ESCO TECHNOLOGIES INC
Form 10-Q
February 09, 2009

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 DECEMBER 31, 2008

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 1-10596

ESCO TECHNOLOGIES INC.

(Exact name of registrant as specified in its charter)

MISSOURI	43-1554045
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
9900A CLAYTON ROAD ST. LOUIS, MISSOURI	63124-1186
(Address of principal executive offices)	(Zip Code)

(314) 213-7200
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days.
Yes 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 acceleratedfiler	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

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

Class	Outstanding at January 31, 2009
Common stock, $.01 par value per share	26,176,558 shares

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

ESCO TECHNOLOGIES INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)
(Dollars in thousands, except per share amounts)

	Three Months Ended December 31,	
	2008	2007
Net sales	$ 149,171	134,957
Costs and expenses:		
Cost of sales	93,561	84,012
Selling, general and administrative expenses	40,054	33,510
Amortization of intangible assets	4,734	3,597
Interest expense, net	2,619	1,359
Other income, net	(118)	(214)
Total costs and expenses	140,850	122,264
Earnings before income taxes	8,321	12,693
Income tax expense	2,501	4,788
Net earnings from continuing operations	5,820	7,905
Loss from discontinued operations, net of tax of $325	-	(115)
Loss on sale from discontinued operations, net of tax of $4,809	-	(4,974)
Net loss from discontinued operations	-	(5,089)
Net earnings	$ 5,820	2,816
Earnings per share:		
Basic - Continuing operations	$ 0.22	0.31
- Discontinued operations	-	(0.20)
- Net earnings	$ 0.22	0.11

Diluted - Continuing operations	$	0.22	0.30
- Discontinued operations		-	(0.19)
- Net earnings	$	0.22	0.11

See accompanying notes to consolidated financial statements.

ESCO TECHNOLOGIES INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(Dollars in thousands)

	December 31, 2008	September 30, 2008
ASSETS	(Unaudited)	
Current assets:		
Cash and cash equivalents	$ 28,433	28,667
Accounts receivable, net	106,292	135,436
Costs and estimated earnings on long-term contracts, less progress billings of $43,283 and $34,978, respectively	8,477	9,095
Inventories	75,900	66,962
Current portion of deferred tax assets	15,984	15,368
Other current assets	11,540	15,108
Total current assets	246,626	270,636
Property, plant and equipment, net	71,866	72,591
Goodwill	329,775	328,878
Intangible assets, net	233,276	238,223
Other assets	18,174	17,745
Total assets	$ 899,717	928,073
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Short-term borrowings and current portion of long-term debt	$ 50,000	50,000
Accounts payable	41,875	49,329
Advance payments on long-term contracts, less costs incurred of $9,517 and $7,880, respectively	6,725	7,467
Accrued salaries	14,388	20,718
Current portion of deferred revenue	19,663	18,920
Accrued other expenses	22,161	22,249
Total current liabilities	154,812	168,683
Long-term portion of deferred revenue	1,962	2,228
Pension obligations	11,274	12,172
Deferred tax liabilities	84,091	83,515
Other liabilities	9,592	9,588
Long-term debt, less current portion	165,573	183,650
Total liabilities	427,304	459,836
Shareholders' equity:		
Preferred stock, par value $.01 per		

share, authorized 10,000,000 shares	-	-
Common stock, par value $.01 per share, authorized 50,000,000 shares, issued 29,501,454 and 29,465,154 shares, respectively	295	295
Additional paid-in capital	255,591	254,240
Retained earnings	279,290	273,470
Accumulated other comprehensive income (loss), net of tax	(2,504)	556
	532,672	528,561
Less treasury stock, at cost: 3,371,106 and 3,375,106 common shares, respectively	(60,259)	(60,324)
Total shareholders' equity	472,413	468,237
Total liabilities and shareholders' equity	$ 899,717	928,073

See accompanying notes to consolidated financial statements.

ESCO TECHNOLOGIES INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)
(Dollars in thousands)

	Three Months Ended December 31,	
	2008	2007
Cash flows from operating activities:		
Net earnings	$ 5,820	2,816
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Net loss from discontinued operations	-	5,089
Depreciation and amortization	7,534	5,702
Stock compensation expense	1,017	1,207
Changes in operating working capital	9,590	(5,006)
Effect of deferred taxes	(1,695)	7,223
Change in deferred revenue and costs, net	565	(7,593)
Pension contributions	(630)	-
Other	(1,081)	171
Net cash provided by operating activities - continuing operations	21,120	9,609
Net loss from discontinued operations, net of tax	-	(5,089)
Net cash provided by discontinued operations	-	125
Net cash used by operating activities - discontinued operations	-	(4,964)
Net cash provided by operating activities	21,120	4,645
Cash flows from investing activities:		
Acquisition of businesses, net of cash acquired	-	(328,829)
Proceeds from sale of marketable securities	-	4,966
Additions to capitalized software	(875)	(5,574)
Capital expenditures - continuing operations	(1,969)	(4,503)

Net cash used by investing activities - continuing operations	(2,844)	(333,940)
Capital expenditures - discontinued operations	-	(1,126)
Proceeds from divestiture of business, net - discontinued operations	-	74,370
Net cash provided by investing activities - discontinued operations	-	73,244
Net cash used by investing activities	(2,844)	(260,696)
Cash flows from financing activities:		
Proceeds from long-term debt	15,000	274,723
Principal payments on long-term debt	(33,077)	(9,723)
Debt issuance costs	-	(2,965)
Net decrease in short-term borrowings - discontinued operations	-	(2,844)
Excess tax benefit from stock options exercised	782	737
Proceeds from exercise of stock options	400	235
Other	(283)	(211)
Net cash (used) provided by financing activities	(17,178)	259,952
Effect of exchange rate changes on cash and cash equivalents	(1,332)	1,155
Net (decrease) increase in cash and cash equivalents	(234)	5,056
Cash and cash equivalents, beginning of period	28,667	18,638
Cash and cash equivalents, end of period	$ 28,433	23,694

See accompanying notes to consolidated financial statements.

ESCO TECHNOLOGIES INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. BASIS OF PRESENTATION

The accompanying consolidated financial statements, in the opinion of management, include all adjustments, consisting of normal recurring accruals, necessary for a fair presentation of the results for the interim periods presented. The consolidated financial statements are presented in accordance with the requirements of Form 10-Q and consequently do not include all the disclosures required by accounting principles generally accepted in the United States of America (GAAP). For further information refer to the consolidated financial statements and related notes included in the Company's Annual Report on Form 10-K for the fiscal year ended September 30, 2008.

The Company's business is typically not impacted by seasonality, however, the results for the three-month period ended December 31, 2008 are not necessarily indicative of the results for the entire 2009 fiscal year. References to the first quarters of 2009 and 2008 represent the fiscal

quarters ended December 31, 2008 and 2007, respectively.

The Filtertek businesses (excluding TekPackaging) were sold during fiscal 2008 and are accounted for as discontinued operations in accordance with SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." Accordingly, the Filtertek businesses are reflected as discontinued operations in the financial statements and related notes for all periods shown.

2. EARNINGS PER SHARE (EPS)

Basic EPS is calculated using the weighted average number of common shares outstanding during the period. Diluted EPS is calculated using the weighted average number of common shares outstanding during the period plus shares issuable upon the assumed exercise of dilutive common share options and vesting of performance-accelerated restricted shares (restricted shares) by using the treasury stock method. The number of shares used in the calculation of earnings per share for each period presented is as follows (in thousands):

	Three Months Ended December 31,	
	2008	2007
Weighted Average Shares Outstanding - Basic	26,108	25,759
Dilutive Options and Restricted Shares	314	443
Adjusted Shares- Diluted	26,422	26,202

Options to purchase 787,092 shares of common stock at prices ranging from $27.44 - $54.88 and options to purchase 592,046 shares of common stock at prices ranging from $35.69 - $54.88 were outstanding during the three month periods ended December 31, 2008 and 2007, respectively, but were not included in the computation of diluted EPS because the options' exercise prices were greater than the average market price of the common shares. The options expire at various periods through 2013. Approximately 244,000 and 192,000 restricted shares were excluded from the computation of diluted EPS based upon the application of the treasury stock method for the three-month period ended December 31, 2008 and 2007, respectively.

3. SHARE-BASED COMPENSATION

The Company provides compensation benefits to certain key employees under several share-based plans providing for employee stock options and/or performance-accelerated restricted shares (restricted shares), and to non-employee directors under a non-employee directors compensation plan.

Stock Option Plans

The Company's stock option awards are generally subject to graded vesting over a three year service period. All outstanding options were granted at prices equal to fair market value at the date of grant. The options granted

prior to September 30, 2003 have a ten-year contractual life from date of issuance, expiring in various periods through 2013. Beginning in fiscal 2004, the options granted have a five-year contractual life from date of issuance.

The fair value of each option award is estimated as of the date of grant using the Black-Scholes option pricing model. The weighted average assumptions for the periods indicated are noted below. Expected volatility is based on historical volatility of ESCO's stock calculated over the expected term of the option. The risk-free rate for the expected term of the option is based on the U.S. Treasury yield curve in effect at the date of grant. The fair value of each option grant is estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted-average assumptions used for grants in the three-month period ended December 31, 2008: expected dividend yield of 0%; expected volatility of 39.2%; risk-free interest rate of 1.9%; and expected term of 3.8 years. Pre-tax compensation expense related to the stock option awards was $0.5 million and $0.6 million for the three-month periods ended December 31, 2008 and 2007, respectively.

Information regarding stock options awarded under the option plans is as follows:

	Shares	Weighted Avg. Price	Aggregate Intrinsic Value (in millions)	Weighted-Average Remaining Contractual Life
Outstanding at October 1, 2008	1,139,201	$30.40		
Granted	128,300	$37.42		
Exercised	(40,693)	$12.70	$ 0.8	
Cancelled	(15,382)	$46.42		
Outstanding at December 31, 2008	1,211,426	$31.55	$ 13.4	2.3 years
Exercisable at December 31, 2008	978,798	$29.26	$ 12.9	

The weighted-average grant-date fair value of options granted during the three-month periods ended December 31, 2008 and 2007 was $12.09 and $10.98, respectively.

Performance-accelerated Restricted Share Awards

The performance-accelerated restricted shares (restricted shares) vest over five years with accelerated vesting if certain performance targets are achieved. In these cases, if it is probable that the performance condition will be met, the Company recognizes compensation cost on a straight-line basis over the shorter performance period; otherwise, it will recognize compensation cost over the longer service period. Compensation cost for the majority of the outstanding restricted share awards is being recognized over the longer performance period as it is not probable the performance condition will be met. The restricted share award grants were valued at the stock price on the date of grant. Pre-tax compensation expense related to

the restricted share awards was $0.5 million and $0.4 million for the three-month periods ended December 31, 2008 and 2007, respectively.

The following summary presents information regarding outstanding restricted share awards as of December 31, 2008 and changes during the three-month period then ended:

	Shares	Weighted Avg. Price
Nonvested at October 1, 2008	202,895	$41.15
Granted	93,834	$37.39
Nonvested at December 31, 2008	296,729	$39.96

Non-Employee Directors Plan

Pursuant to the non-employee directors compensation plan, each non-employee director receives a retainer of 800 common shares per quarter. Pre-tax compensation expense related to the non-employee director grants was $0.2 million and $0.2 million for the three-month periods ended December 31, 2008 and 2007, respectively.

The total share-based compensation cost that has been recognized in results of operations and included within SG&A was $1.0 million and $1.2 million for the three-month periods ended December 31, 2008 and 2007, respectively. The total income tax benefit recognized in results of operations for share-based compensation arrangements was $0.3 million and $0.3 million for the three-month periods ended December 31, 2008 and 2007. As of December 31, 2008, there was $10.6 million of total unrecognized compensation cost related to share-based compensation arrangements. That cost is expected to be recognized over a weighted-average period of 2.7 years.

4. INVENTORIES

Inventories from continuing operations consist of the following (in thousands):

	December 31, 2008	September 30, 2008
Finished goods	$ 27,328	20,590
Work in process, including long- term contracts	17,542	15,736
Raw materials	31,030	30,636
Total inventories	$ 75,900	66,962

5. COMPREHENSIVE INCOME

Comprehensive income for the three-month periods ended December 31, 2008 and 2007 was $2.8 million and $3.8 million, respectively. For the

three-month period ended December 31, 2008, the Company's comprehensive income was negatively impacted by foreign currency translation adjustments and changes in the interest rate swap totaling $3.0 million. For the three-month period ended December 31, 2007, the Company's comprehensive income was positively impacted by foreign currency translation adjustments and changes in the interest rate swap totaling $1.0 million.

6. BUSINESS SEGMENT INFORMATION

The Company is organized based on the products and services that it offers. Under this organizational structure, the Company operates in three segments: Utility Solutions Group (USG), R. F. Shielding and Test (Test) and Filtration/Fluid Flow (Filtration). The USG segment's operations consist primarily of: Aclara Power-Line Systems Inc. (Aclara PLS), Aclara RF Systems Inc. (Aclara RF), Aclara Software, Doble Engineering Company (Doble) and Comtrak Technologies, L.L.C. (Comtrak). The Aclara companies are suppliers of special purpose fixed network communications systems for electric, gas and water utilities, including hardware and software to support advanced metering applications. Doble provides high-end, diagnostic test solutions for the electrical power delivery industry and is a leading supplier of partial discharge testing instruments used to assess the integrity of high voltage power delivery equipment. Test segment operations consist of ETS-Lindgren L.P. (ETS) and Lindgren R.F. Enclosures, Inc. (Lindgren). The Test segment is principally involved in the design and manufacture of EMC test equipment, test chambers, and electromagnetic absorption materials. The Filtration segment's operations consist of: PTI Technologies Inc. (PTI), VACCO Industries (VACCO) and TekPackaging LLC. PTI and VACCO develop and manufacture a wide range of filtration products and are leading suppliers of filters to the commercial and defense aerospace, satellite and industrial markets.

Management evaluates and measures the performance of its operating segments based on "Net Sales" and "EBIT", which are detailed in the table below. EBIT is defined as earnings from continuing operations before interest and taxes. The table below is presented on the basis of continuing operations and excludes discontinued operations.

(In thousands)	Three Months ended December 31,	
NET SALES	2008	2007
USG	$ 90,015	79,309
Test	35,489	32,065
Filtration	23,667	23,583
Consolidated totals	$149,171	134,957
EBIT		
USG	$ 10,525	13,408
Test	3,234	1,990
Filtration	2,863	3,649
Corporate (loss)	(5,682)	(4,995)
Consolidated EBIT	10,940	14,052
Less: Interest expense	(2,619)	(1,359)
Earnings before income		

taxes	$ 8,321	12,693

7. DEBT

The Company's debt is summarized as follows:

(In thousands)	December 31, 2008	September 30, 2008
Revolving credit facility, including current portion	$215,573	233,650
Current portion of long-term debt	(50,000)	(50,000)
Total long-term debt, less current portion	$165,573	183,650

At December 31, 2008, the Company had approximately $108.0 million available to borrow under the credit facility, plus a $50.0 million increase option, in addition to $28.4 million cash on hand. At December 31, 2008, the Company had $215.6 million of outstanding borrowings under the credit facility and outstanding letters of credit of $6.7 million. The Company classified $50 million as the current portion on long-term debt as of December 31, 2008, as the Company intends to repay this amount within the next twelve months, however, the Company has no contractual obligation to repay during the next twelve months.

The credit facility requires, as determined by certain financial ratios, a facility fee ranging from 15 to 25 basis points per annum on the unused portion. The terms of the facility provide that interest on borrowings may be calculated at a spread over the London Interbank Offered Rate (LIBOR) or based on the prime rate, at the Company's election. The facility is secured by the unlimited guaranty of the Company's material domestic subsidiaries and a 65% pledge of the material foreign subsidiaries' share equity. The financial covenants of the credit facility include a leverage ratio and an interest coverage ratio.

8. INCOME TAX EXPENSE

The first quarter 2009 effective income tax rate for continuing operations was 30.1% compared to 37.7% in the first quarter of 2008. On October 3, 2008, the President of the United States signed into law the Tax Extenders and Alternative Minimum Tax Relief Act of 2008. Accordingly, the first quarter 2009 income tax was favorably impacted by an additional $0.7 million, net, research credit for fiscal 2008, reducing the 2009 first quarter effective income tax rate by 8.3%. The Company estimates the annual effective tax rate for fiscal 2009 to be approximately 36%.

During the fourth quarter of 2008, the Internal Revenue Service commenced examination of the Company's U.S. Federal income tax return for the periods ended September 30, 2003 through September 30, 2006 (fiscal 2003-2006). It is reasonably possible that the fiscal 2003-2006 U.S. audit cycle will be completed within the next twelve months, which could result in a decrease in the Company's balance of unrecognized tax benefits. However, an estimate of a range cannot be determined at this time. Various state tax years from 2003 through 2007 remain subject to income tax examinations. The Company is subject to income tax in many jurisdictions outside the United States, none of which is individually material to the Company's financial position, statement of cash flows, or results of operations.

9. RETIREMENT PLANS

A summary of net periodic benefit expense for the Company's defined benefit plans for the three-month periods ended December 31, 2008 and 2007 is shown in the following table. Net periodic benefit cost for each period presented is comprised of the following:

(In thousands)	Three Months Ended December 31, 2008	2007
Defined benefit plans		
Interest cost	$713	713
Expected return on assets	(738)	(738)
Amortization of:		
Prior service cost	4	4
Actuarial loss	52	86
Net periodic benefit cost	$ 31	65

10. DERIVATIVE FINANCIAL INSTRUMENTS

Market risks relating to the Company's operations result primarily from changes in interest rates and changes in foreign currency exchange rates. The Company is exposed to market risk related to changes in interest rates and selectively uses derivative financial instruments, including forward contracts and swaps, to manage these risks. During the first quarter of 2008, the Company entered into a two-year amortizing interest rate swap to hedge some of its exposure to variability in future LIBOR-based interest payments on variable rate debt. The swap notional amount for the first year was $175 million amortizing to $100 million in the second year. All derivative instruments are reported on the balance sheet at fair value. The derivative instrument is designated as a cash flow hedge and the gain or loss on the derivative is deferred in accumulated other comprehensive income until recognized in earnings with the underlying hedged item. Including the impact of interest rate swaps outstanding, the interest rates on approximately 50% of the Company's total borrowings were effectively fixed as of December 31, 2008.

The following is a summary of the notional transaction amounts and fair values for the Company's outstanding derivative financial instruments as of December 31, 2008.

(In thousands)	Notional Amount	Average Receive Rate	Average Pay Rate	Fair Value
Interest rate swaps	$100,000	2.19%	3.99%	($2,600)

11. RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

In December 2007, the Financial Accounting Standards Board (FASB) issued SFAS No. 141R, "Business Combinations" (SFAS 141R), which establishes principles and requirements for how an acquirer recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any noncontrolling interest in an acquiree, including the recognition and measurement of goodwill acquired in a business combination. The requirements of SFAS 141R are effective for business combinations for

which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. Earlier adoption is not permitted.

In February 2008, the FASB released FASB Staff Position No. FAS 157-2, "Effective Date of FASB Statement No. 157," which delayed for one year the effective date of SFAS 157 for all non-financial assets and non-financial liabilities, except those that are recognized or disclosed in the financial statements at fair value at least annually. Items in this classification include goodwill, asset retirement obligations, rationalization accruals, intangible assets with indefinite lives and certain other items. The adoption of SFAS 157 with respect to the Company's non-financial assets and liabilities will be effective October 1, 2009, and is not expected to have a significant effect on the Company's financial position or results of operations.

In March 2008, the FASB issued SFAS No. 161, "Disclosures about Derivative Instruments and Hedging Activities, an amendment of FASB Statement No. 133" (SFAS 161). This statement is intended to improve transparency in financial reporting by requiring enhanced disclosures of an entity's derivative instruments and hedging activities and their effects on the entity's financial position, financial performance, and cash flows. SFAS 161 is effective prospectively for financial statements issued for fiscal years and interim periods beginning after November 15, 2008, with early application permitted. The adoption of SFAS 161 is not expected to have a material impact on the Company's financial position or results of operations.

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

RESULTS OF OPERATIONS

The following discussion refers to the Company's results from continuing operations, except where noted. The Filtertek businesses (excluding TekPackaging) were sold during fiscal 2008 and are accounted for as discontinued operations in accordance with SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." Accordingly, the Filtertek businesses are reflected as discontinued operations in the financial statements and related notes for all periods shown. References to the first quarters of 2009 and 2008 represent the fiscal quarters ended December 31, 2008 and 2007, respectively.

NET SALES

Net sales increased $14.2 million, or 10.5%, to $149.2 million for the first quarter of 2009 from $135.0 million for the first quarter of 2008 mainly due to the impact of a full quarter of Doble's operations versus one month in the prior year's first quarter. The Company acquired Doble on November 30, 2007.

-Utility Solutions Group

Net sales increased $10.7 million, or 13.5%, to $90.0 million for the first quarter of 2009 from $79.3 million for the first quarter of 2008. The sales increase in the first quarter of 2009 as compared to the prior year quarter was primarily due to: an increase of $13.8 million from Doble reflecting the impact of a full quarter of operations versus one month in the prior year first quarter; a $20.8 million increase in sales from Aclara RF primarily due to higher gas product Advanced Metering Infrastructure (AMI) deliveries at Pacific Gas & Electric (PG&E) and the shipment of additional water AMI products; partially offset by a $27.1 million decrease in sales at Aclara PLS driven

mainly by a decrease in sales to PG&E. In the first quarter of 2008, the Company recorded revenue of $20.5 million representing the cumulative effect of the recognition of deferred revenue related to the hardware shipments to PG&E to date, as TWACS NG 3.0 was delivered to PG&E in December 2007.

-Test

For the first quarter of 2009, net sales of $35.5 million were $3.4 million, or 10.6%, higher than the $32.1 million of net sales recorded in the first quarter of 2008. The sales increase in the first quarter of 2009 as compared to the prior year quarter was mainly due to: a $2.1 million increase in net sales from the segment's Asian operations due to an increase in large chamber deliveries to the international wireless and electronics end-markets; and a $1.1 million increase in net sales from the segment's U.S. operations driven by the timing of domestic chamber deliveries.

-Filtration

Net sales increased $0.1 million to $23.7 million for the first quarter of 2009 from $23.6 million of net sales for the first quarter of 2008. The sales increase during the fiscal quarter ended December 31, 2008 as compared to the prior year quarter was mainly due to: a $2.2 million increase in sales at VACCO driven by higher military / defense aircraft product shipments; partially offset by a $2.2 million decrease in net sales at PTI due to lower commercial aerospace shipments resulting from the impact of a Boeing strike during the quarter.

ORDERS AND BACKLOG

Backlog was $258.8 million at December 31, 2008 compared with $266.8 million at September 30, 2008. The Company received new orders totaling $141.1 million in the first quarter of 2009 compared to $130.4 million in the prior year quarter. New orders of $86.5 million were received in the first quarter of 2009 related to USG products, $29.9 million related to Test products, and $24.7 million related to Filtration products. New orders of $67.3 million were received in the first quarter of 2008 related to USG products, $33.3 million related to Test products, and $29.8 million related to Filtration products. The Company received orders totaling $28.8 million and $14.2 million from PG&E during the three-month periods ended December 31, 2008 and 2007, respectively.

AMORTIZATION OF INTANGIBLE ASSETS

Amortization of intangible assets was $4.7 million and $3.6 million for the three-month periods ended December 31, 2008 and 2007, respectively. Amortization of intangible assets for the three-month periods ended December 31, 2008 and 2007 included $1.2 million and $0.7 million, respectively, of amortization of acquired intangible assets related to recent acquisitions. The amortization of these acquired intangible assets are included in Corporate's operating results; see "EBIT - Corporate". The remaining amortization expenses consist of other identifiable intangible assets (primarily software, patents and licenses). During the three-month periods ended December 31, 2008 and 2007, the Company recorded $2.9 million and $2.3 million, respectively, of amortization related to Aclara PLS TWACS NG software.

SELLING, GENERAL AND ADMINISTRATIVE EXPENSES

Selling, general and administrative (SG&A) expenses for the first quarter of 2009 were $40.1 million (26.9% of net sales), compared with $33.5 million (24.8% of net sales) for the prior year quarter. The $6.6 million increase in SG&A

spending in the fiscal quarter ended December 31, 2008 as compared to the prior year quarter was primarily due to a $5.5 million increase in SG&A expenses related to Doble, reflecting a full quarter of SG&A expenses versus one month in the prior year's first quarter.

EBIT

The Company evaluates the performance of its operating segments based on EBIT, defined below. EBIT was $10.9 million (7.3% of net sales) for the first quarter of 2009 and $14.1 million (10.4% of net sales) for the first quarter of 2008. The decrease in EBIT for the first quarter of 2009 as compared to the prior year quarter is primarily due to the decrease in margins at Aclara PLS within the Utility Solutions Group segment.

This Form 10-Q contains the financial measure "EBIT", which is not calculated in accordance with generally accepted accounting principles in the United States of America (GAAP). EBIT provides investors and Management with an alternative method for assessing the Company's operating results. The Company defines "EBIT" as earnings from continuing operations before interest and taxes. Management evaluates the performance of its operating segments based on EBIT and believes that EBIT is useful to investors to demonstrate the operational profitability of the Company's business segments by excluding interest and taxes, which are generally accounted for across the entire Company on a consolidated basis. EBIT is also one of the measures Management uses to determine resource allocations within the Company and incentive compensation. The following table presents a reconciliation of EBIT to net earnings from continuing operations.

(In thousands)	Three Months ended December 31,	
	2008	2007
Consolidated EBIT	$10,940	14,052
Less: Interest expense, net	(2,619)	(1,359)
Less: Income tax expense	(2,501)	(4,788)
Net earnings from continuing operations	$ 5,820	7,905

-Utility Solutions Group (USG)

EBIT in the first quarter of 2009 was $10.5 million (11.7% of net sales) compared to $13.4 million (16.9% of net sales) in the prior year quarter. The $2.9 million decrease in EBIT in the first quarter of 2009 as compared to the prior year quarter was mainly due to a significant decrease in EBIT at Aclara PLS resulting from lower sales to PG&E as described above; additional TWACS NG software amortization; and additional costs to support business development efforts related to the pursuit of international AMI market opportunities. All of the other operating units within the USG segment had increases in EBIT dollars as a result of the sales increases noted above. Aclara RF's EBIT dollars increased 70% as compared to the prior year first quarter, in spite of being negatively impacted by $0.8 million of additional design and development costs related to its RF electric AMI product.

-Test

EBIT in the first quarter of 2009 was $3.2 million (9.1% of net sales) as compared to $2.0 million (6.2% of net sales) in the prior year quarter. EBIT

increased $1.2 million as compared to the prior year quarter mainly due to the sales increases in the current quarter; favorable changes in sales mix; and rigorous cost controls. EBIT dollars increased in the segment's U.S. operations, European operations and Asian operations as compared to the prior year first quarter.

-Filtration

EBIT was $2.9 million (12.1% of net sales) and $3.6 million (15.5% of net sales) in the first quarters of 2009 and 2008, respectively. For the first quarter of 2009 as compared to the prior year quarter, EBIT decreased $0.7 million due to lower sales at PTI described above; additional research and development costs; and bid and proposal costs related to the pursuit of a significant number of space related projects at VACCO.

-Corporate

Corporate costs included in EBIT were $5.7 million and $5.0 million for the three-month periods ended December 31, 2008 and 2007, respectively. The increase in Corporate costs in the first quarter of 2009 as compared to the prior year quarter was primarily due to a $0.5 million increase in amortization expense related to acquired intangible assets recorded at Corporate. Corporate costs included $1.2 million and $0.7 million of pretax amortization of acquired intangible assets for the three-month periods ended December 31, 2008 and 2007, respectively. Corporate costs included $1.0 million and $1.2 million of pretax stock compensation expense for the three-month periods ended December 31, 2008 and 2007, respectively.

INTEREST EXPENSE, NET

Interest expense was $2.6 million and $1.4 million for the three-month periods ended December 31, 2008 and 2007, respectively. The increase in interest expense in the first quarter of 2009 as compared to the prior year period is due to the outstanding borrowings under the revolving credit facility.

INCOME TAX EXPENSE

The first quarter 2009 effective income tax rate for continuing operations was 30.1% compared to 37.7% in the first quarter of 2008. On October 3, 2008, the President of the United States signed into law the Tax Extenders and Alternative Minimum Tax Relief Act of 2008. Accordingly, the first quarter 2009 income tax was favorably impacted by an additional $0.7 million, net, research credit for fiscal 2008, reducing the 2009 first quarter effective income tax rate by 8.3%. The Company estimates the annual effective tax rate for fiscal 2009 to be approximately 36%.

There was no material change in the unrecognized tax benefits of the Company during the three months ended December 31, 2008. The Company anticipates a $0.3 million reduction in the amount of unrecognized tax benefits in the next twelve months as a result of lapses of the applicable statute of limitations.

During the fourth quarter of 2008, the Internal Revenue Service commenced examination of the Company's U.S. Federal income tax return for the periods ended September 30, 2003 through September 30, 2006 (fiscal 2003-2006). It is reasonably possible that the fiscal 2003-2006 U.S. audit cycle will be completed within the next twelve months, which could result in a decrease in the Company's balance of unrecognized tax benefits. However, an estimate of a range cannot be determined at this time. Various state tax years from 2003 through 2007 remain subject to income tax examinations. The Company is subject to income tax in many jurisdictions outside the United States, none of which is individually material

to the Company's financial position, statement of cash flows, or results of operations.

CAPITAL RESOURCES AND LIQUIDITY

Working capital from continuing operations (current assets less current liabilities) decreased to $91.8 million at December 31, 2008 from $102.0 million at September 30, 2008. Accounts receivable decreased by $29.1 million in the first quarter of 2009, of which approximately $16 million related to the USG segment driven by significant collections; $7.0 million related to the Test segment; and $6.0 million related to the Filtration segment. Inventories increased by $8.9 million in the first quarter of 2009 primarily related to an increase of approximately $7.0 million in the USG segment to meet forecasted demand for the remainder of 2009.

Net cash provided by operating activities from continuing operations was $21.1 million and $9.6 million for the three-month periods ended December 31, 2008 and 2007, respectively. The increase is mainly due to a decrease in operating working capital requirements.

Capital expenditures from continuing operations were $2.0 million and $4.5 million in the first quarter of fiscal 2009 and 2008, respectively. The decrease in the first quarter of 2009 as compared to the prior year period is mainly due to expenditures of $2.7 million for the ETS Austin facility expansion which occurred in the first quarter of 2008.

Credit facility

At December 31, 2008, the Company had approximately $108.0 million available to borrow under the credit facility, plus a $50.0 million increase option, in addition to $28.4 million cash on hand. At December 31, 2008, the Company had $215.6 million of outstanding borrowings under the credit facility and outstanding letters of credit of $6.7 million. The Company classified $50.0 million as the current portion on long-term debt as of December 31, 2008, as the Company intends to repay this amount within the next twelve months, however, the Company has no contractual obligation to repay during the next twelve months. Cash flow from operations and borrowings under the Company's bank credit facility are expected to meet the Company's capital requirements and operational needs for the foreseeable future.

Pacific Gas & Electric

Refer to "Pacific Gas & Electric" in "Management's Discussion and Analysis" appearing in the Company's Annual Report on Form 10-K for the fiscal year ended September 30, 2008 for further discussion about the Company's contracts with PG&E.

CRITICAL ACCOUNTING POLICIES

Management has evaluated the accounting policies used in the preparation of the Company's financial statements and related notes and believes those policies to be reasonable and appropriate. Certain of these accounting policies require the application of significant judgment by Management in selecting appropriate assumptions for calculating financial estimates. By their nature, these judgments are subject to an inherent degree of uncertainty. These judgments are based on historical experience, trends in the industry, information provided by

customers and information available from other outside sources, as appropriate. The most significant areas involving Management judgments and estimates may be found in the Critical Accounting Policies section of Management's Discussion and Analysis and in Note 1 to the Consolidated Financial Statements contained in the Company's Annual Report on Form 10-K for the fiscal year ended September 30, 2008 at Exhibit 13.

OTHER MATTERS

Contingencies

As a normal incident of the businesses in which the Company is engaged, various claims, charges and litigation are asserted or commenced against the Company. In the opinion of Management, final judgments, if any, which might be rendered against the Company in current litigation are adequately reserved, covered by insurance, or would not have a material adverse effect on its financial statements.

RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

In December 2007, the FASB issued SFAS No. 141R, "Business Combinations" (SFAS 141R), which establishes principles and requirements for how an acquirer recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any noncontrolling interest in an acquiree, including the recognition and measurement of goodwill acquired in a business combination. The requirements of SFAS 141R are effective for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. Earlier adoption is not permitted.

In February 2008, the FASB released FASB Staff Position No. FAS 157-2, "Effective Date of FASB Statement No. 157," which delayed for one year the effective date of SFAS 157 for all non-financial assets and non-financial liabilities, except those that are recognized or disclosed in the financial statements at fair value at least annually. Items in this classification include goodwill, asset retirement obligations, rationalization accruals, intangible assets with indefinite lives and certain other items. The adoption of SFAS 157 with respect to the Company's non-financial assets and liabilities will be effective October 1, 2009, and is not expected to have a significant effect on the Company's financial position or results of operations.

In March 2008, the FASB issued SFAS No. 161, "Disclosures about Derivative Instruments and Hedging Activities, an amendment of FASB Statement No. 133" (SFAS 161). This statement is intended to improve transparency in financial reporting by requiring enhanced disclosures of an entity's derivative instruments and hedging activities and their effects on the entity's financial position, financial performance, and cash flows. SFAS 161 is effective prospectively for financial statements issued for fiscal years and interim periods beginning after November 15, 2008, with early application permitted. The adoption of SFAS 161 is not expected to have a material impact on the Company's financial position or results of operations.

FORWARD LOOKING STATEMENTS

Statements in this report that are not strictly historical are "forward looking" statements within the meaning of the safe harbor provisions of the federal securities laws. Forward looking statements include, but are not limited to, those relating to the estimates or projections made in connection with the Company's accounting policies, timing and amount of repayment of debt, annual

effective tax rate, the reduction in the amount of unrecognized tax benefits over the next twelve months, the impact of SFAS 157 and SFAS 161, outcome of current claims and litigation, future cash flow, capital requirements and operational needs for the foreseeable future, and the results of tax audits. Investors are cautioned that such statements are only predictions, and speak only as of the date of this report. The Company's actual results in the future may differ materially from those projected in the forward-looking statements due to risks and uncertainties that exist in the Company's operations and business environment including, but not limited to: the risk factors described in Item 1A of the Company's Annual Report on Form 10-K for the fiscal year ended September 30, 2008, the effect of the American Recovery and Reinvestment Act of 2009, actions by PG&E impacting PG&E's AMI projects, the Company's successful performance of large AMI contracts; weakening of economic conditions in served markets; changes in customer demands or customer insolvencies; competition; intellectual property rights; material changes in the costs of certain raw materials including steel and copper; delivery delays or defaults by customers; termination for convenience of customer contracts; timing and magnitude of future contract awards; performance issues with key suppliers, customers and subcontractors; collective bargaining and labor disputes; changes in laws and regulations including changes in accounting standards and taxation requirements; costs relating to environmental matters; litigation uncertainty; and the Company's successful execution of internal operating plans and integration of newly acquired businesses.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Market risks relating to the Company's operations result primarily from changes in interest rates and changes in foreign currency exchange rates. The Company is exposed to market risk related to changes in interest rates and selectively uses derivative financial instruments, including forward contracts and swaps, to manage these risks. During the first quarter of 2008, the Company entered into a two-year amortizing interest rate swap to hedge some of its exposure to variability in future LIBOR-based interest payments on variable rate debt. The swap notional amount for the first year was $175 million amortizing to $100 million in the second year. All derivative instruments are reported on the balance sheet at fair value. The derivative instrument is designated as a cash flow hedge and the gain or loss on the derivative is deferred in accumulated other comprehensive income until recognized in earnings with the underlying hedged item. Including the impact of interest rate swaps outstanding, the interest rates on approximately 50% of the Company's total borrowings were effectively fixed as of December 31, 2008.

The following is a summary of the notional transaction amounts and fair values for the Company's outstanding derivative financial instruments by as of December 31, 2008.

(In thousands)	Notional Amount	Average Receive Rate	Average Pay Rate	Fair Value
Interest rate swaps	$100,000	2.19%	3.99%	($2,600)

In addition, the Company pays 75bps spread on its outstanding debt. Refer to the Company's Annual Report on Form 10-K for the fiscal year ended September 30, 2008 for further discussion about market risk.

ITEM 4. CONTROLS AND PROCEDURES

The Company carried out an evaluation, under the supervision and with the participation of Management, including the Company's Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures as of the end of the period covered by this report. Based upon that evaluation, the Company's Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures were effective as of that date. Disclosure controls and procedures are controls and procedures that are designed to ensure that information required to be disclosed in Company reports filed or submitted under the Securities Exchange Act of 1934 (the "Exchange Act") is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms. There has been no change in the Company's internal control over financial reporting (as defined in Rule 13a-15(f) under the Exchange Act) during the period covered by this report that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II. OTHER INFORMATION

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

In August 2008, the Company's Board of Directors authorized an open market common stock repurchase program of the Company's shares in a value not to exceed $30 million, subject to market conditions and other factors, which covers the period through September 30, 2009. There were no stock repurchases during the three-month period ended December 31, 2008.

ITEM 6. EXHIBITS

a) Exhibits

Exhibit Number		
3.1	Restated Articles of Incorporation	Incorporated by reference to Form 10-K for the fiscal year ended September 30, 1999, at Exhibit 3(a)
3.2	Amended Certificate of Designation Preferences and Rights of Series A Participating Cumulative Preferred Stock of the Registrant	Incorporated by reference to Form 10-Q for the fiscal quarter ended March 31, 2000, at Exhibit 4(e)
3.3	Articles of Merger effective July 10, 2000	Incorporated by reference to Form 10-Q for the fiscal quarter ended June 30, 2000, at Exhibit 3(c)
3.4	Bylaws, as amended and restated as of July 10, 2000	Incorporated by reference to Form 10-K for the fiscal year ended September 30,

		2003, at Exhibit 3.4
3.5	Amendment to Bylaws effective as of February 2, 2007	Incorporated by reference to Form 10-Q for the fiscal quarter ended December 31, 2006, at Exhibit 3.5
3.6	Amendment to Bylaws effective as of November 9, 2007	Incorporate by reference to Current Report on Form 8-K dated November 12, 2007 at Exhibit 3.1
4.1	Specimen Common Stock Certificate	Incorporated by reference to Form 10-Q for the fiscal quarter ended June 30, 2000, at Exhibit 4(a)
4.2	Specimen Rights Certificate	Incorporated by reference to Current Report on Form 8-K dated February 3, 2000, at Exhibit B to Exhibit 4.1
4.3	Rights Agreement dated as of September 24, 1990 (as amended and Restated as of February 3, 2000) between the Registrant and Registrar and Transfer Company, as successor Rights Agent	Incorporated by reference to Current Report on Form 8-K dated February 3, 2000, at Exhibit 4.1
4.4	Credit Agreement dated as of November 30, 2007 among the Registrant, National City Bank and the lenders from time to time parties thereto	Incorporated by reference to Current Report on Form 8-K dated November 30, 2007, at Exhibit 4.1
*31.1	Certification of Chief Executive Officer relating to Form 10-Q for period ended December 31, 2008	
*31.2	Certification of Chief Financial Officer relating to Form 10-Q for period ended December 31, 2008	
*32	Certification of Chief Executive Officer and Chief Financial Officer relating to Form 10-Q for period ended December 31, 2008	

* Denotes filed or furnished herewith.

SIGNATURE

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.

ESCO TECHNOLOGIES INC.

/s/ Gary E. Muenster
Gary E. Muenster
Executive Vice President and Chief Financial Officer
(As duly authorized officer and principal accounting officer of the registrant)

Dated: February 9, 2009