.

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CHART INDUSTRIES, INC. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)
(Dollars in thousands)

	Nine Months Ended September 30,	
	2016	2015
OPERATING ACTIVITIES		
Net income	$28,575	$26,628
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	28,605	34,134
Asset impairment	1,217	1,556
Interest accretion of convertible notes discount	9,268	8,566
Employee share-based compensation expense	9,014	9,203
Financing costs amortization	963	969
Unrealized foreign currency transaction loss (gain)	318	(764)
Other non-cash operating activities	(390)	(136)
Changes in assets and liabilities, net of acquisitions:		
Accounts receivable	55,706	17,269
Inventory	16,246	(8,073)
Unbilled contract revenues and other assets	38,721	13,170
Accounts payable and other liabilities	(43,393)	(36,524)
Customer advances and billings in excess of contract revenue	1,742	(11,573)
Net Cash Provided By Operating Activities	146,592	54,425
INVESTING ACTIVITIES		
Capital expenditures	(13,411)	(36,066)
Payments for land use rights	—	(11,043)
Proceeds from sale of assets	—	395
Government grants	1,055	—
Acquisition of businesses, net of cash acquired	(1,383)	(24,517)
Net Cash Used In Investing Activities	(13,739)	(71,231)
FINANCING ACTIVITIES		
Borrowings on revolving credit facilities	3,820	68,827
Repayments on revolving credit facilities	(6,061)	(67,196)
Borrowings on term loan	13,167	—
Repayments on term loan	(1,508)	—
Proceeds from exercise of options	26	486
Excess tax benefit from share-based compensation	54	133
Payment of contingent consideration	—	(611)
Common stock repurchases	(658)	(849)
Dividend distribution to noncontrolling interest	—	(120)
Other financing activities	—	(156)
Net Cash Provided By Financing Activities	8,840	514
Effect of exchange rate changes on cash	1,875	(4,827)
Net increase (decrease) in cash and cash equivalents	143,568	(21,119)
Cash and cash equivalents at beginning of period	123,708	103,656
CASH AND CASH EQUIVALENTS AT END OF PERIOD	$267,276	$82,537

See accompanying notes to these unaudited condensed consolidated financial statements.

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CHART INDUSTRIES, INC. AND SUBSIDIARIES
Notes to Unaudited Condensed Consolidated Financial Statements – September 30, 2016
(Dollars and shares in thousands, except per share amounts)

NOTE 1 — Basis of Preparation
The accompanying unaudited condensed consolidated financial statements of Chart Industries, Inc. and its consolidated subsidiaries (the “Company” or “Chart”) have been prepared in accordance with U.S. generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by U.S. generally accepted accounting principles for annual financial statements. These financial statements should be read in conjunction with the audited financial statements and notes thereto included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2015. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three and nine months ended September 30, 2016 are not necessarily indicative of the results that may be expected for the year ending December 31, 2016.
Nature of Operations: The Company is a leading diversified global manufacturer of highly engineered equipment for the industrial gas, energy, and biomedical industries. Chart’s equipment and engineered systems are primarily used for low-temperature and cryogenic applications utilizing our expertise in cryogenic systems and equipment, which operate at low temperatures sometimes approaching absolute zero (0 kelvin; -273° Centigrade; -459° Fahrenheit). The Company has domestic operations located across the United States, including principal executive offices located in Ohio, and an international presence in Asia, Australia, Europe and South America.
Principles of Consolidation: The unaudited condensed consolidated financial statements include the accounts of the Company and its subsidiaries. Intercompany accounts and transactions are eliminated in consolidation.
Reclassifications: Certain reclassifications have been made to the 2015 condensed consolidated cash flow statement in order to conform to the 2016 presentation. Additionally, beginning in 2016, the Company allocates share-based compensation expense to each operating segment and maintains share-based compensation expense related to Corporate employees at Corporate. Prior to 2016, all share-based compensation expense was recorded at Corporate. Reclassifications from Corporate to the operating segments have been made to the 2015 selling, general and administrative expenses (“SG&A”) to conform to the 2016 presentation.
Use of Estimates: The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements. These estimates may also affect the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates and assumptions.
Guarantees of Third-Party Performance: During the first quarter of 2016, the Company became a member to a consortium agreement relating to a project with a third-party. This agreement entails the Company guaranteeing not only its own performance, but also the work of a third-party consortium partner. In the event of non-fulfillment of contractual obligations by the consortium partner, the Company may be required to perform the obligations of the consortium partner. The agreement term covers the project through completion; approximately 1.5 years. At September 30, 2016, the estimated cost of the performance under this guarantee was 14.6 million euros (equivalent to $16.3 million). If losses are incurred under the guarantee due to third-party non-performance, the Company has certain rights that would allow it to mitigate such loss. If necessary, the carrying amount of any liability recorded in the condensed consolidated balance sheet would reflect the Company’s best estimate of future payments which it may incur as part of fulfilling its guarantee obligation. Currently, there is no liability recorded at September 30, 2016.
Long-lived Asset Impairments: The Company records impairment losses on long-lived assets used in operations when events and circumstances indicate that long-lived assets might be impaired and the undiscounted cash flows estimated to be generated by those assets are less than the carrying amounts of those assets.
During the third quarter of 2016, the Company identified impairment indicators that suggest the carrying value of a certain asset group in China within the Distribution & Storage (“D&S”) segment may not be recoverable. The primary

impairment indicators include recently completed projections of future cash flows and the associated impact on the long-range strategic plan forecasts, lower than expected cash flows attributed to this asset group and poor market conditions. An undiscounted cash flow test performed for this asset group indicated it was not recoverable. The fair value of the asset group was established using a discounted cash flow model which utilized Level 3 inputs in the fair value hierarchy. As a result of the long-lived asset impairment assessment performed, the Company recorded long-lived asset impairment charges on its D&S reporting unit of $1,217. The impairment charges were $542 related to finite-lived intangible assets and $675 related to tangible property, plant and equipment. There were no remaining long-lived assets recorded on the condensed consolidated balance sheet for this asset group as of September 30, 2016.

Additionally, during the third quarter of 2016, events and circumstances indicated that other tangible property, plant and equipment in China within our D&S segment might be impaired. However, the Company's estimate of undiscounted cash flows indicated that such carrying values were expected to be recovered. Nonetheless, it is reasonably possible that the estimate of undiscounted cash flows may negatively change in the near term, which may result in the need to write down these assets to fair value. The Company's estimate of cash flows may change in the future due to poor market conditions and excess capacity in the industry.

Recently Issued Accounting Standards: In October 2016, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2016-16, "Income Taxes (Topic 740): Intra-Entity Transfers of Assets Other Than Inventory." The FASB issued the update to improve the accounting for the income tax consequences of intra-entity transfers of assets other than inventory. The new guidance clarifies that an entity should recognize the income tax consequences of an intra-entity transfer of an asset other than inventory when the transfer occurs. Two common examples of assets included in the scope of this update are intellectual property and property, plant and equipment. The standard will be effective for fiscal years beginning after December 15, 2017 and interim periods within those years. Early adoption is permitted as of the beginning of an annual reporting period for which financial statements (interim or annual) have not been issued. The amendments in this update must be applied on a modified retrospective basis through a cumulative-effect adjustment to retained earnings as of the beginning of the period of adoption. The Company is currently assessing the effect that the ASU will have on the Company's financial position, results of operations, cash flows and disclosures.

In August 2016, the FASB issued ASU 2016-15, "Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments." The FASB issued the update to clarify how entities should classify certain cash receipts and cash payments on the statement of cash flows. The new guidance also clarifies how the predominance principle should be applied when cash receipts and cash payments have aspects of more than one class of cash flows. The standard will be effective for fiscal years beginning after December 15, 2017 and interim periods within those years and the guidance will generally be applied retroactively. Early adoption is permitted with all of the amendments adopted in the same period. If an entity early adopts the guidance in an interim period, any adjustments must be reflected as of the beginning of the fiscal year that includes that interim period. The Company is currently assessing the effect that the ASU will have on the Company's cash flows.

In June 2016, the FASB issued ASU 2016-13, "Financial Instruments – Credit Losses – Measurement of Credit Losses on Financial Instruments." The FASB issued the update in response to criticism that current guidance delays recognition of credit losses. The new guidance changes the impairment model for most financial assets and certain other instruments. Additionally, for trade and other receivables, held-to-maturity debt securities, loans and other instruments, entities will be required to use a new forward looking "expected loss" model that generally will result in the earlier recognition of allowances for losses. Entities will have to disclose significantly more information, including information they use to track credit quality by year of origination for most financing receivables. Early adoption is permitted for annual periods beginning after December 15, 2018, including interim periods therein. The standard will be effective for fiscal years beginning after December 15, 2019, including interim periods within such fiscal years. The Company is currently assessing the effect that the ASU will have on the Company's financial position, results of operations, cash flows and disclosures.

In March 2016, the FASB issued ASU 2016-09, "Compensation – Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting." The FASB issued the update to change certain aspects of accounting for share-based payments to employees. The update eliminates additional paid-in-capital pools and requires all income tax effects of awards to be recognized in the statements of operations when the awards vest or settle. The standard will be effective for fiscal years beginning after December 15, 2016, including interim periods within such fiscal years. Early adoption is permitted, but all of the guidance must be adopted in the same period. If an entity early adopts the guidance in an interim period, any adjustments must be reflected as of the beginning of the fiscal year that includes that interim period. The Company does not plan to early adopt and is currently assessing the effect that the ASU will have on the Company’s financial position, results of operations, cash flows and disclosures.

In February 2016, the FASB issued ASU 2016-02, “Leases (Topic 842).” The FASB issued the update to require the recognition of lease assets and lease liabilities on the balance sheet of lessees. The standard will be effective for fiscal years beginning after December 15, 2018, including interim periods within such fiscal years. The ASU requires a modified retrospective transition method with the option to elect a package of practical expedients. Early adoption is permitted. The Company is currently assessing the effect that the ASU will have on the Company’s financial position, results of operations, cash flows and disclosures.

In January 2016, the FASB issued ASU 2016-01, “Financial Instruments – Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities.” The amendments address certain aspects of recognition, measurement, presentation, and disclosure of financial instruments. This ASU is effective for fiscal years beginning after December 15, 2017, including interim periods within such fiscal years. Except for certain early application guidance provided in the ASU, early adoption is not permitted. The Company is currently assessing the effect that the ASU will have on the Company's financial position, results of operations, cash flows and disclosures.

(Dollars and shares in thousands, except per share amounts) – Continued

In July 2015, the FASB issued ASU 2015-11, "Simplifying the Measurement of Inventory." The amendments require an entity to measure inventory at the lower of cost and net realizable value. Net realizable value is the estimated selling prices in the ordinary course of business, less reasonably predictable costs of completion, disposal and transportation. The amendments do not apply to inventory that is measured using the last-in, first-out cost method. The amendments apply to all other inventory, which includes inventory that is measured using first-in, first-out or average cost. This ASU is effective for fiscal years beginning after December 15, 2016. The amendments in this ASU are to be applied prospectively. Early adoption is permitted. The Company does not plan to early adopt nor does it expect that the ASU will have a significant impact on the Company's financial position, results of operations, cash flows and disclosures.

In May 2014, the FASB issued ASU 2014-09, "Revenue from Contracts with Customers." The amendments require entities to recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. In August 2015, the FASB issued ASU 2015-14, which deferred the effective date of the new standard by one year. As a result, the standard will be effective for fiscal years beginning after December 15, 2017, including interim periods within such fiscal years. In March 2016, the FASB issued ASU 2016-08, which amended the principal versus agent guidance in the new revenue standard and is intended to result in more consistent application and reduce the cost and complexity of applying the new standard. In April 2016, the FASB issued ASU 2016-10, which amended the guidance to clarify accounting for licenses of intellectual property and to clarify the guidance on performance obligations. In May 2016, the FASB issued ASU 2016-12, which provided narrow-scope amendments and practical expedients for the new revenue standard and is intended to reduce the cost and complexity of applying the new standard. The new revenue recognition ASU allows full retrospective or modified retrospective adoption. Early adoption is permitted as of fiscal years beginning after December 15, 2016, including interim periods within such fiscal years. The Company is currently assessing the transition method and effect that the ASU will have on the Company's financial position, results of operations, cash flows and disclosures but does not intend to early adopt this standard.

Recently Adopted Accounting Standard: In April 2015, the FASB issued ASU 2015-03, "Interest–Imputation of Interest: Simplifying the Presentation of Debt Issuance Costs." The amendments require an entity to present debt issuance costs in the balance sheet as a direct deduction from the related debt liability rather than as an asset. Amortization of debt issuance costs will continue to be reported as interest expense. In August 2015, the FASB issued ASU 2015-15, which states that the SEC staff would not object to an entity deferring and presenting debt issuance costs related to a revolving line-of-credit as an asset and subsequently amortizing the deferred debt issuance costs ratably over the term of the revolving line-of-credit arrangement, regardless of whether a balance is outstanding. The Company adopted the guidance for the fiscal year beginning January 1, 2016. The new guidance was applied retrospectively for the prior period presented. The impact of the adoption of the guidance resulted in classification of the unamortized debt issuance cost related to the convertible notes on the condensed consolidated balance sheets in long-term debt. The unamortized debt issuance costs reclassified at December 31, 2015 were $1,836. Debt issuance costs related to the Senior Secured Revolving Credit Facility are classified in other assets on the condensed consolidated balance sheets.

NOTE 2 — Inventories

The following table summarizes the components of inventory:

	September 30, 2016	December 31, 2015
Raw materials and supplies	$ 72,496	