ESCO TECHNOLOGIES INC
Form 10-Q
August 08, 2008

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 JUNE 30, 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<br>ST. LOUIS, MISSOURI | 63124-1186 |
|---|---|
| (Address of principal executive offices) | (Zip Code) |

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

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 definitions of "large accelerated filer", "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. Large accelerated filer __X__ Accelerated filer ____ Non-accelerated filer ____ Smaller reporting company ____

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

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 July 31, 2008 |
|---|---|
| [Common stock, $.01 par value per share] | 26,035,767 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 June 30, | |
|---|---|---|
| | 2008 | 2007 |
| Net sales | $ 157,669 | 115,365 |
| Costs and expenses: | | |
| Cost of sales | 93,563 | 70,603 |
| Selling, general and administrative expenses | 38,829 | 27,865 |
| Amortization of intangible assets | 4,575 | 2,739 |
| Interest expense (income), net | 2,589 | (131) |
| Other expenses, net | 508 | 2,473 |
| Total costs and expenses | 140,064 | 103,549 |
| Earnings before income taxes | 17,605 | 11,816 |
| Income tax expense | 4,297 | 3,937 |
| Net earnings from continuing operations | 13,308 | 7,879 |
| Earnings from discontinued operations, net of tax of $475 | - | 975 |
| Net earnings | $ 13,308 | 8,854 |
| Earnings per share: | | |
| Basic - Continuing operations | $ 0.51 | 0.30 |
| - Discontinued operations | - | 0.04 |
| - Net earnings | $ 0.51 | 0.34 |
| Diluted - Continuing operations | $ 0.50 | 0.30 |
| - Discontinued operations | - | 0.03 |
| - Net earnings | $ 0.50 | 0.33 |

See accompanying notes to consolidated financial statements.

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

| | Nine Months Ended June 30, | |
|---|---|---|
| | 2008 | 2007 |
| Net sales | $ 427,785 | 304,812 |
| Costs and expenses: | | |
| Cost of sales | 255,838 | 193,315 |
| Selling, general and administrative expenses | 111,885 | 83,056 |
| Amortization of intangible assets | 12,770 | 7,557 |
| Interest expense (income), net | 7,135 | (628) |
| Other expenses, net | 157 | 1,909 |
| Total costs and expenses | 387,785 | 285,209 |
| Earnings before income taxes | 40,000 | 19,603 |
| Income tax expense | 12,705 | 4,122 |
| Net earnings from continuing operations | 27,295 | 15,481 |
| (Loss) earnings from discontinued operations, net of tax of $325 and $868, respectively | (115) | 1,610 |
| Loss on sale of discontinued operations, net of tax of $4,809 | (4,974) | - |
| Net (loss) earnings from discontinued operations | (5,089) | 1,610 |
| Net earnings | $ 22,206 | 17,091 |
| Earnings (loss) per share: | | |
| Basic - Continuing operations | $ 1.06 | 0.60 |
| - Discontinued operations | (0.20) | 0.06 |
| - Net earnings | $ 0.86 | 0.66 |
| Diluted - Continuing operations | $ 1.04 | 0.58 |
| - Discontinued operations | (0.19) | 0.07 |
| - Net earnings | $ 0.85 | 0.65 |

See accompanying notes to consolidated financial statements.

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

| | June 30, 2008 | September 30, 2007 |
|---|---|---|
| ASSETS | (Unaudited) | |
| Current assets: | | |
| Cash and cash equivalents | $ 22,817 | 18,638 |
| Accounts receivable, net | 113,904 | 85,319 |
| Costs and estimated earnings on long-term contracts, less progress billings of $27,278 and $21,292, respectively | 8,676 | 11,520 |
| Inventories | 71,038 | 55,885 |
| Current portion of deferred tax assets | 13,407 | 25,264 |
| Other current assets | 15,770 | 28,054 |
| Current assets of discontinued operations | - | 35,670 |
| Total current assets | 245,612 | 260,350 |
| Property, plant and equipment, net | 74,341 | 50,193 |
| Goodwill | 320,298 | 124,757 |
| Intangible assets, net | 237,173 | 74,624 |
| Other assets | 14,181 | 10,338 |
| Other assets of discontinued operations | - | 55,845 |
| Total assets | $ 891,605 | 576,107 |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | |
| Current liabilities: | | |
| Short-term borrowings and current portion of long-term debt | $ 30,474 | - |
| Accounts payable | 41,647 | 45,726 |
| Advance payments on long-term contracts, less costs incurred of $10,858 and $2,902, respectively | 6,084 | 3,408 |
| Accrued salaries | 17,248 | 12,348 |
| Current portion of deferred revenue | 18,980 | 24,621 |
| Accrued other expenses | 20,679 | 16,103 |
| Current liabilities of discontinued operations | - | 16,994 |
| Total current liabilities | 135,112 | 119,200 |
| Long-term portion of deferred revenue | 9,361 | 4,514 |
| Pension obligations | 9,474 | 8,029 |
| Deferred tax liabilities | 81,245 | 18,522 |
| Other liabilities | 8,853 | 7,825 |
| Long-term debt, less current portion | 200,000 | - |
| Other liabilities of discontinued operations | - | 2,534 |
| Total liabilities | 444,045 | 160,624 |

| | | |
|---|---|---|
| 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 29,408,457 and 29,159,629 shares, respectively | 294 | 292 |
| Additional paid-in capital | 251,502 | 243,131 |
| Retained earnings | 248,965 | 226,759 |
| Accumulated other comprehensive income, net of tax | 7,189 | 6,303 |
| | 507,950 | 476,485 |
| Less treasury stock, at cost: 3,379,106 and 3,416,966 common shares, respectively | (60,390) | (61,002) |
| Total shareholders' equity | 447,560 | 415,483 |
| Total liabilities and shareholders' equity | $ 891,605 | 576,107 |

See accompanying notes to consolidated financial statements.

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

| | Nine Months Ended June 30, | |
|---|---|---|
| | 2008 | 2007 |
| Cash flows from operating activities: | | |
| Net earnings | $ 22,206 | 17,091 |
| Adjustments to reconcile net earnings to net cash provided by operating activities: | | |
| Net loss (earnings) from discontinued operations | 5,089 | (1,610) |
| Depreciation and amortization | 19,898 | 12,139 |
| Stock compensation expense | 3,230 | 3,758 |
| Changes in operating working capital | (9,457) | (23,510) |
| Effect of deferred taxes | 9,166 | 6,959 |
| Change in deferred revenue and costs, net | 326 | 6,427 |
| Other | 693 | (731) |
| Net cash provided by operating activities - continuing operations | 51,151 | 20,523 |
| Net (loss) earnings from discontinued operations | (5,089) | 1,610 |
| Net changes in assets and liabilities of discontinued operations | 1,412 | (254) |
| Net cash (used) provided by operating activities - discontinued operations | (3,677) | 1,356 |

| | | |
|---|---|---|
| Net cash provided by operating activities | 47,474 | 21,879 |
| Cash flows from investing activities: | | |
| Acquisition of businesses, net of cash acquired - continuing operations | (330,796) | (1,250) |
| Proceeds from sale of marketable securities | 4,966 | - |
| Additions to capitalized software | (9,225) | (22,676) |
| Capital expenditures - continuing operations | (12,618) | (8,262) |
| Net cash used by investing activities - continuing operations | (347,673) | (32,188) |
| Capital expenditures - discontinued operations | (1,126) | (4,939) |
| Proceeds from divestiture of business, net - discontinued operations | 74,370 | - |
| Net cash provided (used) by investing activities - discontinued operations | 73,244 | (4,939) |
| Net cash used by investing activities | (274,429) | (37,127) |
| Cash flows from financing activities: | | |
| Net (decrease) increase in short-term borrowings - discontinued operations | (2,844) | 676 |
| Proceeds from long-term debt | 276,197 | - |
| Principal payments on long-term debt | (45,723) | - |
| Debt issuance costs | (2,965) | - |
| Excess tax benefit from stock options exercised | 737 | 73 |
| Proceeds from exercise of stock options | 4,827 | 1,512 |
| Other | 905 | (1,948) |
| Net cash provided by financing activities | 231,134 | 313 |
| Net increase (decrease) in cash and cash equivalents | 4,179 | (14,935) |
| Cash and cash equivalents, beginning of period | 18,638 | 36,819 |
| Cash and cash equivalents, end of period | $ 22,817 | 21,884 |

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, 2007. Certain 2007 amounts have been reclassified to conform with the 2008 presentation.

The Company's business is typically not impacted by seasonality, however, the results for the three and nine-month periods ended June 30, 2008 are not necessarily indicative of the results for the entire 2008 fiscal year.

As a result of the acquisition of Doble Engineering Company (Doble) in November 2007, the Company changed the name of the Communications segment to the Utility Solutions Group segment. The renaming of this segment more accurately describes the segment's operating activities and strategically aligns the respective operating entities to focus on a single goal of satisfying the expanding AMI, Smart Grid, and other operational requirements of electric, gas and water utilities worldwide. The name change was done in conjunction with the Company's strategic integration and rebranding of its Automated Metering Infrastructure (AMI) related technologies under the brand name Aclara, and renaming the businesses as follows: Distribution Control Systems, Inc. renamed Aclara Power-Line Systems Inc.; Hexagram, Inc. renamed Aclara RF Systems Inc.; and Nexus Energy Software, Inc. renamed Aclara Software Inc.

2. DIVESTITURE

On November 25, 2007, the Company completed the sale of the filtration portion of Filtertek Inc. (Filtertek) to Illinois Tool Works Inc. for $74.4 million, net, of cash. The TekPackaging division of Filtertek was not included in the transaction. The Filtertek businesses 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 presented. A pre-tax loss of $0.2 million related to the sale of Filtertek is reflected in the Company's fiscal 2008 first quarter results in discontinued operations. Filtertek's net sales were $13.7 million for the two-month period ended November 25, 2007 and $18.2 million for the three-month period ended December 31, 2006, respectively. Filtertek's operations were included within the Company's Filtration segment prior to divestiture. The operations of the TekPackaging division, currently operating as TekPackaging LLC, are reflected in continuing operations and continue to be included in the Filtration segment.

The major classes of discontinued assets and liabilities included in the Consolidated Balance Sheet at September 30, 2007 are shown below (in thousands).

| | September 30, 2007 |
|---|---|
| Assets: | |
| Accounts receivable, net | $ 17,675 |
| Inventories | 11,986 |
| Other current assets | 6,009 |
| Current assets | 35,670 |
| Net property, plant & equipment | 28,084 |
| Goodwill | 24,709 |
| Other assets | 3,052 |
| Total assets of Discontinued Operations | $ 91,515 |
| Liabilities: | |

| | |
|---|---|
| Accounts payable | $ 8,908 |
| Accrued expenses and other current liabilities | 8,086 |
| Current liabilities | 16,994 |
| Other liabilities | 2,534 |
| Total liabilities of Discontinued Operations | $ 19,528 |

3. ACQUISITION

On November 30, 2007, the Company acquired the capital stock of Doble for a purchase price of approximately $328 million, net of cash acquired. Doble, headquartered in Watertown, Massachusetts, is a worldwide leader in providing high-end diagnostic test solutions for the electric utility industry. The acquisition aligns with the Company's long-term growth strategy of expanding its products and services in the utility industry. The acquisition was funded by a combination of the Company's existing cash, including the proceeds from the divestiture of Filtertek, and borrowings under a new $330 million credit facility led by National City Bank. The operating results for Doble, since the date of acquisition, are included within the Utility Solutions Group segment.

The acquisition was recorded by allocating the cost of completing the acquisition to the assets acquired, including identifiable intangible assets and liabilities assumed, based on their estimated fair values at the acquisition date pursuant to SFAS No. 141, "Business Combinations". The excess of the cost of the acquisition over the net amounts assigned to the fair value of the assets acquired and the liabilities assumed was recorded as goodwill. The final valuation of intangible assets and tax contingencies was completed during the second quarter of 2008. The significant changes from the preliminary valuation included a $36.6 million increase in the value of the trade names, a $21.7 million decrease in goodwill and a $12.5 million increase in deferred tax liabilities. The final valuation of certain tangible assets is expected to be completed prior to September 30, 2008.

The purchase price allocation is as follows:

| (In thousands) | | |
|---|---|---|
| Net tangible assets | | $ 42,196 |
| Identifiable intangible assets: | | |
| Trade names | $ 112,290 | |
| Customer relationships | 52,510 | |
| Software and databases | 3,790 | |
| Total identifiable intangible assets | | 168,590 |
| Goodwill | | 192,591 |
| Long-term deferred tax liabilities | | (65,916) |
| Total cash consideration | | $337,461 |

Reconciliation of purchase price:

| | |
|---|---|
| Purchase price per agreement | $319,000 |
| Add: cash acquired | 9,639 |
| Add: short-term marketable securities acquired | 4,966 |
| Add: transaction costs | 2,574 |
| Add: working capital adjustment, net | 1,282 |
| Total cash consideration | $337,461 |

The identifiable intangible assets consisting of customer relationships will be amortized on a straight-line basis over 20 years and the software and databases will be amortized on a straight-line basis over 5 years. The identifiable intangible asset consisting of trade names has an indefinite life and is not subject to amortization.

Pro Forma Results

The following pro forma financial information for the nine months ended June 30, 2008 and 2007 presents the combined results of operations of ESCO and Doble as if the acquisition had occurred on October 1, 2006, respectively. The pro forma financial information for the periods presented excludes the Filtertek business which was sold on November 25, 2007. The combined results of operations have been adjusted for the impact of certain acquisition-related items, including additional amortization of identifiable intangible assets, additional financing expenses and other direct costs. The impact of pro forma adjustments are tax-effected at the expected future consolidated corporate tax rate.

The unaudited pro forma financial information is not intended to represent, or be indicative of, the Company's consolidated results of operations or financial condition that would have been reported had the acquisition been completed as of the beginning of each of the periods presented. This information is provided for illustrative purposes only and is not necessarily indicative of the Company's future consolidated results of operations or financial condition.

| (In millions, except per share data) | Nine Months ended June 30, | |
|---|---|---|
| | 2008 | 2007 |
| Net sales | $444.1 | 363.7 |
| Net earnings from continuing operations | $ 26.8 | 19.3 |
| Net earnings per share | | |
| Basic | $ 1.04 | 0.74 |
| Diluted | $ 1.02 | 0.73 |

All acquisitions have been accounted for by the purchase method and, accordingly, their results are included in the Company's consolidated financial statements from the respective dates of acquisition. Under the purchase price method, the purchase price is allocated based on the fair value of assets received and liabilities assumed as of the acquisition date.

4. 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 June 30, | | Nine Months Ended June 30, | |
|---|---|---|---|---|
| | 2008 | 2007 | 2008 | 2007 |
| Weighted Average Shares Outstanding - Basic | 25,977 | 25,941 | 25,862 | 25,904 |
| Dilutive Options and Restricted Shares | 425 | 552 | 428 | 578 |
| Adjusted Shares- Diluted | 26,402 | 26,493 | 26,290 | 26,482 |

Options to purchase 265,672 shares of common stock at prices ranging from $43.71 - $54.88 and options to purchase 529,879 shares of common stock at prices ranging from $42.99 - $54.88 were outstanding during the three month periods ended June 30, 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 38,000 and 19,000 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 June 30, 2008 and 2007, respectively.

5. 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. Beginning with fiscal 2006 awards, the Company recognizes compensation cost on a straight-line basis over the requisite service period for the entire award. Prior to fiscal 2006, the Company calculated the pro forma compensation cost using the graded vesting method.

The fair value of each option award is estimated as of the date of grant using a 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. In 2008, the Company utilized historical, company data to develop its expected term assumption. For fiscal years 2006 and 2007, the expected term was calculated in accordance with Staff Accounting Bulletin No. 107 using the simplified method for "plain-vanilla" options. 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 nine-month period ended June 30, 2008: expected dividend yield of 0%; expected volatility of 34.8%; risk-free interest rate of 2.9%; and expected term of 3.8 years. Pre-tax compensation expense related to the stock option awards was $0.5 million and $1.7 million for the three and nine-month periods ended June 30, 2008, respectively, and $0.7 million and $1.9 million for the respective prior year periods.

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, 2007 | 1,558,941 | $30.35 | | |
| Granted | 16,000 | $35.82 | | |
| Exercised | (239,309) | $23.89 | $ 4.4 | |
| Cancelled | (128,146) | $41.91 | | |
| Outstanding at June 30, 2008 | 1,207,486 | $30.48 | $ 20.1 | 2.5 years |
| Exercisable at June 30, 2008 | 939,608 | $26.36 | $ 19.5 | |

The weighted-average grant-date fair value of options granted during the nine-month periods ended June 30, 2008 and 2007 was $10.98 and $12.25, 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 $0.2 million and $1.1 million for the three and nine-month periods ended June 30, 2008, respectively, and $0.2 million and $1.2 million for the respective prior year periods.

The following summary presents information regarding outstanding restricted share awards as of June 30, 2008 and changes during the nine-month period then ended:

| | Shares | Weighted Avg. Price |
|---|---|---|

| | | |
|---|---|---|
| Nonvested at October 1, 2007 | 164,060 | $41.77 |
| Granted | 94,335 | $37.08 |
| Vested | (44,500) | $34.80 |
| Cancelled | (8,000) | $41.74 |
| Nonvested at June 30, 2008 | 205,895 | $41.13 |

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 $0.5 million for the three and nine-month periods ended June 30, 2008, respectively, and $0.2 million and $0.6 million for the respective prior year periods.

The total share-based compensation cost that has been recognized in results of operations and included within SG&A was $0.9 million and $3.2 million for the three and nine-month periods ended June 30, 2008, respectively, and $1.1 million and $3.8 million for the three and nine-month periods ended June 30, 2007. The total income tax benefit recognized in results of operations for share-based compensation arrangements was $0.2 million and $0.8 million for the three and nine-month periods ended June 30, 2008, respectively, and $0.3 million and $1,0 million for the three and nine-month periods ended June 30, 2007. As of June 30, 2008, there was $10.3 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 2.6 years.

6. INVENTORIES

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

| | June 30, 2008 | September 30, 2007 |
|---|---|---|
| Finished goods | $ 18,429 | 17,652 |
| Work in process, including long- term contracts | 17,751 | 13,532 |
| Raw materials | 34,858 | 24,701 |
| Total inventories | $ 71,038 | 55,885 |

7. COMPREHENSIVE INCOME

Comprehensive income for the three-month periods ended June 30, 2008 and 2007 was $14.9 million and $9.8 million, respectively. Comprehensive income for the nine-month periods ended June 30, 2008 and 2007 was $23.1 million and $19.6 million, respectively. For the nine-month period ended June 30, 2008, the Company's comprehensive income was positively impacted by foreign currency translation adjustments of $1.9 million and negatively impacted by interest rate swaps of $1.0 million. For the nine-month period ended June 30, 2007, the Company's comprehensive income was positively impacted by foreign currency translation adjustments of $2.5 million.

8. 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 (formerly the Communications segment), Test and Filtration/Fluid Flow (Filtration). As a result of the acquisition of Doble in November 2007, the Company changed the name of the Communications segment to the Utility Solutions Group segment. The renaming of this segment more accurately describes the segment's operating activities and strategically aligns the respective operating entities to focus on a single goal of satisfying the expanding AMI, Smart Grid, and other operational requirements of electric, gas and water utilities worldwide. The change in segment name was made in conjunction with the Company's strategic integration and rebranding of its AMI related technologies under the brand name Aclara, and renaming the businesses as follows: Distribution Control Systems, Inc. renamed Aclara Power-Line Systems Inc.; Hexagram, Inc. renamed Aclara RF Systems Inc.; and Nexus Energy Software, Inc. renamed Aclara Software Inc. In addition to the AMI businesses operating under the Aclara brand, the Utility Solutions Group also includes Comtrak Technologies, L.L.C. (Comtrak) and Doble. Doble provides high-end, diagnostic test solutions for the electric power delivery industry.

As a result of the divestiture of Filtertek in November 2007, the Company re-evaluated the aggregation criteria of its remaining operating units within the Filtration segment. The TekPackaging LLC business (formerly a division of Filtertek) was not included in the divestiture transaction. Prior to the divestiture of Filtertek, each of the components of the Filtration segment were presented separately due to differing long-term economics. However, as a result of the divestiture of Filtertek, management believes the remaining companies within the Filtration segment now have similar long-term economics and, therefore, will not be presented separately beginning with the first quarter of 2008. The Filtration segment's operations consist of: PTI Technologies Inc., VACCO Industries and TekPackaging LLC.

Test segment operations represent the EMC Group, consisting primarily of ETS-Lindgren L.P. (ETS) and Lindgren R.F. Enclosures, Inc. (Lindgren). The EMC Group is principally involved in the design and manufacture of EMC test equipment, test chambers, and electromagnetic absorption materials.

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 June 30, | | Nine Months ended June 30, | |
|---|---|---|---|---|
| NET SALES | 2008 | 2007 | 2008 | 2007 |
| Utility Solutions Group | $ 93,653 | 53,943 | 247,533 | 133,203 |
| Test | 33,039 | 34,583 | 98,599 | 96,678 |
| Filtration | 30,977 | 26,839 | 81,653 | 74,931 |
| Consolidated totals | $157,669 | 115,365 | 427,785 | 304,812 |

EBIT

| | | | | |
|---|---|---|---|---|
| Utility Solutions Group | $ 17,666 | 8,564 | 41,540 | 11,891 |
| Test | 2,794 | 2,042 | 7,526 | 8,246 |
| Filtration | 5,216 | 5,509 | 13,778 | 12,710 |
| Corporate | (5,482) | (4,430) | (15,709) | (13,872) |
| Consolidated EBIT | 20,194 | 11,685 | 47,135 | 18,975 |
| Add: Interest (expense)/income | (2,589) | 131 | (7,135) | 628 |
| Earnings before income taxes | $ 17,605 | 11,816 | 40,000 | 19,603 |

| IDENTIFIABLE ASSETS | | |
|---|---|---|
| Utility Solutions Group | $201,616 | 147,248 |
| Test | 74,058 | 63,077 |
| Filtration | 59,114 | 59,769 |
| Reconciliation to consolidated totals (Corporate assets) | 556,817 | 283,694 |
| Consolidated totals | $891,605 | 553,788 |

9. DEBT

The Company's debt is summarized as follows:

| (In thousands) | June 30, 2008 | September 30, 2007 |
|---|---|---|
| Revolving credit facility, including current portion | $230,474 | - |
| Current portion of long-term debt | (30,474) | - |
| Total long-term debt, less current portion | $200,000 | - |

On November 30, 2007, in conjunction with the acquisition of Doble, the Company entered into a new $330 million five-year revolving credit facility with a $50 million increase option. This facility replaces the Company's $100 million credit facility that would have otherwise matured in October 2009. The facility is available for direct borrowings and/or the issuance of letters of credit. It is provided by a group of sixteen banks, led by National City Bank as agent, with a maturity of November 30, 2012.

At June 30, 2008, the Company had approximately $97.7 million available to borrow under the credit facility in addition to $22.8 million cash on hand. At June 30, 2008, the Company had $230 million of outstanding borrowings under the credit facility and outstanding letters of credit of $2.3 million. The Company classified $30.5 million as current portion on long-term debt as of June 30, 2008, as the Company intends to repay this amount within the next twelve months.

The new credit facility requires, as determined by certain financial ratios, a facility fee ranging from 15-25 basis points per annum on the revolving line of credit. 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.

10. INCOME TAX EXPENSE

The third quarter of 2008 effective income tax rate for continuing operations was 24.4% compared to 33.3% in the third quarter of 2007. The effective income tax rate from continuing operations in the first nine months of 2008 was 31.8% compared to 21.0% in the prior period. The decrease in the third quarter effective tax rate in 2008 as compared to the prior year was due to a $1.6 million export incentive and a $0.6 million research tax credit which favorably impacted the 2008 third quarter effective tax rate by 8.9% and 3.5%, respectively. Management determined the $1.6 million export incentive is not material to the prior years (2001 - 2006) to which it relates. The third quarter 2007 income tax expense was impacted by the resolution of certain tax exposure items of $0.7 million, reducing the 2007 third quarter effective income tax rate by 5.6%.

The increase in the effective income tax rate in the first nine months of 2008 as compared to the prior year period was due to the favorable impact of research tax credit and the resolution of certain tax exposure items in 2007. The first nine months of 2008 was impacted by a $1.6 million export incentive and a $0.6 million research tax credit which favorably impacted the effective income tax rate in the first nine months of 2008 by 3.9% and 1.6%, respectively. The income tax expense in the first nine months of 2007 was favorably impacted by: $3.1 million, net, research tax credits; and a resolution of certain tax exposure items of $0.7 million, reducing the rate for the first nine months of 2007 by 16.0% and 3.4%, respectively. The Company estimates the fiscal 2008 tax rate to be approximately 34%, excluding the effect of discontinued operations.

Effective October 1, 2007, the Company adopted FASB Interpretation No. 48 (FIN 48), "Accounting for Uncertainty in Income Taxes." FIN 48 provides a financial statement recognition threshold and measurement attribute for a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. The adoption of FIN 48 had the following impact on the Company's financial statements: decreased current assets by $1.5 million, decreased current liabilities by $0.3 million, and decreased long-term liabilities by $1.2 million. As of October 1, 2007, the Company had $6.7 million of unrecognized tax benefits of which $5.9 million, if recognized, would affect the Company's effective tax rate. The Company made no adjustments to retained earnings related to the adoption.

The Company anticipates a $0.3 million reduction in the amount of unrecognized tax benefits in the next twelve months as a result of a lapse of the applicable statute of limitations. The Company's policy is to include interest related to unrecognized tax benefits in income tax expense and penalties in operating expense. As of October 1, 2007, the Company had accrued interest related to uncertain tax positions of $0.1 million, net of federal income tax benefit, on its consolidated balance sheet. No penalties have been accrued due to the Company's net operating loss position.

The principal jurisdictions for which the Company files income tax returns are U.S. federal and the various city, state, and international locations where the Company has operations. Due to the Company's available net operating loss, the 1995 through 2007 U.S. federal tax years remain subject to income tax examinations. The Internal Revenue Service (IRS) will commence examination of the Company's U.S. Federal income tax return for the period ended September 30, 2006 in the fourth quarter of 2008. 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 are individually material to the Company's financial position, statement of cash flows, or results of operations.

11. GOODWILL AND OTHER INTANGIBLE ASSETS

The changes in the carrying amount of goodwill attributable to each business segment from continuing operations for the nine-month period ended June 30, 2008 are presented in the table below.

| (In millions) | Utility Solutions Group | Filtration | Test | Total |
|---|---|---|---|---|
| Balance as of September 30, 2007 | $ 75.4 | 20.3 | 29.1 | 124.8 |
| Acquisitions | 195.1 | - | 0.4 | 195.5 |
| Balance as of June 30, 2008 | $270.5 | 20.3 | 29.5 | 320.3 |

The following table presents the gross carrying amount and accumulated amortization of identifiable intangible assets, other than goodwill, at the dates presented:

| | June 30, 2008 | | | September 30, 2007 | | |
|---|---|---|---|---|---|---|
| | Gross Carrying Amt | Accum Amort | Net | Gross Carrying Amt | Accum Amort | Net |
| Amortized intangible assets: | | | | | | |
| Customer relationships | $ 52.5 | $ 1.5 | $ 51.0 | $ 0.0 | $ 0.0 | $ 0.0 |
| Capitalized software | $ 89.4 | $ 23.6 | $ 65.8 | $ 79.0 | $ 13.6 | $ 65.4 |
| Patents & other | $ 23.5 | $ 18.9 | $ 4.6 | $ 23.3 | $ 17.6 | $ 5.7 |
| Unamortized intangible assets: | | | | | | |
| Trade Names | $115.8 | $ 0.0 | $115.8 | $ 3.5 | $ 0.0 | $ 3.5 |
| Total other intangible assets | $281.2 | $ 44.0 | $237.2 | $105.8 | $ 31.2 | $ 74.6 |

Amortization of intangible assets for the three and nine-month periods ended June 30, 2008 was $4.6 million and $12.8 million, respectively. During the three and nine-month periods ended June 30, 2008, the Company recorded $2.9 million and $8.1 million, respectively, of amortization related to Aclara Power-Line Systems TWACS NG software. Amortization of intangible assets for fiscal years 2008 through 2012 is estimated at approximately $17 million to $22 million per year. The increase in intangible asset amortization in future years is related to the TWACS NG software.

12. RETIREMENT PLANS

A summary of net periodic benefit expense for the Company's defined benefit plans for the three and nine-month periods ended June 30, 2008 and 2007 is shown in the following table. Net periodic benefit cost for each period presented is comprised of the following:

| | Three Months Ended June 30, | | Nine Months Ended June 30, | |
|---|---|---|---|---|
| (In thousands) | 2008 | 2007 | 2008 | 2007 |
| Defined benefit plans | | | | |
| Interest cost | $713 | 688 | 2,138 | 2,063 |
| Expected return on assets | (738) | (700) | (2,213) | (2,100) |
| Amortization of: | | | | |
| Prior service cost | 4 | 2 | 11 | 7 |
| Actuarial loss | 86 | 85 | 259 | 255 |
| Net periodic benefit cost | $ 65 | 75 | 195 | 225 |

13. 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 is $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 75% of the Company's total borrowings were effectively fixed as of June 30, 2008.

The following is a summary of the notional transaction amounts and fair values for the Company's outstanding derivative financial instruments by risk category and instrument type, as of June 30, 2008.

| (In thousands) | Notional Amount | Average Receive Rate | Average Pay Rate | Fair Value |
|---|---|---|---|---|
| Interest rate swaps | $175,000 | 2.68% | 3.99% | ($1,625) |

14. RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements" (SFAS 157), which defines fair value in generally accepted accounting principles and expands disclosures about fair value measurements. This Statement is effective for financial statements issued for fiscal years beginning after November 15, 2007. In February 2008, the FASB amended SFAS

157 to delay the effective date by one year for nonfinancial assets and liabilities that are recognized or disclosed at fair value in the financial statements on a nonrecurring basis. The adoption of SFAS 157 is not expected to have a material impact to the Company's financial position or results of operations.

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 prohibited.

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 to 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

As a result of the acquisition of Doble in November 2007, the Company changed the name of the Communications segment to the Utility Solutions Group segment. The name change was done in conjunction with the Company's strategic integration and rebranding of its AMI related technologies under the brand name Aclara, and renaming the businesses as follows: Distribution Control Systems, Inc. renamed Aclara Power-Line Systems Inc.; Hexagram, Inc. renamed Aclara RF Systems Inc.; and Nexus Energy Software, Inc. renamed Aclara Software Inc.

The following discussion refers to the Company's results from continuing operations, except where noted. The Filtertek businesses (excluding TekPackaging) 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 third quarters of 2008 and 2007 represent the fiscal quarters ended June 30, 2008 and 2007, respectively.

### NET SALES

Net sales increased $42.3 million, or 36.7%, to $157.7 million for the third quarter of 2008 from $115.4 million for the third quarter of 2007 mainly due to the current year acquisition of Doble. Net sales increased $123.0 million, or 40.4% to $427.8 million for the first nine months of 2008 from $304.8 million for the first nine months of 2007. Net sales increased across all segments in the first nine months of 2008 compared to the prior year period, with the most significant increase in the Utility Solutions Group segment of $114.3 million due primarily to an increase in sales volume from the Aclara group and the Doble

acquisition.

-Utility Solutions Group

Net sales increased $39.7 million, or 73.7%, to $93.7 million for the third quarter of 2008 from $53.9 million for the third quarter of 2007. Net sales increased $114.3 million, or 85.8%, to $247.5 million for the first nine months of 2008 from $133.2 million in the prior year period. The sales increase in the third quarter of 2008 as compared to the prior year quarter was due to: an increase of $20.9 million of sales from Doble; a $17.8 million increase in sales from Aclara RF Systems Inc. primarily due to higher gas AMI deliveries at PG&E a $5.8 million increase in sales from Comtrak due to higher shipments to ADT; partially offset by a $5.0 million decrease in sales at Aclara Power-Line Systems driven mainly by lower sales to the investor-owned utility (IOU) market. The sales increase in the first nine months of 2008 as compared to the prior year period was due to: a $59.0 million increase in sales from the Aclara group; $52.0 million of sales from Doble; and a $3.3 million increase in sales from Comtrak due to the timing of product deliveries.

The increase in sales of $59.0 million from the Aclara Group for the first nine months of 2008 as compared to the prior year period was mainly due to: a $33.9 million increase in net sales from Aclara RF Systems Inc. mainly due to a $33.5 million increase in shipments to PG&E for the gas AMI deployment; and a $24.9 million increase in sales from Aclara Power-Line Systems Inc. mainly due to: a $23.0 million increase in sales to PG&E for the electric AMI deployment (of which $20.5 million represented the cumulative effect of the hardware shipments to date as TWACS NG 3.0 was delivered to PG&E in December 2007), an $11.8 million increase in sales to the Puerto Rico Electric Power Authority (PREPA), a $4.5 million increase in sales to other COOP and Municipal customers, partially offset by a $14.3 million decrease in sales to IOU customers.

-Test

For the third quarter of 2008, net sales of $33.0 million were $1.6 million, or 4.5% lower than the $34.6 million of net sales recorded in the third quarter of 2007. Net sales increased $1.9 million, or 2.0%, to $98.6 million for the first nine months of 2008 from $96.7 million for the first nine months of 2007. The sales decrease in the third quarter of 2008 as compared to the prior year quarter was mainly due to: a $3.0 million decrease in net sales from the segment's U.S. operations driven by the timing of domestic chamber deliveries; partially offset by a $1.0 million increase in net sales from the segment's European operations driven by favorable foreign currency values. The sales increase for the first nine months of 2008 compared to the prior year period was due to: a $3.3 million increase in net sales from the segment's European operations driven by favorable foreign currency values and the delivery of test chambers; partially offset by a $2.0 million decrease in net sales from the segment's U.S. operations due to the timing of test chamber sales and sales of components.

-Filtration

Net sales increased $4.1 million, or 15.2%, to $31.0 million for the third quarter of 2008 from $26.9 million of net sales for the third quarter of 2007. Net sales increased $6.8 million, or 9.0%, to $81.7 million for the first nine months of 2008 from $74.9 million in the prior year period. The sales increase during the fiscal quarter ended June 30, 2008 as compared to the prior year quarter was mainly due to: a $2.1 million increase in sales at VACCO driven by higher space product shipments and a $1.2 million increase in sales at TekPackaging LLC. The sales increase in the first nine months of 2008 as compared to the prior year period was mainly due to a $3.7 million increase in commercial aerospace shipments at PTI and a $2.3 million increase in sales at

VACCO driven by higher space product shipments.

ORDERS AND BACKLOG

Backlog from continuing operations was $283.3 million at June 30, 2008 compared with $257.6 million at September 30, 2007. The Company received new orders totaling $159.1 million in the third quarter of 2008 compared to $122.9 million in the prior year quarter. New orders of $96.4 million were received in the third quarter of 2008 related to Utility Solutions Group products (including $7.0 million of Doble related backlog), $34.1 million related to Test products, and $28.6 million related to Filtration products.

The Company received new orders totaling $453.5 million in the first nine months of 2008 compared to $360.1 million in the prior year period. New orders of $263.3 million were received in the first nine months of 2008 related to Utility Solutions Group products (including $7.0 million of Doble related backlog), $100.0 million related to Test products, and $90.2 million related to Filtration products. New orders of $167.9 million were received in the first nine months of 2007 related to Utility Solutions Group products, $106.4 million related to Test products, and $85.8 million related to Filtration products.

In December 2007, the Company signed a contract with PREPA for a total value expected to be $27.0 million for the purchase of Aclara Power-Line Systems meter modules and associated substation equipment to be released through the placement of purchase orders over the next two-and-a-half years. During the first nine months of 2008, the Company recorded $24.8 million in entered orders related to this contract.

On May 21, 2008, the Company announced that PTI Technologies Inc. was awarded a contract to provide hydraulic system components for use on the new Airbus A350 Xtra Wide Body (XWB) aircraft. Production units are expected to be available for delivery in 2012 and, once the A350XWB is in full production, annual revenue from this contract is expected to be approximately $10 million to $15 million, with total potential revenues exceeding $150 million over the production phase of the program.

On July 14, 2008, the Company announced that its Aclara Power-Line Systems Inc. TWACS AMI solution had been selected by Idaho Power (IPC) for its entire electric service territory. The total value of purchase orders anticipated to be issued under this contract are approximately $25 million and the system is expected to be deployed over a three-year period beginning in early fiscal 2009.

On July 23, 2008, the Company announced that the City of New York's Department of Environmental Protection had selected and formally contracted with Aclara RF Systems Inc. to provide its AMI solution for the city's entire water service territory. The total value of purchase orders anticipated to be issued under this contract is approximately $68.3 million and the system is expected to be deployed over a three-year period with the initial orders expected during the fourth quarter of fiscal 2008.

See "CAPITAL RESOURCES AND LIQUIDITY - Pacific Gas & Electric" below for a discussion of PG&E contracts. The Company received orders totaling $31.0 million and $77.5 million from PG&E under these agreements during the three and nine-month periods ended June 30, 2008, respectively. Included in the $31.0 million of orders received from PG&E during the third quarter of 2008 was a $4.7 million order from PG&E for 100,000 Aclara RF System electric devices. Subsequent to June 30, 2008, the Company received an additional $7.8 million of orders from PG&E for 137,000 Aclara RF gas devices.

AMORTIZATION OF INTANGIBLE ASSETS

Amortization of intangible assets was $4.6 million and $12.8 million for the

three and nine-month periods ended June 30, 2008, respectively, compared to $2.7 million and $7.6 million for the respective prior year periods. Amortization of intangible assets for the three and nine-month periods ended June 30, 2008 included $1.1 million and $3.0 million, respectively, of amortization of acquired intangible assets related to recent acquisitions compared to $0.5 million and $1.7 million for the respective prior year periods. 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 and nine-month periods ended June 30, 2008, the Company recorded $2.9 million and $8.1 million, respectively, of amortization related to Aclara Power-Line Systems TWACS NG software compared to $1.8 million and $4.5 million for the respective prior year periods.

SELLING, GENERAL AND ADMINISTRATIVE EXPENSES

Selling, general and administrative (SG&A) expenses for the third quarter of 2008 were $38.8 million (24.6% of net sales), compared with $27.9 million (24.2% of net sales) for the prior year quarter. For the first nine months of 2008, SG&A expenses were $111.9 million (26.2% of net sales) compared with $83.1 million (27.3% of net sales) for the prior year period. The increase in SG&A spending in the fiscal quarter ended June 30, 2008 as compared to the prior year quarter was primarily due to: $7.0 million of SG&A expenses related to Doble and a $3.1 million increase in SG&A related to the Aclara Group mainly due to an increase in sales, marketing, and engineering headcount. The increase in SG&A spending in the first nine months of 2008 as compared to the prior year period was primarily due to $16.7 million of SG&A expenses related to Doble, and a $10.0 million increase in SG&A related to the Aclara Group for the reasons mentioned above.

EBIT

The Company evaluates the performance of its operating segments based on EBIT, defined below. EBIT was $20.2 million (12.8% of net sales) for the third quarter of 2008 and $11.7 million (10.1% of net sales) for the third quarter of 2007. For the first nine months of 2008, EBIT was $47.1 million (11.0% of net sales) and $19.0 million (6.2% of net sales) for the first nine months of 2007. The increase in EBIT for the third quarter of 2008 and first nine months of 2008 as compared to the prior year periods is primarily due to the increase in margins in the Utility Solutions Group segment including the acquisition of Doble.

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 June 30, | | Nine Months ended June 30, | |
|---|---|---|---|---|
| | 2008 | 2007 | 2008 | 2007 |
| Consolidated EBIT | $20,194 | 11,685 | 47,135 | 18,975 |
| Less: Interest (expense), | | | | |

| | | | | |
|---|---|---|---|---|
| net | (2,589) | - | (7,135) | - |
| Add: interest income, net | - | 131 | - | 628 |
| Less: Income tax expense | (4,297) | (3,937) | (12,705) | (4,122) |
| Net earnings from continuing operations | $13,308 | 7,879 | 27,295 | 15,481 |

-Utility Solutions Group

EBIT in the third quarter of 2008 was $17.7 million (18.9% of net sales) compared to $8.6 million (15.9% of net sales) in the prior year quarter. For the first nine months of 2008, EBIT was $41.5 million (16.8% of net sales) compared to $11.9 million (8.9% of net sales) in the prior year period. The $9.1 million increase in EBIT in the third quarter of 2008 as compared to the prior year quarter was due to: the EBIT contribution from Doble; an increase in EBIT from the Aclara Group and Comtrak related to the increased sales volumes. The $29.6 million increase in EBIT for the first nine months of 2008 compared to the prior year period was due to: the EBIT contribution from Doble; and an increase in EBIT from the Aclara Group related to the increased sales volumes (of which approximately $9 million related to the recognition of deferred revenue for PG&E from Aclara Power-Line Systems).

-Test

EBIT in the third quarter of 2008 was $2.8 million (8.5% of net sales) as compared to $2.0 million (5.9% of net sales) in the prior year quarter. For the first nine months of 2008, EBIT was $7.5 million (7.6% of net sales) as compared to $8.2 million (8.5% of net sales) in the prior year period. EBIT increased $0.8 million as compared to the prior year quarter mainly due to changes in product mix and an increase in EBIT from the segment's European operations related to the increased sales volumes. EBIT decreased $0.7 million as compared to the prior year nine-month period primarily due to $0.9 million of non-recurring costs associated with the facility consolidation in Austin, Texas that was completed in January 2008.

-Filtration

EBIT was $5.2 million (16.8% of net sales) and $5.5 million (20.5% of net sales) in the third quarters of 2008 and 2007, respectively, and $13.8 million (16.9% of net sales) and $12.7 million (17.0% of net sales) in the first nine months of 2008 and 2007, respectively. For the third quarter of 2008 as compared to the prior year quarter, EBIT decreased $0.3 million due to slight decreases at PTI and VACCO due to changes in product mix. For the first nine months of 2008 as compared to the prior year period, EBIT increased $1.1 million primarily due to: an increase at PTI due to higher commercial aerospace shipments; an increase at TekPackaging LLC; partially offset by a decrease at VACCO due to changes in product mix.

-Corporate

Corporate costs included in EBIT were $5.5 million and $15.7 million for the three and nine-month periods ended June 30, 2008, respectively, compared to $4.4 million and $13.9 million for the respective prior year periods. The increase in Corporate costs in the first nine months of 2008 as compared to the prior year period was primarily due to a $1.3 million increase in amortization expense related to acquired intangible assets recorded at Corporate and a $0.6 million decrease in royalty income. In the first nine months of 2008, Corporate costs included $3.2 million of pre-tax stock compensation expense and $3.0 million of pre-tax amortization of acquired intangible assets.

INTEREST EXPENSE (INCOME), NET

Interest expense was $2.6 million for the third quarter of 2008 compared to interest income of $0.1 million in the prior year quarter. For the first nine months of 2008, interest expense was $7.1 million compared to interest income of $0.6 million in the prior year period. The increase in interest expense in the third quarter of 2008 and the first nine months of 2008 as compared to the prior year periods is due to the outstanding borrowings under the revolving credit facility related to the Doble acquisition.

INCOME TAX EXPENSE

The third quarter of 2008 effective income tax rate for continuing operations was 24.4% compared to 33.3% in the third quarter of 2007. The effective income tax rate from continuing operations in the first nine months of 2008 was 31.8% compared to 21.0% in the prior year period. The decrease in the third quarter effective tax rate in 2008 as compared to the prior year period was due to a $1.6 million export incentive and a $0.6 million research tax credit which favorably impacted the 2008 third quarter effective tax rate by 8.9% and 3.5%, respectively. The third quarter 2007 income tax expense was impacted by the resolution of certain tax exposure items of $0.7 million, reducing the 2007 third quarter effective income tax rate by 5.6%.

The increase in the effective income tax rate in the first nine months of 2008 as compared to the prior year period was due to the favorable impact of research tax credit and the resolution of certain tax exposure items in 2007. The first nine months of 2008 was impacted by a $1.6 million export incentive and a $0.6 million research tax credit which favorably impacted the effective income tax rate in the first nine months of 2008 by 3.9% and 1.6%, respectively. The income tax expense in the first nine months of 2007 was favorably impacted by: $3.1 million, net, research tax credits; and a resolution of certain tax exposure items of $0.7 million, reducing the rate for the first nine months of 2007 by 16.0% and 3.4%, respectively. The Company estimates the fiscal 2008 tax rate to be approximately 34%, excluding the effect of discontinued operations.

Effective October 1, 2007, the Company adopted FASB Interpretation No. 48 (FIN 48), "Accounting for Uncertainty in Income Taxes." FIN 48 provides a financial statement recognition threshold and measurement attribute for a tax position taken or expected to be taken in a tax return. The Company made no adjustments to retained earnings upon adoption. The Company recorded a $5.8 million increase in its unrecognized tax benefits in the first quarter of 2008.

CAPITAL RESOURCES AND LIQUIDITY

Working capital from continuing operations (current assets less current liabilities) decreased to $110.5 million at June 30, 2008 from $122.5 million at September 30, 2007. Accounts receivable increased by $28.6 million and inventories increased by $15.2 million in the first nine months of 2008 primarily related to acquisition of Doble.

Net cash provided by operating activities from continuing operations was $51.2 million and $20.5 million for the nine-month periods ended June 30, 2008 and 2007, respectively. The increase is mainly due to a decrease in operating working capital requirements.

Capital expenditures from continuing operations were $12.6 million and $8.3 million in the first nine months of fiscal 2008 and 2007, respectively. The increase in the first nine months of 2008 as compared to the prior year period included approximately $2.7 million for the ETS Austin facility expansion.

At June 30, 2008, intangible assets, net, of $237.2 million included $65.8 million of capitalized software. Approximately $56.1 million of the capitalized software balance represents software development costs on the TWACS NG software

within the Utility Solutions Group segment to further penetrate the IOU market. This software is being deployed to efficiently handle the additional levels of communications dictated by the size of the utility service territories and the frequency of meter reads that are required under time-of-use or critical peak pricing scenarios to meet the requirements of large IOUs. Amortization expense of TWACS NG software is on a straight-line basis over seven years and began in March 2006. The Company recorded $2.9 million and $8.1 million in amortization expense related to TWACS NG in the third quarter of 2008 and in the first nine months of 2008, respectively.

Divestiture

On November 25, 2007, the Company completed the sale of the filtration portion of Filtertek Inc. (Filtertek) to Illinois Tool Works Inc. for $74.4 million, net, of cash. The TekPackaging division of Filtertek was not included in the transaction. The Filtertek businesses 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 presented. A pre-tax loss of $0.2 million related to the sale of Filtertek is reflected in the Company's fiscal 2008 first quarter results in discontinued operations. Filtertek's net sales were $13.7 million for the two-month period ended November 25, 2007 and $18.2 million for the three-month period ended December 31, 2006, respectively. The operations of the TekPackaging division, currently operating as TekPackaging LLC, are reflected in continuing operations. The closure and relocation of the Filtertek Puerto Rico facility was completed in March 2004. The Puerto Rico facility was included in current assets from discontinued operations with a carrying value of $1.1 million at December 31, 2007. Effective March 31, 2008, the Company sold the Puerto Rico facility for approximately $1.3 million, net. The cash proceeds were received in April 2008.

Acquisition

On November 30, 2007, the Company acquired the capital stock of Doble for a purchase price of approximately $328 million, net of cash acquired. Doble, headquartered in Watertown, Massachusetts, is a worldwide leader in providing high-end diagnostic test solutions for the electric utility industry. The acquisition aligns with the Company's long-term growth strategy of expanding its products and services in the utility industry. The acquisition was funded by a combination of the Company's existing cash, including the proceeds from the partial divestiture of Filtertek, and borrowings under a new $330 million credit facility led by National City Bank. Doble's annual revenue for the trailing twelve months ended September 30, 2007 was approximately $80 million. The operating results for Doble, since the date of acquisition, are included within the Utility Solutions Group segment. The Company recorded $192.6 million of goodwill and $112.3 million of trade names as a result of the transaction. The Company also recorded $56.3 million of identifiable intangible assets consisting primarily of customer relationships and software/databases which will be amortized on a straight-line basis over periods ranging from five years to twenty years.

Credit facility

On November 30, 2007, in conjunction with the acquisition of Doble, the Company entered into a new $330 million five-year revolving credit facility with a $50 million increase option. This facility replaces the Company's $100 million credit facility that would have otherwise matured in October 2009. The facility is available for direct borrowings and/or the issuance of letters of credit. It is provided by a group of sixteen banks, led by National City Bank as agent, with a maturity of November 30, 2012.

At June 30, 2008, the Company had approximately $97.7 million available to borrow under the credit facility in addition to $22.8 million cash on hand. At June 30, 2008, the Company had $230 million of outstanding borrowings under the credit facility and outstanding letters of credit of $2.3 million. The Company classified $30.5 million as the current portion on long-term debt as of June 30, 2008, as the Company intends to repay this amount within 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

Aclara Power-Line Systems Inc. (formerly known as Distribution Control Systems Inc.) delivered the final software version (TWACS NG 3.0) to PG&E in December 2007 and, as a result, recognized deferred revenue of $20.5 million during the first quarter of 2008. The parties continue to negotiate an amendment to the current contract to conform to the parties' performance. Testing of Aclara RF Systems Inc.'s (formerly known as Hexagram Inc.) RF electric solution by PG&E began in the fiscal fourth quarter of 2007 and continues. During the first nine months of 2008, the Company received $8.8 million of orders from PG&E for 188,000 Aclara RF System electric devices. PG&E has not yet announced what changes, if any, will be made to its AMI project plan, and therefore, the Company continues to be unable to estimate the timing or value of orders that may be received under the Company's PG&E contracts. The Company has been in ongoing negotiations with PG&E related to a further deployment of its Aclara RF electric AMI product. Additionally, the Company is in negotiations with PG&E related to its existing power-line systems (PLS) contract to amend and redefine the remaining financial and performance obligations of both parties. 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, 2007 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, 2007 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 September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements" (SFAS 157), which defines fair value in generally accepted accounting principles and expands disclosures about fair value measurements. This Statement is effective for financial statements issued for fiscal years beginning after November 15, 2007. In February 2008, the FASB amended SFAS 157 to delay the effective date by one year for nonfinancial assets and liabilities that are recognized or disclosed at fair value in the financial statements on a nonrecurring basis. The adoption of SFAS 157 is not expected to have a material impact to the Company's financial position or results of operations.

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 prohibited.

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 to 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 ultimate values and timing of revenues under the Company's PREPA, A350XWB, Idaho Power and City of New York contracts. 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, 2007, and in Part II, Item 1A of the Company's Quarterly Report on Form 10-Q for the three months ended March 31, 2008, actions by PG&E's Board of Directors and PG&E's management impacting PG&E's AMI projects, changes to PG&E's AMI project plan resulting from the evaluation of other AMI vendor technologies or other factors; the timing and terms of the proposed amendment to the current PG&E power-line system contract, the Company's successful performance under the PG&E contracts and other 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 is $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 75% of the Company's total borrowings were effectively fixed as of June 30, 2008.

The following is a summary of the notional transaction amounts and fair values for the Company's outstanding derivative financial instruments by risk category and instrument type, as of June 30, 2008.

| (In thousands) | Notional Amount | Average Receive Rate | Average Pay Rate | Fair Value |
|---|---|---|---|---|
| Interest rate swaps | $175,000 | 2.68% | 3.99% | ($1,625) |

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, 2007 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 1A. RISK FACTORS

The discussion of risk factors in Item 1A of the Company's Annual Report on Form 10-K for the fiscal year ended September 30, 2007 refers to the Company's Communications segment and to its subsidiaries DCSI (Distribution Controls Systems, Inc.) and Hexagram (Hexagram, Inc.). As a result of the acquisition of Doble in November 2007, the Company changed the name of the Communications segment to the Utility Solutions Group segment. The name change was done in conjunction with the Company's strategic integration and rebranding of its AMI related technologies under the brand name Aclara, and renaming the businesses as follows: Distribution Control Systems, Inc. renamed Aclara Power-Line Systems Inc.; Hexagram, Inc. renamed Aclara RF Systems Inc.; and Nexus Energy Software, Inc. renamed Aclara Software Inc.

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 June 30, 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 June 30, 2008 | |
| 31.2 | Certification of Chief Financial Officer relating to Form 10-Q for period ended June 30, 2008 | |
| 32 | Certification of Chief Executive Officer and Chief Financial Officer relating to Form 10-Q for period ended June 30, 2008 | |

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: August 8, 2008