

RAVEN INDUSTRIES INC  
Form 10-Q  
August 30, 2013

UNITED STATES SECURITIES AND EXCHANGE COMMISSION  
Washington, DC 20549  
FORM 10-Q  
(Mark One)

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

For the quarterly period ended July 31, 2013

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: 001-07982

RAVEN INDUSTRIES, INC.  
(Exact name of registrant as specified in its charter)

South Dakota 46-0246171  
(State or other jurisdiction of incorporation or (IRS Employer Identification No.)  
organization)

205 East 6th Street, P.O. Box 5107, Sioux Falls, SD 57117-5107

(Address of principal executive offices)  
(605) 336-2750  
(Registrant's telephone number including area code)

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  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  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  Accelerated filer  Non-accelerated filer  Smaller reporting company   
(Do not check if a 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

As of August 23, 2013 there were 36,387,282 shares of common stock, \$1 par value, of Raven Industries, Inc. outstanding. There were no other classes of stock outstanding.

RAVEN INDUSTRIES, INC.  
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## PART I — FINANCIAL INFORMATION

## ITEM 1. FINANCIAL STATEMENTS

RAVEN INDUSTRIES, INC.  
CONSOLIDATED BALANCE SHEETS  
(unaudited)

| (Dollars and shares in thousands, except per-share data)  | July 31,<br>2013 | January 31,<br>2013 | July 31,<br>2012 |
|---|------------------|---------------------|------------------|
| <b>ASSETS</b>   |                  |                     |                  |
| Current assets  |                  |                     |                  |
| Cash and cash equivalents   | \$55,717         | \$49,353            | \$44,113         |
| Accounts receivable, net  | 49,199           | 56,303              | 49,885           |
| Inventories   | 54,362           | 46,189              | 50,389           |
| Deferred income taxes   | 3,225            | 3,107               | 3,251            |
| Other current assets  | 3,259            | 1,796               | 4,122            |
| Total current assets  | 165,762          | 156,748             | 151,760          |
| Property, plant and equipment, net  | 90,265           | 81,238              | 73,189           |
| Goodwill  | 22,274           | 22,274              | 22,274           |
| Amortizable intangible assets, net  | 8,360            | 8,681               | 8,971            |
| Other assets, net   | 4,145            | 4,269               | 4,254            |
| <b>TOTAL ASSETS</b>   | <b>\$290,806</b> | <b>\$273,210</b>    | <b>\$260,448</b> |
| <b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>   |                  |                     |                  |
| Current liabilities   |                  |                     |                  |
| Accounts payable  | \$18,259         | \$14,438            | \$10,835         |
| Accrued liabilities   | 15,291           | 17,192              | 23,971           |
| Customer advances   | 979              | 1,431               | 1,111            |
| Total current liabilities   | 34,529           | 33,061              | 35,917           |
| Other liabilities   | 18,963           | 18,702              | 19,204           |
| Commitments and contingencies   |                  |                     |                  |
| Shareholders' equity  |                  |                     |                  |
| Common stock, \$1 par value, authorized shares 100,000; issued 65,282; 65,223; and 65,196, respectively | 65,282           | 65,223              | 65,196           |
| Paid-in capital   | 8,198            | 5,885               | 3,934            |
| Retained earnings   | 219,253          | 205,695             | 191,397          |
| Accumulated other comprehensive loss  | (2,153)          | (2,095)             | (1,931)          |
| Treasury stock at cost, 28,897 shares   | (53,362)         | (53,362)            | (53,362)         |
| Total Raven Industries, Inc. shareholders' equity   | 237,218          | 221,346             | 205,234          |
| Noncontrolling interest   | 96               | 101                 | 93               |
| Total shareholders' equity  | 237,314          | 221,447             | 205,327          |
| <b>TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY</b>   | <b>\$290,806</b> | <b>\$273,210</b>    | <b>\$260,448</b> |

The accompanying notes are an integral part of the unaudited consolidated financial statements.



## RAVEN INDUSTRIES, INC.

## CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME

(unaudited)

| (Dollars in thousands, except per-share data)   | Three Months Ended |                  | Six Months Ended |                  |
|---|--------------------|------------------|------------------|------------------|
|   | July 31,<br>2013   | July 31,<br>2012 | July 31,<br>2013 | July 31,<br>2012 |
| Net sales   | \$93,421           | \$101,674        | \$197,101        | \$219,589        |
| Cost of sales   | 66,686             | 71,610           | 135,450          | 148,390          |
| Gross profit  | 26,735             | 30,064           | 61,651           | 71,199           |
| Research and development expenses   | 3,989              | 3,564            | 8,225            | 6,964            |
| Selling, general and administrative expenses  | 10,178             | 9,093            | 19,924           | 18,396           |
| Operating income  | 12,568             | 17,407           | 33,502           | 45,839           |
| Other (expense), net  | (219 )             | (96 )            | (417 )           | (148 )           |
| Income before income taxes  | 12,349             | 17,311           | 33,085           | 45,691           |
| Income taxes  | 4,012              | 5,743            | 10,754           | 15,100           |
| Net income  | 8,337              | 11,568           | 22,331           | 30,591           |
| Net income (loss) attributable to the noncontrolling interest                                 | 4                  | 22               | (5 )             | 2                |
| Net income attributable to Raven Industries, Inc.   | \$8,333            | \$11,546         | \$22,336         | \$30,589         |
| Net income per common share:  |                    |                  |                  |                  |
| Basic   | \$0.23             | \$0.32           | \$0.61           | \$0.84           |
| Diluted   | \$0.23             | \$0.32           | \$0.61           | \$0.84           |
| Cash dividends paid per common share  | \$0.12             | \$0.105          | \$0.24           | \$0.21           |
| Comprehensive income:   |                    |                  |                  |                  |
| Net income  | \$8,337            | \$11,568         | \$22,331         | \$30,591         |
| Other comprehensive income, net of tax:   |                    |                  |                  |                  |
| Foreign currency translation  | (63 )              | (68 )            | (117 )           | (45 )            |
| Postretirement benefits, net of income tax expense of \$16, \$20, \$32 and \$41, respectively | 29                 | 38               | 59               | 76               |
| Other comprehensive (loss) income, net of tax   | (34 )              | (30 )            | (58 )            | 31               |
| Comprehensive income  | 8,303              | 11,538           | 22,273           | 30,622           |
| Comprehensive income (loss) attributable to noncontrolling interest                           | 4                  | 22               | (5 )             | 2                |
| Comprehensive income attributable to Raven Industries, Inc.                                   | \$8,299            | \$11,516         | \$22,278         | \$30,620         |

The accompanying notes are an integral part of the unaudited consolidated financial statements.

RAVEN INDUSTRIES, INC.  
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY  
(unaudited)

| (Dollars in thousands,<br>except per-share<br>amounts)   | \$1 Par<br>Common<br>Stock | Treasury Stock     |          | Retained<br>Earnings | Accumulated<br>Other<br>Comprehensive<br>Income<br>(Loss) | Raven<br>Industries,<br>Inc. Equity | Non-<br>controlling<br>Interest | Total<br>Equity |            |
|--|----------------------------|--------------------|----------|----------------------|---|-------------------------------------|---------------------------------|-----------------|------------|
|  |                            | Paid-in<br>Capital | Shares   |                      |   |                                     |                                 |                 | Cost       |
| Balance January 31,<br>2012  | \$ 32,566                  | \$ 9,607           | (14,449) | \$(53,362)           | \$ 193,650  | \$ (1,962 )                         | \$ 180,499                      | \$ 91           | \$ 180,590 |
| Net income   | —                          | —                  | —        | —                    | 30,589  | —                                   | 30,589                          | 2               | 30,591     |
| Other comprehensive<br>income (loss):  |                            |                    |          |                      |   |                                     |                                 |                 |            |
| Cumulative foreign<br>currency translation<br>adjustment   | —                          | —                  | —        | —                    | —   | (45 )                               | (45 )                           | —               | (45 )      |
| Postretirement benefits<br>reclassified from<br>accumulated other<br>comprehensive income<br>(loss) after tax benefit of<br>\$41 | —                          | —                  | —        | —                    | —   | 76                                  | 76                              | —               | 76         |
| Cash dividends (\$0.21<br>per share)   | —                          | 31                 | —        | —                    | (7,649 )  | —                                   | (7,618 )                        | —               | (7,618 )   |
| Two-for-one stock split  | 32,598                     | (7,405 )           | (14,448) | —                    | (25,193 )   | —                                   | —                               | —               | —          |
| Stock surrendered upon<br>exercise of stock options  | (32 )                      | (2,107 )           | —        | —                    | —   | —                                   | (2,139 )                        | —               | (2,139 )   |
| Employees' stock<br>options exercised  | 64                         | 2,011              | —        | —                    | —   | —                                   | 2,075                           | —               | 2,075      |
| Share-based<br>compensation  | —                          | 1,570              | —        | —                    | —   | —                                   | 1,570                           | —               | 1,570      |
| Tax benefit from<br>exercise of stock options  | —                          | 227                | —        | —                    | —   | —                                   | 227                             | —               | 227        |
| Balance July 31, 2012  | \$ 65,196                  | \$ 3,934           | (28,897) | \$(53,362)           | \$ 191,397  | \$ (1,931 )                         | \$ 205,234                      | \$ 93           | \$ 205,327 |
| Balance January 31,<br>2013  | \$ 65,223                  | \$ 5,885           | (28,897) | \$(53,362)           | \$ 205,695  | \$ (2,095 )                         | \$ 221,346                      | \$ 101          | \$ 221,447 |
| Net income (loss)  | —                          | —                  | —        | —                    | 22,336  | —                                   | 22,336                          | (5 )            | 22,331     |
| Other comprehensive<br>income (loss):  |                            |                    |          |                      |   |                                     |                                 |                 |            |
| Cumulative foreign<br>currency translation<br>adjustment   | —                          | —                  | —        | —                    | —   | (117 )                              | (117 )                          | —               | (117 )     |
| Postretirement benefits<br>reclassified from<br>accumulated other<br>comprehensive income  | —                          | —                  | —        | —                    | —   | 59                                  | 59                              | —               | 59         |

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|   |           |          |          |            |           |             |            |       |            |
|---|-----------|----------|----------|------------|-----------|-------------|------------|-------|------------|
| (loss) after tax benefit of<br>\$32                 |           |          |          |            |           |             |            |       |            |
| Cash dividends (\$0.24<br>per share)                | —         | 51       | —        | —          | (8,778 )  | —           | (8,727 )   | —     | (8,727 )   |
| Stock surrendered upon<br>exercise of stock options | (51 )     | (1,581 ) | —        | —          | —         | —           | (1,632 )   | —     | (1,632 )   |
| Employees' stock<br>options exercised               | 110       | 1,320    | —        | —          | —         | —           | 1,430      | —     | 1,430      |
| Share-based<br>compensation                         | —         | 2,276    | —        | —          | —         | —           | 2,276      | —     | 2,276      |
| Tax benefit from<br>exercise of stock options       | —         | 247      | —        | —          | —         | —           | 247        | —     | 247        |
| Balance July 31, 2013                               | \$ 65,282 | \$ 8,198 | (28,897) | \$(53,362) | \$219,253 | \$ (2,153 ) | \$ 237,218 | \$ 96 | \$ 237,314 |

The accompanying notes are an integral part of the unaudited consolidated financial statements.

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RAVEN INDUSTRIES, INC.  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
(unaudited)

| (Dollars in thousands)  | Six Months Ended |                  |
|---|------------------|------------------|
|   | July 31,<br>2013 | July 31,<br>2012 |
| <b>OPERATING ACTIVITIES:</b>  |                  |                  |
| Net income  | \$22,331         | \$30,591         |
| Adjustments to reconcile net income to net cash provided by operating activities: |                  |                  |
| Depreciation and amortization   | 6,653            | 6,036            |
| Gain on acquisition-related contingent liability settlement                       | —                | (508)            |
| Change in fair value of acquisition-related contingent consideration              | 283              | 508              |
| Loss from equity investment   | 111              | 57               |
| Deferred income taxes   | (246)            | (590)            |
| Share-based compensation expense  | 2,276            | 1,570            |
| Change in operating assets and liabilities:                                       |                  |                  |
| Accounts receivable   | 7,024            | 10,798           |
| Inventories   | (8,197)          | 4,368            |
| Prepaid expense and other assets  | (1,439)          | (990)            |
| Operating liabilities   | 894              | (7,407)          |
| Other operating activities, net   | 47               | 29               |
| Net cash provided by operating activities   | 29,737           | 44,462           |
| <b>INVESTING ACTIVITIES:</b>  |                  |                  |
| Capital expenditures  | (13,746)         | (16,870)         |
| Other investing activities, net   | (534)            | 22               |
| Net cash used in investing activities   | (14,280)         | (16,848)         |
| <b>FINANCING ACTIVITIES:</b>  |                  |                  |
| Dividends paid  | (8,727)          | (7,618)          |
| Payments of acquisition-related contingent liability                              | (353)            | (1,867)          |
| Other financing activities, net   | 45               | 163              |
| Net cash used in financing activities   | (9,035)          | (9,322)          |
| Effect of exchange rate changes on cash   | (58)             | (21)             |
| Net increase in cash and cash equivalents   | 6,364            | 18,271           |
| Cash and cash equivalents at beginning of year                                    | 49,353           | 25,842           |
| Cash and cash equivalents at end of period  | \$55,717         | \$44,113         |

The accompanying notes are an integral part of the unaudited consolidated financial statements.



RAVEN INDUSTRIES, INC.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
(unaudited)  
(Dollars in thousands, except per-share amounts)

(1) BASIS OF PRESENTATION AND PRINCIPLES OF CONSOLIDATION

Raven Industries, Inc. (the Company or Raven) is a diversified technology company providing a variety of products to customers within the industrial, agricultural, energy, construction and military/aerospace markets. The Company is comprised of three unique operating units, or divisions, classified into reportable segments: Applied Technology, Engineered Films and Aerostar.

The accompanying unaudited consolidated financial information, which includes the accounts of Raven and its wholly-owned or controlled subsidiaries, net of intercompany balances and transactions which have been eliminated, has been prepared by the Company in accordance with accounting principles generally accepted in the United States of America (GAAP) for interim financial information and the instructions to Form 10-Q and Article 10 of Regulation S-X of the Securities and Exchange Commission (SEC). Accordingly, it does not include all of the information and notes required by GAAP for complete financial statements. This financial information should be read in conjunction with the consolidated financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the fiscal year ended January 31, 2013.

In the opinion of management, all adjustments (consisting of normal recurring adjustments) considered necessary for a fair statement of this financial information have been included. Financial results for the interim three- and six-month periods ended July 31, 2013 are not necessarily indicative of the results that may be expected for the year ending January 31, 2014. The January 31, 2013 consolidated balance sheet was derived from audited financial statements, but does not include all disclosures required by GAAP. Preparing financial statements in conformity with GAAP requires management to make certain estimates and assumptions. These affect the reported amounts of assets and liabilities as of the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Noncontrolling interests represent capital contributions, income and loss attributable to the owners of less than wholly-owned and consolidated entities. The Company owns a 75% interest in an entity consolidated under the Aerostar business segment. Given the Company's majority ownership interest, the accounts of the business venture have been consolidated with the accounts of the Company, and a noncontrolling interest has been recorded for the noncontrolling investor interests in the net assets and operations of the business venture.

(2) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

There have been no material changes to the Company's significant accounting policies as described in the Company's Annual Report on Form 10-K for the fiscal year ended January 31, 2013.

(3) NET INCOME PER SHARE

Basic net income per share is computed by dividing net income by the weighted average common shares and stock units outstanding. Diluted net income per share is computed by dividing net income by the weighted average common and common equivalent shares outstanding which includes the shares issuable upon exercise of employee stock options (net of shares assumed purchased with the option proceeds), stock units and restricted stock units outstanding. Performance share awards are included in the diluted calculation based upon what would be issued if the end of the most recent reporting period was the end of the term of the award.

Certain outstanding options and restricted stock units were excluded from the diluted net income per-share calculations because their effect would have been anti-dilutive under the treasury stock method.

The options and restricted stock units excluded from the diluted net income per-share share calculation were as follows:

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|  | Three Months Ended |                  | Six Months Ended |                  |
|--|--------------------|------------------|------------------|------------------|
|  | July 31,<br>2013   | July 31,<br>2012 | July 31,<br>2013 | July 31,<br>2012 |
| Anti-dilutive options and restricted stock units | 674,094            | 393,333          | 628,747          | 352,467          |

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(Dollars in thousands, except per-share amounts)

The computation of earnings per share is presented below:

|   | Three Months Ended |                  | Six Months Ended |                  |
|---|--------------------|------------------|------------------|------------------|
|   | July 31,<br>2013   | July 31,<br>2012 | July 31,<br>2013 | July 31,<br>2012 |
| Numerator:  |                    |                  |                  |                  |
| Net income attributable to Raven Industries, Inc.           | \$8,333            | \$11,546         | \$22,336         | \$30,589         |
| Denominator:  |                    |                  |                  |                  |
| Weighted average common shares outstanding                  | 36,375,172         | 36,286,300       | 36,355,522       | 36,265,479       |
| Weighted average stock units outstanding                    | 70,956             | 56,623           | 64,105           | 52,896           |
| Denominator for basic calculation                           | 36,446,128         | 36,342,923       | 36,419,627       | 36,318,375       |
| Weighted average common shares outstanding                  | 36,375,172         | 36,286,300       | 36,355,522       | 36,265,479       |
| Weighted average stock units outstanding                    | 70,956             | 56,623           | 64,105           | 52,896           |
| Dilutive impact of stock options and restricted stock units | 164,079            | 222,068          | 180,736          | 226,296          |
| Denominator for diluted calculation                         | 36,610,207         | 36,564,991       | 36,600,363       | 36,544,671       |
| Net income per share - basic                                | \$0.23             | \$0.32           | \$0.61           | \$0.84           |
| Net income per share - diluted                              | \$0.23             | \$0.32           | \$0.61           | \$0.84           |

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(Dollars in thousands, except per-share amounts)

(4) SELECTED BALANCE SHEET INFORMATION

Following are the components of selected items from the Consolidated Balance Sheets:

|  | July 31, 2013 | January 31, 2013 | July 31, 2012 |
|--|---------------|------------------|---------------|
| Accounts receivable, net:                    |               |                  |               |
| Trade accounts                               | \$49,404      | \$56,508         | \$50,055      |
| Allowance for doubtful accounts              | (205 )        | (205 )           | (170 )        |
|  | \$49,199      | \$56,303         | \$49,885      |
| Inventories:                                 |               |                  |               |
| Finished goods                               | \$7,980       | \$8,571          | \$7,394       |
| In process                                   | 2,562         | 2,675            | 4,979         |
| Materials                                    | 43,820        | 34,943           | 38,016        |
|  | \$54,362      | \$46,189         | \$50,389      |
| Property, plant and equipment, net:          |               |                  |               |
| Property, plant and equipment                | \$171,392     | \$156,658        | \$145,433     |
| Accumulated depreciation                     | (81,127 )     | (75,420 )        | (72,244 )     |
|  | \$90,265      | \$81,238         | \$73,189      |
| Accrued liabilities:                         |               |                  |               |
| Salaries and benefits                        | \$2,391       | \$4,265          | \$3,605       |
| Vacation                                     | 4,171         | 4,025            | 4,155         |
| 401(k) contributions                         | 417           | 520              | 611           |
| Insurance obligations                        | 2,321         | 2,506            | 3,003         |
| Warranties                                   | 2,047         | 1,888            | 1,949         |
| Acquisition-related contingent liabilities   | 594           | 712              | 7,028         |
| Taxes - accrued and withheld                 | 1,900         | 1,392            | 1,999         |
| Other  | 1,450         | 1,884            | 1,621         |
|  | \$15,291      | \$17,192         | \$23,971      |
| Other liabilities:                           |               |                  |               |
| Postretirement benefits                      | \$8,208       | \$8,072          | \$7,520       |
| Acquisition-related contingent consideration | 2,196         | 2,359            | 2,108         |
| Deferred income taxes                        | 2,357         | 2,453            | 3,919         |
| Uncertain tax positions                      | 6,202         | 5,818            | 5,657         |
|  | \$18,963      | \$18,702         | \$19,204      |

(5) ACQUISITIONS OF AND INVESTMENTS IN BUSINESSES AND TECHNOLOGIES

Ranchview

Pursuant to the Company's 2009 purchase of substantially all of the assets of Ranchview Inc. (Ranchview), a privately held Canadian corporation, Raven agreed to pay contingent consideration for future sales of Ranchview products up to a maximum of \$4,000. During the first quarter of fiscal 2013, the Company paid \$1,841 in cash to the previous Ranchview owner for an early buyout of the outstanding acquisition-related contingent liability. This resulted in a gain of \$508 which is included in Applied Technology operating income for the six-month period ended July 31, 2012.

(6) EMPLOYEE POSTRETIREMENT BENEFITS

The Company provides postretirement medical and other benefits to senior executive officers and senior managers. There are no plan assets for the plans and any obligations are covered through operating cash and investments. The

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components of net periodic benefit cost for postretirement benefits are as follows:

|                                  | Three Months Ended |                  | Six Months Ended |                  |
|----------------------------------|--------------------|------------------|------------------|------------------|
|                                  | July 31,<br>2013   | July 31,<br>2012 | July 31,<br>2013 | July 31,<br>2012 |
| Service cost                     | \$51               | \$47             | \$101            | \$94             |
| Interest cost                    | 87                 | 84               | 174              | 168              |
| Amortization of actuarial losses | 45                 | 58               | 91               | 116              |
| Net periodic benefit cost        | \$183              | \$189            | \$366            | \$378            |

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(Dollars in thousands, except per-share amounts)

Postretirement benefit cost components are reclassified in their entirety from accumulated other comprehensive loss to net periodic benefit cost. Net periodic benefit costs are reported in net income as “Cost of sales” or “Selling, general and administrative expenses” in a manner consistent with the classification of direct labor and personnel costs of the eligible employees.

#### (7) WARRANTIES

Accruals necessary for product warranties are estimated based on historical warranty costs and average time elapsed between purchases and returns for each division. Additional accruals are made for any significant, discrete warranty issues. Changes in the warranty accrual were as follows:

|                                       | Three Months Ended |                  | Six Months Ended |                  |
|---------------------------------------|--------------------|------------------|------------------|------------------|
|                                       | July 31,<br>2013   | July 31,<br>2012 | July 31,<br>2013 | July 31,<br>2012 |
| Beginning balance                     | \$1,990            | \$1,792          | \$1,888          | \$1,699          |
| Accrual for warranties                | 868                | 778              | 1,732            | 1,598            |
| Settlements made (in cash or in kind) | (811 )             | (621 )           | (1,573 )         | (1,348 )         |
| Ending balance                        | \$2,047            | \$1,949          | \$2,047          | \$1,949          |

#### (8) FINANCING ARRANGEMENTS

Raven has an uncollateralized credit agreement with Wells Fargo Bank, N.A. providing a line of credit of \$10,500 with a maturity date of November 30, 2013, bearing interest at 1.50% above the daily one-month London Inter-bank Market Rate. Letters of credit totaling \$850 have been issued under the line of credit, primarily to support self-insured workers' compensation bonding requirements. No borrowings were outstanding as of July 31, 2013, January 31, 2013 or July 31, 2012, and \$9,650 was available at July 31, 2013.

#### (9) DIVIDENDS

Dividends paid during the three and six months ended July 31, 2013 were \$4,366 and \$8,727, respectively, or 12.0 cents per share. Dividends paid during the three and six months ended July 31, 2012 were \$3,812 and \$7,618, respectively, or 10.5 cents per share.

#### (10) SHARE-BASED COMPENSATION

Under the Amended and Restated 2010 Stock Incentive Plan effective March 23, 2012, administered by the Personnel and Compensation Committee of the Board of Directors, two types of awards were granted during the six months ended July 31, 2013 and July 31, 2012. None of these awards were granted during the three-month periods ended July 31, 2013 or 2012, respectively.

##### Stock Option Awards

On March 25, 2013, the Company granted 198,900 non-qualified stock options. On April 2, 2012, the Company granted 151,200 non-qualified stock options. Options are granted with exercise prices not less than market value of the Company's common stock at the date of grant. The stock options vest over a four-year period and expire after five years. Options contain retirement and change-in-control provisions that may accelerate the vesting period. The fair value of each option grant is estimated on the date of grant using the Black-Scholes option pricing model. The Company uses historical data to estimate option exercises and employee terminations within this valuation model.

The fair values of options granted were estimated using the following assumptions:

Six Months Ended

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|                                 | July 31, 2013 |   | July 31, 2012 |   |
|---------------------------------|---------------|---|---------------|---|
| Risk-free interest rate         | 0.59          | % | 0.86          | % |
| Expected dividend yield         | 1.46          | % | 1.33          | % |
| Expected volatility factor      | 41.39         | % | 49.65         | % |
| Expected option term (in years) | 3.75          |   | 3.75          |   |

The weighted average grant date fair value of options granted during the six months ended July 31, 2013 was \$9.34.

The weighted average grant date fair value of options granted during the six months ended July 31, 2012 was \$10.96.

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(Dollars in thousands, except per-share amounts)

### Restricted Stock Unit Awards (RSUs)

On March 25, 2013, the Company granted 25,540 time-vested RSUs to employees. On April 2, 2012 the Company granted 21,120 time-vested RSUs to employees. The fair value of a time-vested RSU is measured based upon the closing market price of the Company's common stock on the date of grant. The grant date fair value of the time-vested RSUs granted during the six months ended July 31, 2013 and 2012 was \$32.85 and \$31.66, respectively. Time-vested RSUs will vest if, at the end of the three-year period, the employee remains employed by the Company. Dividends are cumulatively earned on the time-vested RSUs over the vesting period.

The Company also granted performance-based RSUs on March 25, 2013 and April 2, 2012. The exact number of performance shares to be issued will vary from 0% to 150% of the target award, depending on the Company's actual performance over the three-year period in comparison to the target award based on return on sales (ROS), which is defined as net income divided by net sales. The performance-based RSUs will vest if, at the end of the three-year performance period, the Company has achieved certain performance goals and the employee remains employed by the Company. Dividends are cumulatively earned on performance-based RSUs over the vesting period. The number of RSUs that will vest is determined by an estimated ROS target over the three-year performance period. The estimated ROS performance used to estimate the number of restricted stock units expected to vest is evaluated at least quarterly. The number of restricted stock units issued at the vesting date will be based on actual results.

The fair value of the performance-based restricted stock units is based upon the closing market price of the Company's common stock on the grant date. The number of performance-based RSUs granted is based on 100% of the target award. During the six-month periods ended July 31, 2013 and 2012, the Company granted 56,222 and 50,940 performance-based RSUs, respectively. The grant date fair value of these performance-based RSUs was \$32.85 and \$31.66, respectively.

### (11) SEGMENT REPORTING

The Company's reportable segments are defined by their product lines which have been grouped in these segments based on common technologies, production methods and inventories. The Company measures the performance of its segments based on their operating income excluding administrative and general expenses. Other expense and income taxes are not allocated to individual operating segments, and assets not identifiable to an individual segment are included as corporate assets. Segment information is reported consistent with the Company's management reporting structure.

Raven's reportable segments are Applied Technology Division, Engineered Films Division and Aerostar Division. The Company realigned the assets and team members of its Electronic Systems Division and deployed them into the Company's Aerostar and Applied Technology Divisions effective June 1, 2012. All prior period segment information reflects this change.

Business segment net sales and operating income results are as follows:

|  | Three Months Ended |                  | Six Months Ended |                  |
|--|--------------------|------------------|------------------|------------------|
|  | July 31,<br>2013   | July 31,<br>2012 | July 31,<br>2013 | July 31,<br>2012 |
| Net sales                                |                    |                  |                  |                  |
| Applied Technology Division              | \$39,091           | \$40,071         | \$90,272         | \$93,812         |
| Engineered Films Division                | 37,264             | 36,785           | 71,757           | 77,879           |
| Aerostar Division                        | 20,722             | 26,845           | 42,437           | 52,480           |
| Intersegment eliminations <sup>(a)</sup> | (3,656 )           | (2,027 )         | (7,365 )         | (4,582 )         |
| Consolidated net sales                   | \$93,421           | \$101,674        | \$197,101        | \$219,589        |
| Operating income                         |                    |                  |                  |                  |



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|  |          |          |          |          |
|--|----------|----------|----------|----------|
| Applied Technology Division              | \$11,870 | \$12,909 | \$31,027 | \$34,959 |
| Engineered Films Division                | 4,770    | 6,819    | 9,524    | 15,998   |
| Aerostar Division                        | 964      | 2,309    | 2,770    | 3,751    |
| Intersegment eliminations <sup>(a)</sup> | (17 )    | 17       | (38 )    | (62 )    |
| Total reportable segment income          | 17,587   | 22,054   | 43,283   | 54,646   |
| Administrative and general expenses      | (5,019 ) | (4,647 ) | (9,781 ) | (8,807 ) |
| Consolidated operating income            | \$12,568 | \$17,407 | \$33,502 | \$45,839 |

<sup>(a)</sup> Intersegment sales were primarily from Aerostar to Applied Technology.

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(12) NEW ACCOUNTING STANDARDS

Accounting Standards Adopted

During the six months ended July 31, 2013 the following accounting pronouncements were adopted or effective that are of significance, or potential significance, to the Company.

In February 2013 the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2013-02, "Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income (AOCI)" (ASU No. 2013-02). ASU No. 2013-02 requires that an entity present, either on the face of the statement where net income is reported or in the notes, the effect of significant reclassifications out of AOCI to net income when GAAP requires that the amount be reclassified in its entirety to net income. For amounts not required to be entirely reclassified to net income, ASU No. 2013-02 requires the cross-referencing of these amounts to other disclosures that provide detail about these amounts. This guidance, required to be applied prospectively, was effective for the Company on February 1, 2013. The adoption of this guidance had no effect on the Company's consolidated financial position, results of operations or cash flows as it is disclosure-only in nature.

Pending Accounting Standards

At July 31, 2013 there are no accounting pronouncements pending that are of significance, or potential significance, to the Company.

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

The following commentary on the operating results, liquidity, capital resources and financial condition of Raven Industries, Inc. (the Company or Raven) should be read in conjunction with the unaudited Consolidated Financial Statements in Item 1 of Part 1 of this Quarterly Report on Form 10-Q and the Company's Annual Report on Form 10-K for the year ended January 31, 2013. There have been no material changes to the Company's critical accounting policies discussed therein.

### EXECUTIVE SUMMARY

Raven is a diversified technology company providing a variety of products to customers within the industrial, agricultural, energy, construction and military/aerospace markets. The Company is comprised of unique operating units, classified into three reportable segments: Applied Technology Division, Engineered Films Division and Aerostar Division. While each segment has distinct characteristics, the products and technologies are largely extensions of durable competitive advantages rooted in the original research balloon business.

Management uses a number of metrics to assess the Company's performance:

- Consolidated net sales, gross margins, operating income, operating margins, net income and earnings per share
- Cash flow from operations and shareholder returns
- Return on sales, assets and equity
- Segment net sales, gross profit, gross margins, operating income and operating margins

### Vision and Strategy

At Raven, there is a singular purpose behind everything we do. It is: to solve great challenges. Great challenges require great solutions. Solutions driven by quality, service, innovation and peak performance set Raven apart in the development of technology that helps the world grow more food, produce more energy, protect the environment and live safely.

The Raven business model is our platform for success. Our business model is defensible, sustainable and gives us a consistent approach in the pursuit of quality financial results. This overall approach to creating value, which is employed across the three unique business segments is summarized as follows:

- Serve a set of diversified market segments with attractive near- and long-term growth prospects;
- Consistently manage a pipeline of growth initiatives within our market segments;
- Aggressively compete on quality, service, innovation and peak performance;
- Hold ourselves accountable for continuous improvement;
- Value our balance sheet as a source of strength and stability; and
- Make corporate responsibility a top priority.

The diversified business model enables us to weather near-term challenges, while continuing to grow and build for our future. It is our culture and it is woven into how we do business.

## Results of Operations

Consolidated financial highlights for the second quarter and first six months of fiscal 2014 and fiscal 2013 include the following:

| (dollars in thousands, except per-share data)     | Three Months Ended |                  |             | Six Months Ended |                  |             |
|---|--------------------|------------------|-------------|------------------|------------------|-------------|
|   | July 31,<br>2013   | July 31,<br>2012 | %<br>Change | July 31,<br>2013 | July 31,<br>2012 | %<br>Change |
| Net sales   | \$93,421           | \$101,674        | (8 )%       | \$197,101        | \$219,589        | (10 )%      |
| Gross profit                                      | 26,735             | 30,064           | (11 )%      | 61,651           | 71,199           | (13 )%      |
| Gross margins <sup>(a)</sup>                      | 28.6 %             | 29.6 %           |             | 31.3 %           | 32.4 %           |             |
| Operating income                                  | \$12,568           | \$17,407         | (28 )%      | \$33,502         | \$45,839         | (27 )%      |
| Operating margins                                 | 13.5 %             | 17.1 %           |             | 17.0 %           | 20.9 %           |             |
| Net income attributable to Raven Industries, Inc. | \$8,333            | \$11,546         | (28 )%      | \$22,336         | \$30,589         | (27 )%      |
| Diluted earnings per share                        | \$0.23             | \$0.32           |             | \$0.61           | \$0.84           |             |
| Operating cash flow                               |                    |                  |             | \$29,737         | \$44,462         |             |
| Capital expenditures                              |                    |                  |             | \$(13,746 )      | \$(16,870 )      |             |
| Cash dividends                                    |                    |                  |             | \$(8,727 )       | \$(7,618 )       |             |

(a) The Company's gross and operating margins may not be comparable to industry peers due to the diversity of its operations and variability in the classification of expenses across industries in which the Company operates.

Net income attributable to Raven for the three months ended July 31, 2013 was \$8.3 million, or \$0.23 per diluted share, versus \$11.5 million, or \$0.32 per diluted share. For the second quarter, net sales were \$93.4 million, down \$8.3 million compared to \$101.7 million in the prior-year second quarter. Net sales rose modestly in the Engineered Films division and were down slightly in Applied Technology. Aerostar sales declined 23% reflecting the current constraints on federal spending and planned transition away from avionics customers.

For the six-month period, net sales decreased 10% to \$197.1 million, from \$219.6 million one year earlier. For the same period, net income attributable to Raven was \$22.3 million, or \$0.61 per diluted share, down 27% from \$30.6 million, or \$0.84 per diluted share, in fiscal 2013. Each of the Company's three divisions reported sales declines compared with the prior year period and lower Engineered Films gross margins were the main drivers for the decrease.

## Applied Technology

Net sales of \$39.1 million in the second quarter of fiscal 2014 were down \$1.0 million, or 2%, as compared to the prior year period and operating income decreased \$1.0 million, or 8%, to \$11.9 million. For the six-month period, net sales declined \$3.5 million, or 4%, to \$90.3 million as compared to \$93.8 million and operating income decreased \$3.9 million, or 11%, to \$31.0 million. The decrease in sales reflects softness of demand during the first quarter of fiscal 2014 compared to fiscal 2013, which continued into the second quarter. Lower operating income is primarily the result of the decrease in sales as well as continued investment in research, marketing and product development to secure future growth.

## Engineered Films

For the second quarter, net sales of \$37.3 million grew \$0.5 million, or 1%, as compared with the second quarter of last year. Second quarter operating income of \$4.8 million declined 30% year-over-year. Fiscal 2014 first half net sales decreased \$6.1 million, or 8%, to \$71.8 million and operating income of \$9.5 million was down 40% from the prior year period. Net sales for the first half of fiscal 2014 were impacted by lower energy market sales compared to the first half of fiscal 2013. Operating income for the three- and six-month periods were negatively impacted by substantially higher resin costs compared to the comparative periods.

Aerostar

Fiscal 2014 second quarter net sales were \$20.7 million compared to \$26.8 million in the previous year's second quarter, a \$6.1 million decrease. Operating income decreased by \$1.3 million, or 58%, to \$1.0 million from the previous year second quarter results. Fiscal 2014 year-to-date net sales of \$42.4 million were down \$10.1 million from \$52.5 million and operating income of \$2.8 million was \$1.0 million, or 26%, lower than fiscal 2013 year-to-date comparative results. The net sales decrease was expected and due primarily to reduced demand from Aerostar's U.S. government customers and planned declines with avionics customers. Higher research balloon sales and Vista radar system sales partially offset these expected decreases. This change in product mix

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and higher operating expenses were the main driver of the operating income decline for the three and six-month periods ended July 31, 2013 versus the prior year's comparative periods.

## RESULTS OF OPERATIONS - SEGMENT ANALYSIS

### Applied Technology

Applied Technology designs, manufactures, sells and services innovative precision agriculture products and information management tools that help growers reduce costs, precisely control inputs and improve farm yields around the world.

| (dollars in thousands)              | Three Months Ended |                  |           |             | Six Months Ended |                  |           |             |
|-------------------------------------|--------------------|------------------|-----------|-------------|------------------|------------------|-----------|-------------|
|                                     | July 31,<br>2013   | July 31,<br>2012 | \$ Change | %<br>Change | July 31,<br>2013 | July 31,<br>2012 | \$ Change | %<br>Change |
| Net sales                           | \$39,091           | \$40,071         | \$(980)   | (2)%        | \$90,272         | \$93,812         | \$(3,540) | (4)%        |
| Gross profit                        | 17,660             | 17,926           | (266)     | (1)%        | 42,443           | 45,249           | (2,806)   | (6)%        |
| Gross margins                       | 45.2%              | 44.7%            |           |             | 47.0%            | 48.2%            |           |             |
| Operating expenses                  | \$5,790            | \$5,017          | \$773     | 15%         | \$11,416         | \$10,290         | \$1,126   | 11%         |
| Operating expenses as %<br>of sales | 14.8%              | 12.5%            |           |             | 12.6%            | 11.0%            |           |             |
| Operating income                    | \$11,870           | \$12,909         | \$(1,039) | (8)%        | \$31,027         | \$34,959         | \$(3,932) | (11)%       |
| Operating margins                   | 30.4%              | 32.2%            |           |             | 34.4%            | 37.3%            |           |             |

The following factors were the primary drivers of the three- and six-month year-over-year changes:

**Market conditions.** Global market fundamentals remained healthy as population and income growth in emerging economies have increased demand for food. Emerging agriculture markets abroad are at varying life cycle stages providing opportunities for Raven's precision agriculture products to meet market needs. Growth in these international markets has moderated in some areas of the world while there is strength in others. The Company continues to invest in growth internationally for the long term. Demand in the U.S. and Canadian aftermarket was lower in the first quarter of fiscal 2014 due to uncertainty in the marketplace. Apprehension given the drought conditions last year and falling commodity prices put pressure on demand through the second quarter of fiscal 2014. Original equipment manufacturing (OEM) partners maintained strong demand.

**Sales volume.** Second quarter fiscal 2014 net sales decreased \$1.0 million, or 2%, to \$39.1 million compared to \$40.1 million in the prior year second quarter. Lower demand for application controls was partially offset by higher OEM demand for guidance and steering systems. Year-to-date sales of \$90.3 million were below the prior year comparative results by \$3.5 million or 4%. Sales of field computers and application controls were down due to weaker demand in the U.S. aftermarket and timing of demand year-over-year. These decreases were partially offset by strong OEM demand for guidance and steering products.

**International sales decreased.** For the three-month period, international sales totaled \$11.0 million, decreasing 7% from a year ago and representing 28% of segment revenue compared to 30% in the prior year three-month period. International sales of \$24.9 million in the first six months of fiscal 2014 accounted for 28% of segment revenue for the six-month period. This percentage of revenue remained consistent with the prior year six-month period but represented a decline of \$1.5 million year-over-year. Product deliveries to South America increased year-over-year; however, lower demand in Canada, South Africa and Eastern Europe offset this increase for both the three- and six-month periods.

**Gross margins.** Gross margins increased to 45.2% for the three months ended July 31, 2013 from 44.7% for the three months ended July 31, 2012. First half gross margins declined to 47.0% from 48.2%. The decrease primarily reflects the lower sales volume during the current year period. The prior year-to-date gross margins were favorably impacted by the early buyout of an acquisition related contingent liability discussed in Note 5 in Item 1, Part 1 of this Quarterly Report on Form 10-Q.

Operating expenses. Second quarter operating expense as a percentage of net sales was 14.8%, up from 12.5% in the prior year's second quarter. Year-to-date operating expenses as a percentage of net sales was 12.6% compared to 11.0% for fiscal 2013. The increase is attributable to higher spending in research and development (R&D) on lower sales volumes.

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### Engineered Films

Engineered Films manufactures high performance plastic films and sheeting for industrial, energy, construction, geomembrane and agricultural applications.

| (dollars in thousands)              | Three Months Ended |                  |           |             | Six Months Ended |                  |           |             |
|-------------------------------------|--------------------|------------------|-----------|-------------|------------------|------------------|-----------|-------------|
|                                     | July 31,<br>2013   | July 31,<br>2012 | \$ Change | %<br>Change | July 31,<br>2013 | July 31,<br>2012 | \$ Change | %<br>Change |
| Net sales                           | \$37,264           | \$36,785         | \$479     | 1 %         | \$71,757         | \$77,879         | \$(6,122) | (8) %       |
| Gross profit                        | 6,253              | 8,242            | (1,989)   | (24) %      | 12,636           | 18,771           | (6,135)   | (33) %      |
| Gross margins                       | 16.8 %             | 22.4 %           |           |             | 17.6 %           | 24.1 %           |           |             |
| Operating expenses                  | \$1,483            | \$1,423          | \$60      | 4 %         | \$3,112          | \$2,773          | \$339     | 12 %        |
| Operating expenses as %<br>of sales | 4.0 %              | 3.9 %            |           |             | 4.3 %            | 3.6 %            |           |             |
| Operating income                    | \$4,770            | \$6,819          | \$(2,049) | (30) %      | \$9,524          | \$15,998         | \$(6,474) | (40) %      |
| Operating margins                   | 12.8 %             | 18.5 %           |           |             | 13.3 %           | 20.5 %           |           |             |

The following factors were the primary drivers of the three- and six-month year-over-year changes:

**Market conditions.** Declining demand for pit liners in our energy market beginning in the second half of fiscal 2013 has rebounded slightly during the second quarter of fiscal 2014, marking signs that the energy market is stabilizing. Environmental and water conservation projects increase demand for the division's containment liners in the geomembrane market and provide sales growth opportunities for these products. Beginning in the second quarter of fiscal 2014, demand has also strengthened for agricultural barrier films used in high value crop production.

**Sales volume and selling prices.** Second quarter net sales were up 1% to \$37.3 million compared to the prior year second quarter net sales of \$36.8 million. Selling prices were down about 4% as compared to the prior year quarter. First half fiscal 2014 net sales were down \$6.1 million, or 8%, to \$71.8 million compared to first half fiscal 2013 net sales of \$77.9 million. Lower energy market sales, primarily during the first quarter, drove the decline - down \$6.0 million from the prior year six-month period. Geomembrane market sales decreased slightly year-over-year as the prior year included sales for a significant geomembrane reservoir project in Ohio. Sales volume and selling prices for the fiscal 2014 six-month period were down 3% and 5%, respectively, compared to the prior-year periods.

**Gross margin decrease.** For the three- and six-month periods, margins decreased about six and seven percentage points, respectively. The current year periods were impacted by substantially higher resin costs combined with market conditions that did not allow pass-through cost, as well as reduced manufacturing efficiencies due to new line start-up costs.

**Operating expenses.** Second quarter operating expenses as a percentage of net sales was 4.0% compared to 3.9% in the prior three-month period. Year-to-date operating expenses of \$3.1 million were up \$0.3 million, or 12%, over the prior year due to higher R&D spending for new product development on lower sales volume.

### Aerostar

Aerostar designs and manufactures surveillance technology and specialty-sewn and sealed products including tethered aerostats, high-altitude scientific balloons, protective wear, parachutes, military decoys and marine navigation equipment. Aerostar also provides electronics manufacturing services (EMS) with a focus on high-mix, low-volume production. Assemblies manufactured by the Aerostar segment include avionics, communication, environmental controls and other products where high quality is critical.

Aerostar acquired Vista Research, Inc. (Vista) at the end of fiscal 2012. Vista's smart-sensing radar systems (SSRS) use sophisticated signal processing algorithms and are employed in a host of detection and tracking applications, including wide-area surveillance for border patrol and the military.





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| (dollars in thousands)              | Three Months Ended |                  |            |             | Six Months Ended |                  |             |             |
|-------------------------------------|--------------------|------------------|------------|-------------|------------------|------------------|-------------|-------------|
|                                     | July 31,<br>2013   | July 31,<br>2012 | \$ Change  | %<br>Change | July 31,<br>2013 | July 31,<br>2012 | \$ Change   | %<br>Change |
| Net sales                           | \$20,722           | \$26,845         | \$(6,123 ) | (23 )%      | \$42,437         | \$52,480         | \$(10,043 ) | (19 )%      |
| Gross profit                        | 2,839              | 3,879            | (1,040 )   | (27 )%      | 6,610            | 7,241            | (631 )      | (9 )%       |
| Gross margins                       | 13.7 %             | 14.4 %           |            |             | 15.6 %           | 13.8 %           |             |             |
| Operating expenses                  | \$1,875            | \$1,570          | \$305      | 19 %        | \$3,840          | \$3,490          | \$350       | 10 %        |
| Operating expenses as %<br>of sales | 9.0 %              | 5.8 %            |            |             | 9.0 %            | 6.7 %            |             |             |
| Operating income                    | \$964              | \$2,309          | \$(1,345 ) | (58 )%      | \$2,770          | \$3,751          | \$(981 )    | (26 )%      |
| Operating margins                   | 4.7 %              | 8.6 %            |            |             | 6.5 %            | 7.1 %            |             |             |

The following factors were the primary drivers of the year-over-year changes for the three- and six-month periods:

**Market conditions.** Certain of Aerostar's markets are subject to significant variability due to U.S. federal spending. Uncertainty and sluggish demand in these markets continued throughout fiscal 2013 and into fiscal 2014. In collaboration with Google on a pilot program to provide high-speed wireless Internet accessibility to rural, remote and underserved areas of the world, Aerostar is pioneering leading-edge applications of its high-altitude balloons. While in its early stages, this program positions Aerostar for significant growth potential, albeit with a higher risk of uncertainty.

**Sales volumes.** Net sales for the current quarter did not reach last year's second quarter levels, declining 23% from \$26.8 million to \$20.7 million. Year-to-date sales of \$42.4 million were down \$10.0 million, a year-over-year decrease of 19%. The primary drivers of the quarter and year-to-date sales declines were reduced demand from U.S. government customers resulting in lower sales of parachutes and planned declines in avionics sales. These decreases were partially offset by additional high altitude balloon sales to Google, higher Vista net sales of support activities under existing contracts and increased intercompany sourcing to Applied Technology.

**Gross margin change.** For the six-month period ended July 31, 2013, margins increased about two percentage points compared to the six-month period ended July 31, 2012 due to increased sales of higher-margin product lines and increased sales at Vista.

**Operating expenses.** Second quarter operating expense of \$1.9 million, or 9.0% of net sales, increased from 5.8% of net sales in the second quarter of fiscal 2013. Year-to-date operating expense as a percentage of net sales was also 9.0%, up from 6.7% in the prior year period. Increased R&D spending on product development and selling expense associated with product demonstration over lower sales volumes drove the percentage higher in the current year.

Corporate Expenses (administrative expenses; other (expense), net; and income taxes)

| (dollars in thousands)                  | Three Months Ended |                  | Six Months Ended |                  |
|---|--------------------|------------------|------------------|------------------|
|   | July 31,<br>2013   | July 31,<br>2012 | July 31,<br>2013 | July 31,<br>2012 |
| Administrative expenses                 | \$5,019            | \$4,647          | \$9,781          | \$8,807          |
| Administrative expenses as a % of sales | 5.4 %              | 4.6 %            | 5.0 %            | 4.0 %            |
| Other (expense), net                    | \$(219 )           | \$(96 )          | \$(417 )         | \$(148 )         |
| Effective tax rate                      | 32.5 %             | 33.2 %           | 32.5 %           | 33.0 %           |

Administrative expenses for the three- and six-month periods ended July 31, 2013 increased \$0.4 million, or 8%, and \$1.0 million, or 11%, respectively, compared to the three- and six-month periods ended July 31, 2012. This increase is due to the Company's investments in additional finance, legal, human resources and information technology personnel to support current and future growth strategies through a strengthened corporate infrastructure. This growth has been tempered over the last two quarters and the number of employees in these roles has remained relatively consistent.

Other (expense), net consists mainly of activity related to the company's equity investment, interest income and foreign currency transaction gains or losses.

## OUTLOOK

Raven continues to become a more technology-focused Company - centered on solving the specific great challenges of hunger, security, energy independence and natural resource preservation and serving our core markets. Raven is transitioning from a company with a strong contract manufacturing orientation to one that is driven by proprietary products and services. During this

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evolution, management anticipates some volatility in our results. And, as expected, the economic headwinds and near-term challenges faced in the fiscal first quarter persisted in our second quarter.

Aerostar in particular continued to be impacted by reduced demand from U.S. agency customers and planned transition away from electronic manufacturing services for avionics customers that do not fit our business model. Management is working to compensate for government uncertainty by focusing on expanding proprietary technology revenues, including advanced radar systems, high altitude research balloons and aerostats to international markets. Over the past three years, the Company has been allocating capital to these three breakout growth drivers, believing that over the course of the next two to three years any one of these more speculative, higher risk growth opportunities could double or triple the size of the division, or any of them could deliver just enough revenue to cover their cost of capital.

As a diversified company, management considers this Aerostar role a benefit, believing that Applied Technology and Engineered Films are well positioned to deliver more incremental growth, and Aerostar provides the potential for strong upside, albeit with a higher risk of uncertainty. Management expects to see strength across each of the divisions during the third quarter. Applied Technology will be driven by sales of new products and improving market conditions. Engineered Films will continue to leverage opportunity in agricultural barrier films and move forward with new film capabilities while working to increase sales in the energy market which management believes is stabilizing. Aerostar will continue to experience reduced demand from Raven's U.S. government customers, but the Company has opportunities to substantially offset this by increasing Vista and other proprietary product sales. The Company's strong balance sheet and technological leadership in its chosen markets gives management confidence for the long-term, despite potentially volatile results as we transition to a more technology-driven company. Management continues to expect a stronger second-half performance on a year-over-year comparative basis, but does not believe that will be enough to deliver profit growth for the full year. Management expects to achieve attractive returns on equity and will continue to deliver strong returns to shareholders through dividends and long-term growth.

#### LIQUIDITY AND CAPITAL RESOURCES

The Company's balance sheet continues to reflect significant liquidity and a strong capital base. Management focuses on the current cash balance and operating cash flows in considering liquidity, as operating cash flows have historically been Raven's primary source of liquidity. Management expects that current cash, combined with the generation of positive operating cash flows, will be sufficient to fund the Company's normal operating, investing and financing activities. Sufficient borrowing capacity also exists if necessary for a large acquisition or major business expansion.

Raven's cash needs are seasonal, with working capital demands strongest in the first quarter. As a result, the discussion of trends in operating cash flows focuses on the primary drivers of year-over-year variability in working capital. Cash and cash equivalents totaled \$55.7 million at July 31, 2013, an increase of \$6.3 million from \$49.4 million at January 31, 2013. The comparable balance one year earlier was \$44.1 million.

Raven has an uncollateralized credit agreement that provides a \$10.5 million line of credit and expires November 30, 2013. There is no outstanding balance under the line of credit at July 31, 2013. The line of credit is reduced by outstanding letters of credit totaling \$0.9 million as of July 31, 2013.

#### Operating Activities

Operating cash flows result primarily from cash received from customers, which is offset by cash payments for inventories, services, employee compensation and income taxes. Management evaluates working capital levels through the computation of average days sales outstanding and inventory turnover. Average days sales outstanding is a measure of the Company's efficiency in enforcing its credit policy. The inventory turnover ratio is a metric used to evaluate the effectiveness of inventory management, with further consideration given to balancing the disadvantages of excess inventory with the risk of delayed customer deliveries.

Cash provided by operating activities was \$29.7 million for the first six months of fiscal 2014 compared with \$44.5 million in the first six months of fiscal 2013. The decrease in operating cash flows is the result of lower company

earnings, less cash generated by the change in accounts receivable balances and an increase in cash consumed by inventory changes. These decreases were partially offset by cash generated by the change in operating liabilities, primarily driven by accounts payable.

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Changes in inventory and accounts receivable consumed \$1.2 million of cash in the first six months of fiscal 2014 compared to generating \$15.2 million one year ago. The Company's inventory turnover rate declined slightly from the prior year despite the higher raw materials inventory levels (trailing 12-month inventory turn of 5.2X in fiscal 2014 versus 5.3X in fiscal 2013). Cash collections continue to be efficient despite the increase in trailing 12 months days sales outstanding of 51 days at July 31, 2013 compared to 48 days at July 31, 2012.

#### Investing Activities

Cash used in investing activities totaled \$14.3 million in the first six months of fiscal 2014 compared to \$16.8 million in the first six months of fiscal 2013. Year-to-date capital spending consisted primarily of expenditures to expand Engineered Films' manufacturing capacity, facility expansion for Aerostar and renovation of the Company's headquarters.

The Company continued its commitment to investment in its business for long-term growth. In addition, management will evaluate strategic acquisitions that result in expanded capabilities and solidify competitive advantages. Management anticipates fiscal 2014 capital spending of approximately \$30 million.

#### Financing Activities

Cash used in financing activities was \$9.0 million for the six months ended July 31, 2013 compared to \$9.3 million one year ago. Dividends of \$8.7 million, or 24.0 cents per share, were paid during the current year compared to \$7.6 million, or 21.0 cents per share, in the prior year. During the six months ended July 31, 2013 and July 31, 2012, the Company made payments of \$0.4 million and \$1.9 million, respectively, on acquisition-related contingent liabilities.

#### OFF-BALANCE SHEET ARRANGEMENTS AND CONTRACTUAL OBLIGATIONS

There have been no material changes since the fiscal year ended January 31, 2013.

#### ACCOUNTING PRONOUNCEMENTS

##### Accounting Standards Adopted

During the six months ended July 31, 2013 the following accounting pronouncements were adopted or effective that are of significance, or potential significance, to the Company.

In February 2013 the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2013-02, "Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income (AOCI)" (ASU No. 2013-02). ASU No. 2013-02 requires that an entity present, either on the face of the statement where net income is reported or in the notes, the effect of significant reclassifications out of AOCI to net income when GAAP requires that the amount be reclassified in its entirety to net income. For amounts not required to be entirely reclassified to net income, ASU No. 2013-02 requires the cross-referencing of these amounts to other disclosures that provide detail about these amounts. This guidance, required to be applied prospectively, was effective for the Company on February 1, 2013. The adoption of this guidance had no effect on the Company's consolidated financial position, results of operations or cash flows as it is disclosure-only in nature.

##### Pending Accounting Standards

At July 31, 2013 there are no accounting pronouncements pending that are of significance, or potential significance, to the Company.

#### FORWARD-LOOKING STATEMENTS

Certain statements contained in this Quarterly Report on Form 10-Q are "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, including statements regarding the expectations, beliefs, intentions or strategies regarding the

future. Without limiting the foregoing, the words “anticipates,” “believes,” “expects,” “intends,” “may,” “plans” and similar expressions are intended to identify forward-looking statements. The Company intends that all forward-looking statements be subject to the safe harbor provisions of the Private Securities Litigation Reform Act. Although management believes that the expectations reflected in forward-looking statements are based on reasonable assumptions, there is no assurance that these assumptions are correct or that these expectations will be achieved. Assumptions involve important risks and uncertainties that could significantly affect results in the future. These risks and uncertainties include, but are not limited to, those relating to weather conditions and commodity prices, which could affect sales and profitability in some of the Company’s primary markets, such as agriculture, construction, and oil and gas drilling; or changes in competition, raw material availability, technology or relationships with the Company’s largest customers, risks and uncertainties relating to development of new technologies to satisfy customer requirements, possible development of competitive technologies, ability to scale production of new products without negatively impacting quality and cost, and ability to finance investment and working capital needs for new development projects, as well as other risks described in the Company's 10-K for the fiscal year ended January 31, 2013 and the 10-Q for the period ended July 31, 2013 under Item 1A. This list is not exhaustive,

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and the Company does not have an obligation to revise any forward-looking statements to reflect events or circumstances after the date these statements are made.

### ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The exposure to market risks pertains mainly to changes in interest rates on cash and cash equivalents and short-term investments. The Company has no debt outstanding as of July 31, 2013. The Company does not expect operating results or cash flows to be significantly affected by changes in interest rates. Additionally, the Company does not enter into derivatives or other financial instruments for trading or speculative purposes. However, the Company does utilize derivative financial instruments to manage the economic impact of fluctuation in foreign currency exchange rates on those transactions that are denominated in currency other than its functional currency, which is the U.S. dollar. The use of these financial instruments had no material effect on the Company's financial condition, results of operations or cash flows.

The Company's subsidiaries that operate outside the United States use their local currency as the functional currency. The functional currency is translated into U.S. dollars for balance sheet accounts using the period-end exchange rates and average exchange rates for the statement of income. Adjustments resulting from financial statement translations are included as cumulative translation adjustments in accumulated other comprehensive income (loss) within shareholders' equity. Foreign currency transaction gains or losses are recognized in the period incurred and are included in "Other (expense), net" in the Consolidated Statements of Income and Comprehensive Income. Foreign currency fluctuations had no material effect on the Company's financial condition, results of operations or cash flows.

### ITEM 4. CONTROLS AND PROCEDURES

#### Evaluation of Disclosure Controls and Procedures

Disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) of the Securities and Exchange Act of 1934, as amended (the Exchange Act)) are our controls and other procedures that are designed to ensure that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is accumulated and communicated to our management, including our Chief Executive Officer (CEO) and Chief Financial Officer (CFO), as appropriate to allow timely decisions regarding required disclosure.

As of July 31, 2013, the end of the period covered by this report, management evaluated the effectiveness of the Company's disclosure controls and procedures as of such date. Based on their evaluation, the CEO and CFO have concluded that the Company's disclosure controls and procedures were effective as of July 31, 2013.

#### Changes in Internal Control over Financial Reporting

There were no changes in the Company's internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) that occurred during the quarter ended July 31, 2013 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.



RAVEN INDUSTRIES, INC.

PART II — OTHER INFORMATION

Item 1. Legal Proceedings:

The Company is involved as a defendant in lawsuits, claims or disputes arising in the normal course of business. The potential costs and liability of such claims cannot be determined at this time. Management believes that any liability resulting from these claims will be substantially mitigated by insurance coverage. Accordingly, management does not believe the ultimate outcome of these matters will be significant to its results of operations, financial position or cash flows.

Item 1A. Risk Factors: Information on the Company's risk factors is set forth in Item 1A "Risk Factors" in the Company's Annual Report on Form 10-K for the year ended January 31, 2013. In addition, the Company recognizes potential risks of growth including uncertainties relating to development of new technologies to satisfy customer requirements, possible development of competitive technologies, ability to scale production of new products without negatively impacting quality and cost, and ability to finance investment and working capital needs for new development projects.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds: None

Item 3. Defaults Upon Senior Securities: None

Item 4. Mine Safety Disclosures: None

Item 5. Other Information: None

Item 6. Exhibits:

| Exhibit Number | Description   |
|----------------|---|
| 31.1           | Certification of Chief Executive Officer Pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 31.2           | Certification of Chief Financial Officer Pursuant to Rule 13a-14(a) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 32.1           | Certification of Chief Executive Officer Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.                                |
| 32.2           | Certification of Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.                                |
| 101.INS        | XBRL Instance Document  |
| 101.SCH        | XBRL Taxonomy Extension Schema  |
| 101.CAL        | XBRL Taxonomy Extension Calculation Linkbase  |
| 101.DEF        | XBRL Taxonomy Extension Definition Linkbase   |

101.LAB XBRL Taxonomy Extension Label Linkbase

101.PRE XBRL Taxonomy Extension Presentation Linkbase

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**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

RAVEN INDUSTRIES, INC.

/s/ Thomas Iacarella

Thomas Iacarella

Vice President and Chief Financial Officer

(Principal Financial and Accounting Officer)

Date: August 29, 2013

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