

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-Q**

(Mark One)

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

For the quarterly period ended December 31, 2019

OR

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

For the transition period from _____ to _____

Commission File Number 001-36454



KIMBALL ELECTRONICS, INC.

(Exact name of registrant as specified in its charter)

Indiana

(State or other jurisdiction of
incorporation or organization)

1205 Kimball Boulevard, Jasper, Indiana

(Address of principal executive offices)

35-2047713

(I.R.S. Employer Identification No.)

47546

(Zip Code)

(812) 634-4000

Registrant's telephone number, including area code

Not Applicable

Former name, former address and former fiscal year, if changed since last report

Securities registered pursuant to Section 12(b) of the Act:

<u>Title of each Class</u>	<u>Trading Symbol</u>	<u>Name of each exchange on which registered</u>
Common Stock, no par value	KE	The NASDAQ Stock Market LLC

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

Yes No

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T (Section 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit such files).

Yes No

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

Large accelerated filer

Accelerated filer

Emerging growth company

Non-accelerated filer

Smaller reporting company

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

The number of shares outstanding of the Registrant's common stock as of January 24, 2020 was 25,198,049 shares.

KIMBALL ELECTRONICS, INC.

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

**KIMBALL ELECTRONICS, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS**
(Amounts in Thousands, Except for Share Data)

	(Unaudited) December 31, 2019	June 30, 2019
ASSETS		
Current Assets:		
Cash and cash equivalents	\$ 52,203	\$ 49,276
Receivables, net of allowances of \$259 and \$270, respectively	196,323	225,555
Contract assets	67,007	51,929
Inventories	202,402	203,840
Prepaid expenses and other current assets	22,578	24,713
Total current assets	540,513	555,313
Property and Equipment, net of accumulated depreciation of \$224,957 and \$216,955, respectively	147,761	143,629
Goodwill	19,936	18,104
Other Intangible Assets, net of accumulated amortization of \$31,180 and \$29,874, respectively	20,742	22,188
Other Assets	29,013	24,877
Total Assets	\$ 757,965	\$ 764,111
LIABILITIES AND SHARE OWNERS' EQUITY		
Current Liabilities:		
Current portion of borrowings under credit facilities	\$ 27,930	\$ 34,713
Accounts payable	195,159	197,001
Accrued expenses	35,979	43,196
Total current liabilities	259,068	274,910
Other Liabilities:		
Long-term debt under credit facilities, less current portion	91,500	91,500
Long-term income taxes payable	9,765	9,765
Other long-term liabilities	20,794	18,082
Total other liabilities	122,059	119,347
Share Owners' Equity:		
Preferred stock-no par value		
Shares authorized: 15,000,000		
Shares issued: None	—	—
Common stock-no par value		
Shares authorized: 150,000,000		
Shares issued: 29,430,000	—	—
Additional paid-in capital	305,041	305,917
Retained earnings	147,192	133,982
Accumulated other comprehensive loss	(8,945)	(7,628)
Treasury stock, at cost:		
Shares: 4,235,000 and 4,011,000, respectively	(66,450)	(62,417)
Total Share Owners' Equity	376,838	369,854
Total Liabilities and Share Owners' Equity	\$ 757,965	\$ 764,111

See [Notes to Condensed Consolidated Financial Statements](#).

KIMBALL ELECTRONICS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(Amounts in Thousands, Except for Per Share Data)

(Unaudited)	Three Months Ended		Six Months Ended	
	December 31		December 31	
	2019	2018	2019	2018
Net Sales	\$ 307,084	\$ 284,149	\$ 620,469	\$ 549,769
Cost of Sales	286,573	263,705	577,765	511,139
Gross Profit	20,511	20,444	42,704	38,630
Selling and Administrative Expenses	11,827	10,232	22,905	21,478
Other General Income	—	—	—	(92)
Operating Income	8,684	10,212	19,799	17,244
Other Income (Expense):				
Interest income	7	17	25	23
Interest expense	(1,149)	(1,090)	(2,357)	(1,479)
Non-operating income (expense), net	1,285	(520)	73	(691)
Other income (expense), net	143	(1,593)	(2,259)	(2,147)
Income Before Taxes on Income	8,827	8,619	17,540	15,097
Provision for Income Taxes	2,215	1,504	4,330	2,913
Net Income	\$ 6,612	\$ 7,115	\$ 13,210	\$ 12,184
Earnings Per Share of Common Stock:				
Basic	\$ 0.26	\$ 0.27	\$ 0.52	\$ 0.46
Diluted	\$ 0.26	\$ 0.27	\$ 0.52	\$ 0.46
Average Number of Shares Outstanding:				
Basic	25,247	25,993	25,371	26,250
Diluted	25,330	26,036	25,503	26,404

See [Notes to Condensed Consolidated Financial Statements](#).

KIMBALL ELECTRONICS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(Amounts in Thousands)

(Unaudited)	Three Months Ended December 31, 2019			Three Months Ended December 31, 2018		
	Pre-tax	Tax	Net of Tax	Pre-tax	Tax	Net of Tax
Net income			\$ 6,612			\$ 7,115
Other comprehensive income (loss):						
Foreign currency translation adjustments	\$ 2,463	\$ —	\$ 2,463	\$ (1,366)	\$ —	\$ (1,366)
Postemployment severance actuarial change	(69)	17	(52)	97	(22)	75
Derivative gain (loss)	1,304	(297)	1,007	(208)	68	(140)
Reclassification to (earnings) loss:						
Derivatives	(899)	185	(714)	(85)	11	(74)
Amortization of actuarial change	(103)	26	(77)	(117)	28	(89)
Other comprehensive income (loss)	\$ 2,696	\$ (69)	\$ 2,627	\$ (1,679)	\$ 85	\$ (1,594)
Total comprehensive income			\$ 9,239			\$ 5,521

(Unaudited)	Six Months Ended December 31, 2019			Six Months Ended December 31, 2018		
	Pre-tax	Tax	Net of Tax	Pre-tax	Tax	Net of Tax
Net income			\$ 13,210			\$ 12,184
Other comprehensive income (loss):						
Foreign currency translation adjustments	\$ (1,202)	\$ —	\$ (1,202)	\$ (2,024)	\$ —	\$ (2,024)
Postemployment severance actuarial change	(234)	69	(165)	310	(74)	236
Derivative gain (loss)	1,579	(329)	1,250	1,739	(356)	1,383
Reclassification to (earnings) loss:						
Derivatives	(1,310)	265	(1,045)	15	(16)	(1)
Amortization of actuarial change	(205)	50	(155)	(228)	55	(173)
Other comprehensive income (loss)	\$ (1,372)	\$ 55	\$ (1,317)	\$ (188)	\$ (391)	\$ (579)
Total comprehensive income			\$ 11,893			\$ 11,605

See [Notes to Condensed Consolidated Financial Statements](#).

KIMBALL ELECTRONICS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Amounts in Thousands)

(Unaudited)	Six Months Ended December 31	
	2019	2018
Cash Flows From Operating Activities:		
Net income	\$ 13,210	\$ 12,184
Adjustments to reconcile net income to net cash provided by (used for) operating activities:		
Depreciation and amortization	14,986	14,007
(Gain) loss on sales of assets	6	(150)
Deferred income tax and other deferred charges	441	(1,473)
Deferred tax valuation allowance	377	(445)
Stock-based compensation	2,175	2,854
Other, net	139	(335)
Change in operating assets and liabilities:		
Receivables	28,924	282
Contract assets	(15,078)	(6,388)
Inventories	1,313	(36,635)
Prepaid expenses and other assets	1,052	(765)
Accounts payable	(256)	12,257
Accrued expenses and taxes payable	(8,007)	213
Net cash provided by (used for) operating activities	39,282	(4,394)
Cash Flows From Investing Activities:		
Capital expenditures	(21,929)	(8,517)
Proceeds from sales of assets	91	401
Payments for acquisitions, net of cash acquired	—	(43,889)
Purchases of capitalized software	(180)	(648)
Other, net	44	172
Net cash used for investing activities	(21,974)	(52,481)
Cash Flows From Financing Activities:		
Proceeds from credit facilities	—	66,000
Payments on credit facilities	—	(10,386)
Additional net change in revolving credit facilities	(6,783)	12,398
Repurchases of common stock	(6,108)	(18,537)
Payments related to tax withholding for stock-based compensation	(1,012)	(1,766)
Debt issuance costs	—	(445)
Net cash (used for) provided by financing activities	(13,903)	47,264
Effect of Exchange Rate Change on Cash and Cash Equivalents	(478)	(954)
Net Increase (Decrease) in Cash and Cash Equivalents	2,927	(10,565)
Cash and Cash Equivalents at Beginning of Period	49,276	46,428
Cash and Cash Equivalents at End of Period	\$ 52,203	\$ 35,863
Supplemental Disclosure of Cash Flow Information		
Cash paid during the period for:		
Income taxes	\$ 4,875	\$ 4,733
Interest expense	\$ 2,684	\$ 1,020

See [Notes to Condensed Consolidated Financial Statements](#).

KIMBALL ELECTRONICS, INC.
CONDENSED CONSOLIDATED STATEMENT OF SHARE OWNERS' EQUITY
(Amounts in Thousands, Except for Share Data)

(Unaudited)	Three Months Ended				
	Additional Paid- In Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Treasury Stock	Total Share Owners' Equity
Amounts at September 30, 2019	\$ 304,112	\$ 140,580	\$ (11,572)	\$ (63,867)	\$ 369,253
Net income		6,612			6,612
Other comprehensive income (loss)			2,627		2,627
Issuance of non-restricted stock (3,000 shares)	21			44	65
Compensation expense related to stock compensation plans	908				908
Repurchase of Common Stock (179,000 shares)				(2,627)	(2,627)
Amounts at December 31, 2019	\$ 305,041	\$ 147,192	\$ (8,945)	\$ (66,450)	\$ 376,838
Amounts at September 30, 2018	\$ 301,729	\$ 107,493	\$ (5,884)	\$ (44,454)	\$ 358,884
Net income		7,115			7,115
Other comprehensive income (loss)			(1,594)		(1,594)
Issuance of non-restricted stock (4,000 shares)	28			44	72
Compensation expense related to stock compensation plans	1,368				1,368
Repurchase of Common Stock (748,000 shares)				(13,268)	(13,268)
Amounts at December 31, 2018	\$ 303,125	\$ 114,608	\$ (7,478)	\$ (57,678)	\$ 352,577
	Six Months Ended				
(Unaudited)	Additional Paid- In Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Treasury Stock	Total Share Owners' Equity
Amounts at June 30, 2019	\$ 305,917	\$ 133,982	\$ (7,628)	\$ (62,417)	\$ 369,854
Net income		13,210			13,210
Other comprehensive income (loss)			(1,317)		(1,317)
Issuance of non-restricted stock (4,000 shares)	22			48	70
Compensation expense related to stock compensation plans	2,138				2,138
Performance share issuance (181,000 shares)	(3,036)			2,027	(1,009)
Repurchase of Common Stock (409,000 shares)				(6,108)	(6,108)
Amounts at December 31, 2019	\$ 305,041	\$ 147,192	\$ (8,945)	\$ (66,450)	\$ 376,838
Amounts at June 30, 2018	\$ 304,215	\$ 99,374	\$ (6,899)	\$ (41,163)	\$ 355,527
Net income		12,184			12,184
Other comprehensive income (loss)			(579)		(579)
Cumulative effect of accounting change		3,050			3,050
Issuance of non-restricted stock (4,000 shares)	28			44	72
Compensation expense related to stock compensation plans	2,777				2,777
Performance share issuance (203,000 shares)	(3,895)			2,133	(1,762)
Repurchase of Common Stock (1,025,000 shares)				(18,692)	(18,692)
Amounts at December 31, 2018	\$ 303,125	\$ 114,608	\$ (7,478)	\$ (57,678)	\$ 352,577

See [Notes to Condensed Consolidated Financial Statements](#).

KIMBALL ELECTRONICS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Note 1. Business Description and Summary of Significant Accounting Policies

Business Description:

Kimball Electronics, Inc. (also referred to herein as “Kimball Electronics,” the “Company,” “we,” “us,” or “our”) is a global, multifaceted manufacturing solutions provider. We provide contract electronics manufacturing services (“EMS”) and diversified manufacturing services, including engineering and supply chain support, to customers in the automotive, medical, industrial, and public safety end markets. We offer a package of value that begins with our core competency of producing “durable electronics” and includes our set of robust processes and procedures that help us ensure that we deliver the highest levels of quality, reliability, and service throughout the entire life cycle of our customers’ products. We further offer diversified contract manufacturing services for non-electronic components, medical disposables, precision molded plastics, and production automation, test, and inspection equipment. We are well recognized by customers and industry trade publications for our excellent quality, reliability, and innovative service.

Basis of Presentation:

The Condensed Consolidated Financial Statements presented herein reflect the consolidated financial position as of December 31, 2019 and June 30, 2019, results of operations for the three and six months ended December 31, 2019 and 2018, cash flows for the six months ended December 31, 2019 and 2018, and share owners’ equity for the three and six months ended December 31, 2019 and 2018. The financial data presented herein is unaudited and should be read in conjunction with the annual Consolidated Financial Statements as of and for the year ended June 30, 2019 and related notes thereto included in our Annual Report on Form 10-K. As such, certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America (“U.S. GAAP”) have been condensed or omitted, although we believe that the disclosures are adequate to make the information presented not misleading. Intercompany transactions and balances have been eliminated. Management believes the financial statements include all adjustments (consisting only of normal recurring adjustments) considered necessary to present fairly the financial statements for the interim periods. The results of operations for the interim periods shown in this report are not necessarily indicative of results for any future interim period or for the entire fiscal year.

Revenue Recognition:

Our revenue is generated from contracts with customers primarily for manufacturing services provided for the production of electronic assemblies, components, medical disposables, and automation, test, and inspection equipment all built to customer’s specifications. Our customer agreements are generally not for a definitive term but continue for the relevant product’s life cycle. Typically, our customer agreements do not commit the customer to purchase our services until a purchase order is provided, which is generally short-term in nature. Customer purchase orders primarily have a single performance obligation. Generally, the prices stated in the customer purchase orders are agreed upon prices for the manufactured product and do not vary over the term of the order, and therefore, the majority of our contracts do not contain variable consideration. In limited circumstances, we may enter into a contract where we offer our customer a rebate once specific volume thresholds have been met; in these cases, the rebates are accounted for as variable consideration.

The majority of our revenue is recognized over time as manufacturing services are performed as we manufacture a product to customer specifications with no alternative use and we have an enforceable right to payment for performance completed to date. The remaining revenue for manufacturing services is recognized when the customer obtains control of the product, typically either upon shipment or delivery of the product dependent on the terms of the contract, and the customer is able to direct the use of and obtain substantially all of the remaining benefits from the asset. We generally recognize revenue over time using costs based input methods, in which judgment is required to evaluate assumptions including the total estimated costs to determine our progress towards contract completion and to calculate the corresponding amount of revenue to recognize. Estimated costs include material, direct and indirect labor, and appropriate applied overheads. Costs based input methods are considered a faithful depiction of our efforts and progress toward satisfying our performance obligations for manufacturing services and for which we believe we are entitled to payment for performance completed to date. The cumulative effect of revisions to estimates related to net contract revenues or costs are recorded in the period in which the revisions to estimates are identified and the amounts can be reasonably estimated.

We have elected to account for shipping and handling activities related to contracts with customers as costs to fulfill our promise to transfer the associated services and products. Accordingly, we record customer payments of shipping and handling costs as a component of net sales and classify such costs as a component of cost of sales. We recognize sales net of applicable sales or value add taxes. Based on estimated product returns and price concessions, a reserve for returns and allowances is recorded at the time revenue is recognized, resulting in a reduction of net revenue.

Direct incremental costs to obtain and fulfill a contract are capitalized as a contract asset only if they are material, expected to be recovered, and are not accounted for in accordance with other guidance. Incidental items that are immaterial in the context of the contract are recognized as expense in the period incurred.

Notes Receivable and Trade Accounts Receivable:

The Company's notes receivable and trade accounts receivable are recorded per the terms of the agreement or sale, and accrued interest is recognized when earned. We determine on a case-by-case basis the cessation of accruing interest, the resumption of accruing interest, the method of recording payments received on nonaccrual receivables, and the delinquency status for our limited number of notes receivable.

In the ordinary course of business, customers periodically negotiate extended payment terms on trade accounts receivable. Customary terms require payment within 30 to 45 days, with any terms beyond 45 days being considered extended payment terms. We may utilize accounts receivable factoring arrangements with third-party financial institutions in order to extend terms for the customer without negatively impacting our cash flow. These arrangements in all cases do not contain recourse provisions which would obligate us in the event of our customers' failure to pay. Receivables are considered sold when they are transferred beyond the reach of Kimball Electronics and its creditors, the purchaser has the right to pledge or exchange the receivables, and we have surrendered control over the transferred receivables. In the six months ended December 31, 2019 and 2018, we sold, without recourse, \$142.4 million and \$127.3 million of accounts receivable, respectively. Factoring fees were \$0.5 million and \$0.4 million during the three months ended December 31, 2019 and 2018, respectively, and \$1.1 million and \$0.8 million during the six months ended December 31, 2019 and 2018, respectively. Factoring fees are recorded in Selling and Administrative Expenses on our Condensed Consolidated Statements of Income.

One of the Company's China operations, in limited circumstances, may receive banker's acceptance drafts from customers as payment for their trade accounts receivable. The banker's acceptance drafts are non-interest bearing and primarily mature within six months from the origination date. The Company has the ability to sell the drafts at a discount or transfer the drafts in settlement of current accounts payable prior to the scheduled maturity date. These drafts, which totaled \$4.0 million at December 31, 2019 and \$4.2 million at June 30, 2019, are reflected in Receivables on the Condensed Consolidated Balance Sheets until the banker's drafts are sold at a discount, transferred in settlement of current accounts payable, or cash is received at maturity. Banker's acceptance drafts sold at a discount or transferred in settlement of current accounts payable during the six months ended December 31, 2019 and 2018 were \$0.8 million and \$1.2 million, respectively. See [Note 6 - Commitments and Contingent Liabilities](#) of Notes to Condensed Consolidated Financial Statements for more information on banker's acceptance drafts.

Other General Income:

Other General Income in the six months ended December 31, 2018 included \$0.1 million of pre-tax income resulting from a payment received related to a class action lawsuit in which Kimball Electronics was a class member. No Other General Income was recorded in the six months ended December 31, 2019.

Non-operating Income (Expense), net:

Non-operating income (expense), net includes the impact of such items as foreign currency rate movements and related derivative gain or loss, fair value adjustments on supplemental employee retirement plan ("SERP") investments, government subsidies, bank charges, and other miscellaneous non-operating income and expense items that are not directly related to operations. The gain (loss) on SERP investments is offset by a change in the SERP liability that is recognized in Selling and Administrative Expenses.

Components of Non-operating income (expense), net:

	Three Months Ended		Six Months Ended	
	December 31		December 31	
(Amounts in Thousands)	2019	2018	2019	2018
Foreign currency/derivative gain (loss)	\$ 770	\$ 45	\$ (343)	\$ (655)
Gain (loss) on SERP investments	502	(626)	480	(507)
Foreign government subsidies	65	105	65	571
Other	(52)	(44)	(129)	(100)
Non-operating income (expense), net	\$ 1,285	\$ (520)	\$ 73	\$ (691)

Income Taxes:

In determining the quarterly provision for income taxes, we use an estimated annual effective tax rate which is based on expected annual income, statutory tax rates, and available tax planning opportunities in the various jurisdictions in which we operate. Unusual or infrequently occurring items are separately recognized in the quarter in which they occur.

Deferred income tax assets and liabilities, recorded in Other Assets and Other long-term liabilities, respectively, in the Condensed Consolidated Balance Sheets, are recognized for the estimated future tax consequences attributable to temporary differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. These assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which the temporary differences are expected to reverse. We evaluate the recoverability of deferred tax assets each quarter by assessing the likelihood of future taxable income and available tax planning strategies that could be implemented to realize our deferred tax assets. If recovery is not likely, we provide a valuation allowance based on our best estimate of future taxable income in the various taxing jurisdictions and the amount of deferred taxes ultimately realizable. Future events could change management's assessment.

We operate within multiple taxing jurisdictions and are subject to tax audits in these jurisdictions. These audits can involve complex uncertain tax positions, which may require an extended period of time to resolve. A tax benefit from an uncertain tax position may be recognized only if it is more likely than not that the tax position will be sustained on examination by taxing authorities, based on the technical merits of the position. We maintain a liability for uncertain income tax and other tax positions, including accrued interest and penalties on those positions. As tax positions are effectively settled, the tax liability is adjusted accordingly. We recognize interest and penalties related to unrecognized tax benefits in Provision for Income Taxes on the Condensed Consolidated Statements of Income.

The U.S. Tax Cuts and Jobs Act ("Tax Reform") was enacted into law on December 22, 2017. Tax Reform made broad and complex changes to the U.S. tax code, for which complete guidance may have not yet been issued. Tax Reform changes included, but were not limited to, (i) reducing the U.S. corporate statutory tax rate, (ii) requiring a one-time transition tax on certain unremitted earnings of foreign subsidiaries that is payable over an eight-year period, (iii) eliminating U.S. federal income taxes on dividends from foreign subsidiaries, and (iv) bonus depreciation that will allow for full expensing of qualifying property. As of December 31, 2019 and June 30, 2019, the remaining provision recorded for the one-time deemed repatriation tax was \$9.8 million, payable through fiscal year 2026, and is recorded in Long-term income taxes payable on the Condensed Consolidated Balance Sheets.

New Accounting Standards:

Adopted in fiscal year 2020:

In February 2016, the Financial Accounting Standards Board ("FASB") issued guidance on leases with subsequent amendments to this new guidance in January 2018, July 2018, and December 2018. The new guidance requires lessees to recognize assets and liabilities on the balance sheet for the rights and obligations created by those leases and requires additional qualitative and quantitative disclosures. Under previous guidance, only capital leases were recognized on the balance sheet. We adopted this standard on July 1, 2019, the beginning of our first quarter of fiscal year 2020, under the modified retrospective method. As allowed by the July 2018 amendment, the Company has not recast the comparative periods.

We elected the "package of practical expedients," which permits us not to reassess under the new standard our prior conclusions about lease identification, classification, and initial direct costs. We also elected the short-term lease recognition exemption, permitting us not to recognize right-of-use assets and lease liabilities for leases with a term of 12 months or less and do not include a purchase option whose exercise is reasonably certain.

Lease assets and liabilities are initially recognized based on the present value of lease payments over the lease term calculated using our estimated incremental borrowing rate, unless the implicit rate is readily determinable. The estimated incremental borrowing rate is the rate of interest we would have to pay on a collateralized basis to borrow an amount equal to the lease payments under similar terms. Lease terms include options to extend or terminate the lease when it is reasonably certain that those options will be exercised.

The adoption resulted in the recognition of \$2.6 million of right-of-use assets and lease liabilities on our Condensed Consolidated Balance Sheet, primarily for our real estate operating leases. The adoption did not have a material effect on our results of operations or cash flows. There was no cumulative-effect adjustment to equity. See [Note 14 - Leases](#) of Notes to Condensed Consolidated Financial Statements for more information on leases.

In August 2017, the FASB issued guidance on Derivatives and Hedging. The pronouncement expands and refines hedge accounting, aligns the recognition and presentation of the effects of hedging instruments and hedge items in the financial statements, and includes certain targeted improvements to ease the application of current guidance related to the assessment of hedge effectiveness. The Company adopted this during the first quarter of fiscal year 2020 with an immaterial effect on our Condensed Consolidated Financial Statements.

Not Yet Adopted:

In August 2018, the FASB issued guidance on Customer's Accounting for Fees Paid in a Cloud Computing Arrangement. This new guidance amends the accounting for implementation, setup, and other upfront costs incurred in a cloud computing hosting arrangement. The amendment aligns the requirement for capitalizing implementation costs incurred in a hosting arrangement that is a service contract with the requirements for capitalizing implementation costs incurred to develop or obtain internal-use software. The amendment also requires companies to expense the capitalized implementation costs of a hosting arrangement that is a service contract over the term of the hosting arrangement, including options to extend the agreement that is in control of the customer. The guidance is effective for fiscal years beginning after December 15, 2019 and interim periods within those fiscal years. Early adoption is permitted. The guidance is to be adopted either retrospectively or prospectively to all implementation costs incurred after the date of adoption. We are currently evaluating the impact of the adoption of this guidance on our consolidated financial statements.

In December 2019, the FASB issued guidance on Simplifying the Accounting for Income Taxes, intended to simplify various aspects related to the accounting for income taxes. The guidance is effective for fiscal years beginning after December 15, 2020 and for interim periods within those fiscal years. Early adoption is permitted. We are currently evaluating the impact of the adoption of this guidance on our consolidated financial statements.

Note 2. Acquisition

On October 1, 2018, the Company completed the acquisition of GES Holdings, Inc., Global Equipment Services and Manufacturing, Inc., and its subsidiaries (collectively referred to as "GES"). The acquisition included purchasing substantially all of the assets and assuming certain liabilities of GES Holdings, Inc., Global Equipment Services and Manufacturing, Inc., GES Infotek Pvt. Ltd., (India), GES Japan KK, Global Equipment Services and Manufacturing (Suzhou) Co., Ltd., (China), Suzhou Global Equipment Services and Trading Co., Ltd. (China), and acquiring 100% of the capital stock of Global Equipment Services & Manufacturing Vietnam Company Limited.

This acquisition supported the Company's strategy for growth and diversification into a multifaceted manufacturing solutions company. GES specializes in design, production, and servicing of automation, test, and inspection equipment for industrial applications in the semiconductor, electronics, and life sciences industries.

Incremental costs directly related to the acquisition has totaled \$1.7 million, which were expensed as incurred and were recorded in Selling and Administrative Expenses on our Condensed Consolidated Statements of Income. These costs incurred during the three and six months ended December 31, 2019 and 2018 were not material. The operating results of this acquisition are included in the Company's consolidated financial statements beginning on the acquisition date of October 1, 2018.

The GES acquisition was accounted for as a business combination. The Company has recorded a net adjusted purchase price of \$42.4 million which includes a reduction for an estimated net working capital adjustment of \$7.6 million. The net working capital adjustment as provided for in the agreement is being disputed by the sellers of GES and is continuing to be resolved through the dispute resolution procedure provided for under the terms of the asset purchase agreement.

Cash paid, net of cash acquired, was \$43.9 million, and a net receivable due from the seller was recognized for \$3.8 million. The acquisition was primarily funded with the Company's primary credit facility. The Company determined this acquisition is not a significant subsidiary.

The following table summarizes the final purchase price allocation to assets acquired and liabilities assumed based on their estimated fair values as of the acquisition date, with the excess allocated to goodwill. Measurement period adjustments during the first quarter of fiscal year 2020 included a reduction of \$2.0 million to Property and Equipment as a result of additional information obtained related to the valuation of certain equipment as of the acquisition date and a \$0.2 million reduction in Other long-term liabilities to adjust deferred tax liabilities on the equipment. These measurement period adjustments to the purchase price allocation in the first quarter of fiscal year 2020 increased Goodwill by \$1.8 million. The twelve-month measurement period ended on September 30, 2019. Adjustments after the measurement period related to the purchase price allocation, specifically as it relates to an adjustment for the final resolution of the net working capital adjustment, as applicable, will be recorded in earnings during the period of resolution and will not be reflected in goodwill. For tax purposes, \$4.5 million of the goodwill recorded is expected to be deductible.

(Amounts in Thousands)	October 1, 2018	
Cash	\$	2,257
Receivables		15,656
Inventories		6,454
Prepaid expenses and other current assets		1,424
Property and Equipment		7,037
Other Intangible Assets		19,259
Other Assets		498
Goodwill		13,745
Total assets acquired	\$	66,330
Borrowings under Credit Facilities	\$	12,843
Accounts payable		4,113
Accrued expenses		1,340
Other long-term liabilities		5,653
Total liabilities assumed	\$	23,949
Net assets acquired	\$	42,381

Income tax liabilities, indirect tax liabilities, and liabilities for unrecognized tax benefits, including interest and penalties, of \$4.2 million were recorded related to pre-closing tax periods of Global Equipment Services & Manufacturing Vietnam Company Limited of which \$3.9 million was recorded in Other long-term liabilities and \$0.3 million was included in Accrued expenses. This reflects management's best assessment of the estimated taxes, interest, and penalties as of the acquisition date that are more likely than not to be paid, or for indirect taxes the probable amounts due to the tax authorities, including interest and penalties, under the applicable laws in the various jurisdictions. Because of the complexity of some of these uncertainties, the ultimate resolution may result in a payment that is significantly different from our current estimate of the tax liabilities. Included in Receivables was a related indemnification asset of \$4.2 million for these estimated tax liabilities. The seller has agreed to indemnify the Company in the purchase agreements for all taxes allocable to all pre-closing tax periods.

Other Intangible Assets include the estimated fair values for finite-lived intangible assets acquired and are listed in the table below along with their estimated useful lives which are being amortized on a straight-line basis.

(Amounts in Thousands)	Estimated Fair Value	Estimated useful life (years)
Software	\$ 379	3 to 7
Technology	5,060	5
Trade name	6,369	10
Customer relationships	7,451	15
	\$ 19,259	

Note 3. Revenue from Contracts with Customers

The following table disaggregates our revenue by end market vertical for the three and six months ended December 31, 2019 and 2018.

(Amounts in Millions)	Three Months Ended		Six Months Ended	
	December 31		December 31	
	2019	2018	2019	2018
Vertical Markets:				
Automotive	\$ 134.9	\$ 112.4	\$ 259.3	\$ 218.3
Medical	85.7	85.7	187.0	167.9
Industrial	66.4	62.2	131.1	119.6
Public Safety	14.6	17.9	31.7	35.0
Other	5.5	5.9	11.4	9.0
Total net sales	<u>\$ 307.1</u>	<u>\$ 284.1</u>	<u>\$ 620.5</u>	<u>\$ 549.8</u>

For the three months ended December 31, 2019 and 2018, approximately 69% of our net sales were recognized over time as manufacturing services were performed under a customer contract on a product with no alternative use and we have an enforceable right to payment for performance completed to date. For the six months ended December 31, 2019 and 2018, approximately 69% and 71% of our net sales, respectively, were recognized over time. The remaining sales revenues were primarily recognized at a point in time when the customer obtained control of the manufactured product.

The timing differences of revenue recognition, billings to our customers, and cash collections from our customers result in billed accounts receivable and unbilled accounts receivable. Contract assets on the Condensed Consolidated Balance Sheets relate to unbilled accounts receivable and occur when revenue is recognized over time as manufacturing services are provided and the billing to the customer has not yet occurred as of the balance sheet date. Contract assets were \$67.0 million and \$51.9 million as of December 31, 2019 and June 30, 2019, respectively.

In limited circumstances, the Company may receive payments from customers in advance of the satisfaction of performance obligations primarily for tooling or other miscellaneous services or costs. These advance payments are recognized as contract liabilities until the performance obligations are completed and are included in Accrued expenses on the Condensed Consolidated Balance Sheets, which amounted to \$4.3 million and \$6.3 million as of December 31, 2019 and June 30, 2019, respectively.

Note 4. Inventories

Inventories were valued using the lower of first-in, first-out ("FIFO") cost and net realizable value. Inventory components were as follows:

(Amounts in Thousands)	December 31, 2019	June 30, 2019
Finished products	\$ 3,977	\$ 2,708
Work-in-process	3,306	4,119
Raw materials	195,119	197,013
Total inventory	<u>\$ 202,402</u>	<u>\$ 203,840</u>

Note 5. Accumulated Other Comprehensive Income (Loss)

During the six months ended December 31, 2019 and 2018, the changes in the balances of each component of Accumulated Other Comprehensive Income (Loss), net of tax, were as follows:

Accumulated Other Comprehensive Income (Loss)

(Amounts in Thousands)	Foreign Currency Translation Adjustments	Derivative Gain (Loss)	Post Employment Benefits Net Actuarial Gain (Loss)	Accumulated Other Comprehensive Income (Loss)
Balance at June 30, 2019	\$ (6,848)	\$ (1,598)	\$ 818	\$ (7,628)
Other comprehensive income (loss) before reclassifications	(1,202)	1,250	(165)	(117)
Reclassification to (earnings) loss	—	(1,045)	(155)	(1,200)
Net current-period other comprehensive income (loss)	(1,202)	205	(320)	(1,317)
Balance at December 31, 2019	<u>\$ (8,050)</u>	<u>\$ (1,393)</u>	<u>\$ 498</u>	<u>\$ (8,945)</u>
Balance at June 30, 2018	\$ (4,357)	\$ (3,379)	\$ 837	\$ (6,899)
Other comprehensive income (loss) before reclassifications	(2,024)	1,383	236	(405)
Reclassification to (earnings) loss	—	(1)	(173)	(174)
Net current-period other comprehensive income (loss)	(2,024)	1,382	63	(579)
Balance at December 31, 2018	<u>\$ (6,381)</u>	<u>\$ (1,997)</u>	<u>\$ 900</u>	<u>\$ (7,478)</u>

The following reclassifications were made from Accumulated Other Comprehensive Income (Loss) to the Condensed Consolidated Statements of Income:

Reclassifications from Accumulated Other Comprehensive Income (Loss)	Three Months Ended		Six Months Ended		Affected Line Item in the Condensed Consolidated Statements of Income
	December 31		December 31		
(Amounts in Thousands)	2019	2018	2019	2018	
Derivative gain (loss) ⁽¹⁾	\$ 899	\$ 87	\$ 1,310	\$ (30)	Cost of Sales
	—	(2)	—	15	Non-operating income (expense), net
	(185)	(11)	(265)	16	Benefit (Provision) for Income Taxes
	<u>\$ 714</u>	<u>\$ 74</u>	<u>\$ 1,045</u>	<u>\$ 1</u>	Net of Tax
Postemployment Benefits:					
Amortization of actuarial gain ⁽²⁾	103	117	205	228	Non-operating income (expense), net
	(26)	(28)	(50)	(55)	Benefit (Provision) for Income Taxes
	<u>\$ 77</u>	<u>\$ 89</u>	<u>\$ 155</u>	<u>\$ 173</u>	Net of Tax
Total reclassifications for the period	<u>\$ 791</u>	<u>\$ 163</u>	<u>\$ 1,200</u>	<u>\$ 174</u>	Net of Tax

Amounts in parentheses indicate reductions to income.

(1) See [Note 9 - Derivative Instruments](#) of Notes to Condensed Consolidated Financial Statements for further information on derivative instruments.

(2) See [Note 11 - Postemployment Benefits](#) of Notes to Condensed Consolidated Financial Statements for further information on postemployment benefit plans.

Note 6. Commitments and Contingent Liabilities

Standby letters of credit may be issued to third-party suppliers and insurance institutions and can only be drawn upon in the event of the Company's failure to pay its obligations to a beneficiary. As of December 31, 2019, we had a maximum financial exposure from unused standby letters of credit totaling \$0.4 million. We don't expect circumstances to arise that would require us to perform under any of these arrangements and believe that the resolution of any claims that might arise in the future, either individually or in the aggregate, would not materially affect our Condensed Consolidated Financial Statements. Accordingly, no liability has been recorded as of December 31, 2019 with respect to the standby letters of credit. The Company also may enter into commercial letters of credit to facilitate payments to vendors and from customers.

One of the Company's China operations, in limited circumstances, receives banker's acceptance drafts from customers as settlement for their trade accounts receivable. We in turn may transfer the acceptance drafts to a supplier of ours in settlement of current accounts payable. These drafts contain certain recourse provisions afforded to the transferee under laws of The People's Republic of China. If a transferee were to exercise its available recourse rights, the draft would revert back to our China operation and we would be required to satisfy the obligation with the transferee. At December 31, 2019, the drafts transferred and outstanding totaled \$0.6 million. No transferee has exercised their recourse rights against us. For additional information on banker's acceptance drafts, see [Note 1 – Business Description and Summary of Significant Accounting Policies](#) of Notes to Condensed Consolidated Financial Statements.

The Company provides only assurance-type warranties for a limited time period, which cover workmanship and assures the product complies with specifications provided by or agreed upon with the customer. We maintain a provision for limited warranty repair or replacement of products manufactured and sold, which has been established in specific manufacturing contract agreements. We estimate product warranty liability at the time of sale based on historical repair or replacement cost trends in conjunction with the length of the warranty offered. Management refines the warranty liability periodically based on changes in historical cost trends and in certain cases where specific warranty issues become known.

Changes in the product warranty accrual for the six months ended December 31, 2019 and 2018 were as follows:

(Amounts in Thousands)	Six Months Ended	
	December 31	
	2019	2018
Product warranty liability at the beginning of the period	\$ 958	\$ 656
Additions to warranty accrual (including changes in estimates)	(289)	66
Settlements made (in cash or in kind)	(30)	(39)
Product warranty liability at the end of the period	<u>\$ 639</u>	<u>\$ 683</u>

Note 7. Credit Facilities

Credit facilities consisted of the following:

(Amounts in Millions, in U.S Dollar Equivalents)	Unused Borrowings at December 31, 2019	Borrowings Outstanding at December 31, 2019	Borrowings Outstanding at June 30, 2019
Primary credit facility ⁽¹⁾	\$ 36.9	\$ 112.7	\$ 122.8
Thailand overdraft credit facility	3.0	—	—
China revolving credit facility	7.5	—	—
Netherlands revolving credit facility	3.6	6.7	3.4
Poland revolving credit facility	16.8	—	—
Total credit facilities	<u>\$ 67.8</u>	\$ 119.4	\$ 126.2
Less: current portion		\$ (27.9)	\$ (34.7)
Long-term debt under credit facilities, less current portion ⁽²⁾		<u>\$ 91.5</u>	<u>\$ 91.5</u>

(1) At December 31, 2019, the Company maintains a U.S. primary credit facility (the “primary facility”) dated as of July 27, 2018 and scheduled to mature in July 2023. The primary facility provides for \$150 million in borrowings, with an option to increase the amount available for borrowing to \$225 million upon request, subject to the consent of each lender participating in such increase. This facility is maintained for working capital and general corporate purposes of the Company including capital expenditures and potential acquisitions. A commitment fee is payable on the unused portion of the credit facility at a rate that ranges from 20.0 to 25.0 basis points per annum as determined by the Company’s ratio of consolidated total indebtedness to adjusted consolidated EBITDA, as defined in the primary facility. Types of borrowings available on the primary facility include revolving loans, multi-currency term loans, and swingline loans.

The interest rate on borrowings is dependent on the type of borrowings and will be one of the two options:

- the London Interbank Offered Rate (“LIBOR”) in effect two business days prior to the advance (adjusted upwards to reflect bank reserve costs) for such interest period as defined in the agreement, plus the Eurocurrency Loans spread which can range from 125.0 to 175.0 basis points based on the Company’s ratio of consolidated total indebtedness to adjusted consolidated EBITDA; or
- the Alternate Base Rate (“ABR”), which is defined as the highest of the fluctuating rate per annum equal to the higher of
 - a. JPMorgan’s prime rate;
 - b. 1% per annum above the Adjusted LIBOR Rate (as defined in the Credit Agreement); or
 - c. 1/2 of 1% per annum above the Federal Funds Effective Rate (as defined in the Credit Agreement);

plus the ABR Loans spread which can range from 25.0 to 75.0 basis points based on the Company’s ratio of consolidated total indebtedness to adjusted consolidated EBITDA.

The Company’s financial covenants under the primary credit facility require:

- a ratio of consolidated total indebtedness minus unencumbered U.S. cash on hand in the United States in excess of \$15 million to adjusted consolidated EBITDA, determined as of the end of each of its fiscal quarters for the then most recently ended four fiscal quarters, to not be greater than 3.0 to 1.0, and
- a fixed charge coverage ratio, determined as of the end of each of its fiscal quarters for the then most recently ended four fiscal quarters, to not be less than 1.1 to 1.0.

The Company had \$0.4 million in letters of credit contingently committed against the credit facility at December 31, 2019.

(2) The amount of Long-term debt, less current maturities at December 31, 2019 reflects the borrowings on the primary facility that the Company intends, and has the ability, to refinance for a period longer than twelve months.

The weighted-average interest rate on the borrowings outstanding under the credit facilities at December 31, 2019 was 3.7%.

Note 8. Fair Value

The Company categorizes assets and liabilities measured at fair value into three levels based upon the assumptions (inputs) used to price the assets or liabilities. Level 1 provides the most reliable measure of fair value, whereas level 3 generally requires significant management judgment. The three levels are defined as follows:

- Level 1: Unadjusted quoted prices in active markets for identical assets and liabilities.
- Level 2: Observable inputs other than those included in level 1. For example, quoted prices for similar assets or liabilities in active markets or quoted prices for identical assets or liabilities in inactive markets.
- Level 3: Unobservable inputs reflecting management's own assumptions about the inputs used in pricing the asset or liability.

There were no changes in the inputs or valuation techniques used to measure fair values during these six months ended December 31, 2019. For more information on inputs and fair valuation techniques used, refer to our Annual Report on Form 10-K for the year ended June 30, 2019.

Recurring Fair Value Measurements:

As of December 31, 2019 and June 30, 2019, the fair values of financial assets and liabilities that are measured at fair value on a recurring basis using the market approach are categorized as follows:

(Amounts in Thousands)	December 31, 2019		
	Level 1	Level 2	Total
Assets			
Cash equivalents	\$ 1,134	\$ —	\$ 1,134
Derivatives: foreign exchange contracts	—	1,609	1,609
Trading securities: mutual funds held in nonqualified SERP	10,020	—	10,020
Total assets at fair value	<u>\$ 11,154</u>	<u>\$ 1,609</u>	<u>\$ 12,763</u>
Liabilities			
Derivatives: foreign exchange contracts	\$ —	\$ 446	\$ 446
Total liabilities at fair value	<u>\$ —</u>	<u>\$ 446</u>	<u>\$ 446</u>
June 30, 2019			
(Amounts in Thousands)	Level 1	Level 2	Total
Assets			
Cash equivalents	\$ 1,123	\$ —	\$ 1,123
Derivatives: foreign exchange contracts	—	1,832	1,832
Trading securities: mutual funds held in nonqualified SERP	9,268	—	9,268
Total assets at fair value	<u>\$ 10,391</u>	<u>\$ 1,832</u>	<u>\$ 12,223</u>
Liabilities			
Derivatives: foreign exchange contracts	\$ —	\$ 299	\$ 299
Total liabilities at fair value	<u>\$ —</u>	<u>\$ 299</u>	<u>\$ 299</u>

We had no level 3 assets or liabilities measured at fair value during these six months ended December 31, 2019.

The nonqualified supplemental employee retirement plan ("SERP") assets consist primarily of equity funds, balanced funds, bond funds, and a money market fund. The SERP investment assets are offset by a SERP liability which represents the Company's obligation to distribute SERP funds to participants. See [Note 10 - Investments](#) of Notes to Condensed Consolidated Financial Statements for further information regarding the SERP.

Financial Instruments Not Carried At Fair Value:

Financial instruments that are not reflected in the Condensed Consolidated Balance Sheets at fair value that have carrying amounts which approximate fair value include notes receivable and borrowings under credit facilities. There were no changes to the inputs and valuation techniques used to assess the fair value of these financial instruments during the six months ended December 31, 2019. For more information on inputs and fair valuation techniques used, refer to our Annual Report on Form 10-K for the year ended June 30, 2019.

The carrying value of our cash deposit accounts, trade accounts receivable, and trade accounts payable approximates fair value due to the relatively short maturity and immaterial non-performance risk.

Note 9. Derivative Instruments

Foreign Exchange Contracts:

We operate internationally and are therefore exposed to foreign currency exchange rate fluctuations in the normal course of business. Our primary means of managing this exposure is to utilize natural hedges, such as aligning currencies used in the supply chain with the sale currency. To the extent natural hedging techniques do not fully offset currency risk, we use derivative instruments with the objective of reducing the residual exposure to certain foreign currency rate movements. Factors considered in the decision to hedge an underlying market exposure include the materiality of the risk, the volatility of the market, the duration of the hedge, the degree to which the underlying exposure is committed to, and the availability, effectiveness, and cost of derivative instruments. Derivative instruments are only utilized for risk management purposes and are not used for speculative or trading purposes.

We use forward contracts designated as cash flow hedges to protect against foreign currency exchange rate risks inherent in forecasted transactions denominated in a foreign currency. Foreign exchange contracts are also used to hedge against foreign currency exchange rate risks related to intercompany balances denominated in currencies other than the functional currencies. As of December 31, 2019, we had outstanding foreign exchange contracts to hedge currencies against the U.S. dollar in the aggregate notional amount of \$30.2 million and to hedge currencies against the Euro in the aggregate notional amount of 76.6 million Euro. The notional amounts are indicators of the volume of derivative activities but may not be indicators of the potential gain or loss on the derivatives.

In limited cases due to unexpected changes in forecasted transactions, cash flow hedges may cease to meet the criteria to be designated as cash flow hedges. Depending on the type of exposure hedged, we may either purchase a derivative contract in the opposite position of the undesignated hedge or may retain the hedge until it matures if the hedge continues to provide an adequate offset in earnings against the currency revaluation impact of foreign currency denominated liabilities.

The fair value of outstanding derivative instruments is recognized on the balance sheet as a derivative asset or liability. When derivatives are settled with the counterparty, the derivative asset or liability is relieved and cash flow is impacted for the net settlement. For derivative instruments that meet the criteria of hedging instruments under FASB guidance, the gain or loss on the derivative instrument is initially recorded net of related tax effect in Accumulated Other Comprehensive Income (Loss), a component of Share Owners' Equity, and are subsequently reclassified into earnings in the period or periods during which the hedged transaction is recognized in earnings. The gain or loss associated with derivative instruments that are not designated as hedging instruments or that cease to meet the criteria for hedging under FASB guidance is also reported immediately in Non-operating income (expense), net on the Condensed Consolidated Statements of Income.

Based on fair values as of December 31, 2019, we estimate that approximately \$0.8 million of a pre-tax derivative gain deferred in Accumulated Other Comprehensive Loss will be reclassified into earnings, along with the earnings effects of related forecasted transactions, within the next 12 months. Gains on foreign exchange contracts are generally offset by losses in operating income in the income statement when the underlying hedged transaction is recognized in earnings. Because gains or losses on foreign exchange contracts fluctuate partially based on currency spot rates, the future effect on earnings of the cash flow hedges alone is not determinable, but in conjunction with the underlying hedged transactions, the result is expected to be a decline in currency risk. The maximum length of time we had hedged our exposure to the variability in future cash flows was 12 months as of both December 31, 2019 and June 30, 2019.

See [Note 8 - Fair Value](#) of Notes to Condensed Consolidated Financial Statements for further information regarding the fair value of derivative assets and liabilities and the Condensed Consolidated Statements of Comprehensive Income for the changes in deferred derivative gains and losses. Information on the location and amounts of derivative fair values in the Condensed Consolidated Balance Sheets and derivative gains and losses in the Condensed Consolidated Statements of Income are presented below.

We adopted a new accounting standard effective July 1, 2019 which eliminated the requirement to separately measure and report hedge ineffectiveness. See [Note 1 - Business Description and Summary of Significant Accounting Policies](#) of Notes to Condensed Consolidated Financial Statements for more information on the adoption of this new accounting standard.

Fair Value of Derivative Instruments on the Condensed Consolidated Balance Sheets

(Amounts in Thousands)	Asset Derivatives			Liability Derivatives		
	Balance Sheet Location	Fair Value As of		Balance Sheet Location	Fair Value As of	
		December 31, 2019	June 30, 2019		December 31, 2019	June 30, 2019
Derivatives Designated as Hedging Instruments:						
Foreign exchange contracts	Prepaid expenses and other current assets	\$ 1,231	\$ 1,136	Accrued expenses	\$ 262	\$ 278
Derivatives Not Designated as Hedging Instruments:						
Foreign exchange contracts	Prepaid expenses and other current assets	378	696	Accrued expenses	184	21
Total derivatives		\$ 1,609	\$ 1,832		\$ 446	\$ 299

The Effect of Derivative Instruments on Other Comprehensive Income (Loss)

(Amounts in Thousands)	Three Months Ended		Six Months Ended	
	December 31		December 31	
	2019	2018	2019	2018
Amount of Pre-Tax Gain or (Loss) Recognized in Other Comprehensive Income (Loss) (OCI) on Derivatives:				
Foreign exchange contracts	\$ 1,304	\$ (208)	\$ 1,579	\$ 1,739

The Effect of Derivative Instruments on Condensed Consolidated Statements of Income

(Amounts in Thousands)	Derivatives in Cash Flow Hedging Relationships	Location of Gain or (Loss)	Three Months Ended		Six Months Ended	
			December 31		December 31	
			2019	2018	2019	2018
Amount of Pre-Tax Gain or (Loss) Reclassified from Accumulated OCI into Income:						
Foreign exchange contracts		Cost of Sales	\$ 899	\$ 87	\$ 1,310	\$ (30)
Foreign exchange contracts		Non-operating income (expense)	—	(2)	—	15
Total			\$ 899	\$ 85	\$ 1,310	\$ (15)

Derivatives Not Designated as Hedging Instruments

Amount of Pre-Tax Gain or (Loss) Recognized in Income on Derivatives:						
Foreign exchange contracts		Non-operating income (expense)	\$ (638)	\$ 928	\$ 1,060	\$ 1,492
Total Derivative Pre-Tax Gain (Loss) Recognized in Income			\$ 261	\$ 1,013	\$ 2,370	\$ 1,477

Note 10. Investments

The Company maintains a self-directed supplemental employee retirement plan (“SERP”) for executive and other key employees. The Company SERP utilizes a rabbi trust, and therefore assets in the SERP portfolio are subject to creditor claims in the event of bankruptcy. The Company recognizes SERP investment assets on the balance sheet at current fair value. A SERP liability of the same amount is recorded on the balance sheet representing an obligation to distribute SERP funds to participants. The SERP investment assets are classified as trading, and accordingly, realized and unrealized gains and losses are recognized in income in the other income (expense) category. Adjustments made to revalue the SERP liability are also recognized in income as selling and administrative expenses and offset valuation adjustments on SERP investment assets. The increase/(decrease) in net unrealized holding gains for the six months ended December 31, 2019 and 2018 was, in thousands, \$296 and \$(729), respectively.

SERP asset and liability balances applicable to Kimball Electronics participants were as follows:

(Amounts in Thousands)	December 31, 2019	June 30, 2019
SERP investments - current asset	\$ 1,905	\$ 1,728
SERP investments - other long-term asset	8,115	7,540
Total SERP investments	<u>\$ 10,020</u>	<u>\$ 9,268</u>
SERP obligation - current liability	\$ 1,905	\$ 1,728
SERP obligation - other long-term liability	8,115	7,540
Total SERP obligation	<u>\$ 10,020</u>	<u>\$ 9,268</u>

Note 11. Postemployment Benefits

The Company maintains severance plans for all domestic employees and other statutory required postemployment plans for certain foreign subsidiaries. The domestic severance plans provide severance benefits to eligible employees meeting the plans’ qualifications, primarily involuntary termination without cause. The foreign postemployment plans include local pension, retirement, or severance plans. There are no statutory requirements for us to contribute to the plans, nor do employees contribute to the plans. The plans hold no assets. Benefits are paid using available cash on hand when eligible employees meet plan qualifications for payment. The net periodic postemployment benefit costs were not material for the six months ended December 31, 2019 and 2018. Unusual or non-recurring severance actions are not estimable using actuarial methods and are expensed in accordance with the applicable U.S. GAAP.

Note 12. Stock Compensation Plans

The Company maintains a stock compensation plan, the Kimball Electronics, Inc. 2014 Stock Option and Incentive Plan (the “Plan”), which allows for the issuance of up to 4.5 million shares and may be awarded in the form of incentive stock options, stock appreciation rights, restricted shares, unrestricted shares, restricted share units, or performance shares and performance units. The Plan is a ten-year plan with no further awards allowed to be made under the Plan after October 1, 2024. The Plan was re-approved by the Company’s Share Owners at its annual meeting on November 7, 2019. The Company also maintains a nonqualified deferred stock compensation plan, the Kimball Electronics, Inc. Non-Employee Directors Stock Compensation Deferral Plan (the “Deferral Plan”), which allows Non-Employee Directors of the Company’s Board of Directors (the “Board”) to elect to defer all, or a portion of, their retainer fees in stock until retirement or termination from the Board or death. The Deferral Plan allows for issuance of up to 1.0 million shares of the Company’s common stock. For more information on the Plan and the Deferral Plan, refer to our Annual Report on Form 10-K for the year ended June 30, 2019.

During the first six months of fiscal year 2020, the following stock compensation was awarded under the Plan and the Deferral Plan.

Stock Compensation Awarded	Quarter Awarded	Shares/Units	Grant Date Fair Value ⁽²⁾
Long-Term Performance Shares ⁽¹⁾	1st Quarter	252,878	\$14.39
Unrestricted shares ⁽³⁾	1st Quarter	500	\$14.39
Unrestricted shares ⁽³⁾	2nd Quarter	3,758	\$17.30
Deferred share units ⁽⁴⁾	2nd Quarter	32,950	\$17.30

- (1) Long-term performance shares were awarded to officers and other key employees. Payouts will be based upon a combination of a bonus percentage attainment component calculated under the Company’s profit sharing incentive bonus plan, adjusted to a three-year average bonus percentage, and a growth attainment component, which is the Company’s growth in sales revenue based on comparison of its three-year compounded annual growth rate (“CAGR”) with the Electronics Manufacturing Services Industry’s three-year CAGR. The long-term performance shares awarded are based on three successive annual performance measurement periods, with each annual tranche having a grant date when economic profit tiers are established and approved by the Compensation and Governance Committee of the Board near the beginning of the applicable fiscal year and a vesting date shortly after the end of each annual period. The number of shares issued will be less than the maximum shares issuable if one or both of the above-mentioned incentive metric maximum thresholds are not obtained.
- (2) The grant date fair value is based on the stock price at the date of the award and for long-term performance shares is applicable to the first tranche only.
- (3) Unrestricted shares were awarded to a non-employee member of the Board during the second quarter of fiscal year 2020 as compensation for the portion of director’s annual retainer fees as a result of the directors’ election to be paid in unrestricted shares in lieu of cash payment or deferred share units. Director’s fees are expensed over the period that directors earn the compensation. Unrestricted shares were also awarded to a key employee during the first quarter of fiscal year 2020 which were expensed immediately. Unrestricted shares do not have vesting periods, holding periods, restrictions on sales, or other restrictions.
- (4) Deferred share units were awarded to non-employee members of the Board as compensation for the portion of director’s annual retainer fees as a result of directors’ elections to receive deferred share units in lieu of cash payment or unrestricted shares. Director’s fees are expensed over the period that directors earn the compensation. Deferred share units are participating securities and are payable in common stock in a lump sum or installments in accordance with deferral elections upon a Director’s retirement or termination from the Board or death.

Note 13. Goodwill and Other Intangible Assets

A summary of goodwill is as follows:

(Amounts in Thousands)

Balance as of June 30, 2019

Goodwill	\$ 30,930
Accumulated impairment	(12,826)
Goodwill, net	18,104
Goodwill, Additions	1,832

Balance as of December 31, 2019

Goodwill	32,762
Accumulated impairment	(12,826)
Goodwill, net	\$ 19,936

During the first quarter of fiscal year 2020, we added \$1.8 million to goodwill resulting from measurement period adjustments to the purchase price allocation of the GES acquisition. See [Note 2 - Acquisition](#) of Notes to Condensed Consolidated Financial Statements for more information on this acquisition.

A summary of other intangible assets subject to amortization is as follows:

(Amounts in Thousands)	December 31, 2019			June 30, 2019		
	Cost	Accumulated Amortization	Net Value	Cost	Accumulated Amortization	Net Value
	Capitalized Software	\$ 31,875	\$ 27,353	\$ 4,522	\$ 32,015	\$ 27,124
Customer Relationships	8,618	1,760	6,858	8,618	1,506	7,112
Technology	5,060	1,271	3,789	5,060	766	4,294
Trade Name	6,369	796	5,573	6,369	478	5,891
Other Intangible Assets	\$ 51,922	\$ 31,180	\$ 20,742	\$ 52,062	\$ 29,874	\$ 22,188

During the three months ended December 31, 2019 and 2018, amortization expense of other intangible assets was, in millions, \$0.8 and \$0.7, respectively. During the six months ended December 31, 2019 and 2018, amortization expense of other intangible assets was, in millions, \$1.6 and \$0.9, respectively.

The estimated useful life of internal-use software ranges from 3 years to 10 years. The amortization period for the customer relationships, technology, and trade name intangible assets is 15 years, 5 years, and 10 years, respectively. We have no intangible assets with indefinite useful lives which are not subject to amortization.

Note 14. Leases

The Company determines if a contract is or contains a lease at inception. The Company leases certain office, manufacturing, and warehouse facilities under operating leases, in addition to land on which certain office and manufacturing facilities reside. These operating leases expire from fiscal year 2020 to 2057. The Company has a minimal number of finance leases with an immaterial impact on its Condensed Consolidated Financial Statements.

Operating lease costs for the three and six months ended December 31, 2019 were \$0.3 million and \$0.6 million, respectively, including short-term and variable lease costs. Cash payments for operating leases included in the measurement of lease liabilities for the six months ended December 31, 2019 were \$0.4 million, which is included in Cash Flows from Operating Activities in the Condensed Consolidated Statement of Cash Flows.

The lease assets and liabilities, which exclude leases with terms of 12 months or less, as of December 31, 2019 were as follows:

(Amounts in Thousands)	
Operating lease right-of-use assets (included in Other Assets)	\$ 2,246
Operating lease liability, current (included in Accrued expenses)	\$ 777
Operating lease liability, noncurrent (included in Other long-term liabilities)	\$ 1,469
Weighted average remaining lease term in years - operating leases	5.3
Weighted average discount rate - operating leases	3.5%

Future lease payments as of December 31, 2019 are as follows:

(Amounts in Thousands)

2020 ⁽¹⁾	\$ 452
2021	710
2022	575
2023	95
2024	95
Thereafter	475
Total undiscounted lease payments	<u>\$ 2,402</u>
Less: imputed interest	156
Total lease liabilities	<u>\$ 2,246</u>

(1) Represents estimated lease payments for the remaining six-month period ending June 30, 2020.

As reported under the previous lease accounting standard, the aggregate future minimum rental payments on our operating leases, as of June 30, 2019, were, in millions, \$0.8, \$0.7, \$0.6, \$0.1, and \$0.1 for the five years ending June 30, 2024, respectively, and \$0.5 million thereafter.

Note 15. Share Owners' Equity

On October 21, 2015, the Board authorized an 18-month stock repurchase plan (the "Stock Repurchase Plan") allowing a repurchase of up to \$20 million worth of common stock. Then, separately on each of September 29, 2016, August 23, 2017, and November 8, 2018, the Board extended and increased the Stock Repurchase Plan to allow the repurchase of up to an additional \$20 million worth of common stock with no expiration date, which brought the total authorized stock repurchases under the Plan to \$80 million. Purchases may be made under various programs, including in open-market transactions, block transactions on or off an exchange, or in privately negotiated transactions, all in accordance with applicable securities laws and regulations. The Stock Repurchase Plan may be suspended or discontinued at any time.

During the six months ended December 31, 2019, the Company repurchased \$6.1 million of common stock at an average price of \$14.93 which was recorded as Treasury stock, at cost in the Condensed Consolidated Balance Sheets. Since the inception of the Stock Repurchase Plan, the Company has repurchased \$74.0 million of common stock at an average cost of \$15.03 per share.

Note 16. Earnings Per Share

Basic and diluted earnings per share were calculated as follows under the two-class method:

	Three Months Ended		Six Months Ended	
	December 31		December 31	
(Amounts in thousands, except per share data)	2019	2018	2019	2018
Basic and Diluted Earnings Per Share:				
Net Income	\$ 6,612	\$ 7,115	\$ 13,210	\$ 12,184
Less: Net Income allocated to participating securities	9	7	17	9
Net Income allocated to common Share Owners	<u>\$ 6,603</u>	<u>\$ 7,108</u>	<u>\$ 13,193</u>	<u>\$ 12,175</u>
Basic weighted average common shares outstanding	25,247	25,993	25,371	26,250
Dilutive effect of average outstanding performance shares	65	24	121	136
Dilutive effect of average outstanding deferred stock units	18	19	11	18
Dilutive weighted average shares outstanding	<u>25,330</u>	<u>26,036</u>	<u>25,503</u>	<u>26,404</u>
Earnings Per Share of Common Stock:				
Basic	\$ 0.26	\$ 0.27	\$ 0.52	\$ 0.46
Diluted	\$ 0.26	\$ 0.27	\$ 0.52	\$ 0.46

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Business Overview

We are a global, multifaceted manufacturing solutions provider. We provide contract electronics manufacturing services ("EMS") and diversified manufacturing services, including engineering and supply chain support, to customers in the automotive, medical, industrial, and public safety end markets. Our core competency is producing durable electronics, and we further offer diversified contract manufacturing services for non-electronic components, medical disposables, precision molded plastics, and production automation, test, and inspection equipment. Our manufacturing services, including engineering and supply chain support, utilize common production and support capabilities globally. We are well recognized by our customers and the industry for our excellent quality, reliability, and innovative service. In 2018, we were recognized for achieving the Highest Overall Customer Rating in CIRCUITS ASSEMBLY's 2018 Service Excellence Awards. CIRCUITS ASSEMBLY is a leading brand and technical publication for electronics manufacturers worldwide.

The contract manufacturing services industry is very competitive. As a mid-sized player, we can expect to be challenged by the agility and flexibility of the smaller, regional players, and we can expect to be challenged by the scale and price competitiveness of the larger, global players. We enjoy a unique market position between these extremes which allows us to compete with the larger scale players for high-volume projects, but also maintain our competitive position in the generally lower volume durable electronics market space. We expect to continue to effectively operate in this market space; however, one significant challenge will be maintaining our profit margins while we continue our revenue growth. Price increases are uncommon in the market as production efficiencies and material pricing advantages for most projects drive costs and prices down over the life of the projects. This characteristic of the contract electronics marketplace is expected to continue.

We continue to monitor the current economic and industry conditions for uncertainties that may pose a threat to our future growth or cause disruption in business strategy, execution, and timing in the markets in which we compete. One such trend that the EMS industry has recently experienced is component shortages and component allocations. Component shortages or allocations could increase component costs and potentially interrupt our operations and negatively impact our ability to meet commitments to customers. We have taken various actions to mitigate the risk and minimize the adverse effect the component shortages or allocations could have on our results and the impact to our customers. In addition, the impact from tariffs and additional proposed tariffs on components we utilize in our domestic manufacturing process, of which many currently can only be sourced from China, may adversely affect the competitiveness of our domestic operations. We are also monitoring the coronavirus outbreak in China and the related impact on our operations in our two China facilities, including the effect on shipments in and out of China, the availability of critical components, and the health and availability of our workforce.

The September 2019 edition of Manufacturing Market Insider published by New Venture Research indicated that the group of the largest 20 contract manufacturers, of which we are a member, experienced revenue growth of 4.9% in the first half of calendar year 2019 when compared to the first half of calendar year 2018. During the first half of calendar year 2019, we experienced growth of 12.7% when compared to the first half of calendar year 2018.

Our overall expectation for the contract manufacturing services market is moderate growth with mixed demand. Our focus is on the four key vertical markets of automotive, medical, industrial, and public safety. Our current goal is to grow at an 8% annual organic growth rate.

The automotive end market continues to benefit from the trend of increasing electronic content that is placed in automobiles. We experienced growth in the automotive market over the prior year, led by the continued ramp-up of new programs including programs for fully electric vehicles. In the medical market, year-over-year growth for the first half of the fiscal year was driven largely from an overall strengthening of the market. In the industrial market, growth was driven in large part to increased demand for smart metering products. Overall, we have experienced mixed demand in the public safety market. We continue to monitor the current economic environment and its potential impact on our customers.

We expect to make investments that will help us continue our development into a multifaceted manufacturing solutions provider, including through acquisitions. As discussed in [Note 2 - Acquisition](#) of Notes to Condensed Consolidated Financial Statements, we completed the acquisition of GES Holdings, Inc., Global Equipment Services and Manufacturing, Inc., and its subsidiaries (collectively referred to as "GES") on October 1, 2018. GES specializes in design, production, and servicing of automation, test, and inspection equipment for industrial applications in the semiconductor, electronics, and life sciences industries.

We have a strong focus on cost control and closely monitor market changes and our liquidity in order to proactively adjust our operating costs and discretionary capital spending as needed. Managing working capital in conjunction with fluctuating demand levels is likewise key. In addition, a long-standing component of our profit sharing incentive bonus plan is that it is linked to our financial performance which results in varying amounts of compensation expense as profits change.

We continue to maintain a strong balance sheet, which included a current ratio of 2.1, a debt-to-equity ratio of 0.3, and Share Owners' equity of \$377 million at December 31, 2019. Our short-term liquidity available, represented as cash and cash equivalents plus the unused amount of our credit facilities, some of which are uncommitted, totaled \$120.0 million at December 31, 2019.

In addition to the above discussion related to the current market conditions, management currently considers the following events, trends, and uncertainties to be most important to understanding our financial condition and operating performance:

- Due to the contract and project nature of the contract manufacturing industry, fluctuation in the demand for our products and variation in the gross margin on those programs is inherent to our business. Effective management of manufacturing capacity is, and will continue to be, critical to our success.
- The nature of the EMS industry is such that the start-up of new customers and new programs to replace expiring programs occurs frequently. While our agreements with customers generally do not have a definitive term and thus could be canceled at any time with little or no notice, we generally realize relatively few cancellations prior to the end of the product's life cycle. We attribute this to our focus on long-term customer relationships, meeting customer expectations, required capital investment, and product qualification cycle times. As such, our ability to continue contractual relationships with our customers, including our principal customers, is not certain. New customers and program start-ups generally cause losses early in the life of a program, which are generally recovered as the program becomes established and matures.
- Risk factors within our business include, but are not limited to, general economic and market conditions, customer order delays, globalization, impact related to tariffs and other trade barriers, foreign currency exchange rate fluctuations, rapid technological changes, component availability, supplier and customer financial stability, the contract nature of this industry, the concentration of sales to large customers, and the potential for customers to choose a dual sourcing strategy or to in-source a greater portion of their manufacturing. The continuing success of our business is dependent upon our ability to replace expiring customers/programs with new customers/programs. We monitor our success in this area by tracking the number of customers and the percentage of our net sales generated from them by years of service as depicted in the table below. While variation in the size of program award makes it difficult to directly correlate this data to our sales trends, we believe it does provide useful information regarding our customer loyalty and new business growth. Additional risk factors that could have an effect on our performance are located within the "Risk Factors" section of our Annual Report on Form 10-K for the year ended June 30, 2019. See Item [1A - Risk Factors](#) of this Quarterly Report on Form 10-Q for the quarter ended December 31, 2019 for revised risk factors.

Customer Service Years	Six Months Ended	
	December 31	
	2019	2018
More than 10 Years		
% of Net Sales	77%	77%
# of Customers	37	30
5 to 10 Years		
% of Net Sales	10%	9%
# of Customers	19	16
Less than 5 Years		
% of Net Sales	13%	14%
# of Customers	21	29
Total		
% of Net Sales	100%	100%
# of Customers	77	75

- Employees throughout our business operations are an integral part of our ability to compete successfully, and the stability of the management team is critical to long-term Share Owner value. Our talent management and succession planning processes help to maintain stability in management.

Certain preceding statements could be considered forward-looking statements under the Private Securities Litigation Reform Act of 1995 and are subject to certain risks and uncertainties including, but not limited to, successful integration of acquisitions and new operations, adverse changes in the global economic conditions, the geopolitical environment, loss of key customers or suppliers, or similar unforeseen events. Additional information on risks is contained in our Annual Report on Form 10-K for the year ended June 30, 2019. See Item [1A - Risk Factors](#) of this Quarterly Report on Form 10-Q for the quarter ended December 31, 2019 for revised risk factors.

Financial Overview

(Amounts in Millions, Except for Per Share Data)	At or for the Three Months Ended December 31				
	2019	as a % of Net Sales	2018	as a % of Net Sales	% Change
Net Sales	\$ 307.1		\$ 284.1		8%
Gross Profit	\$ 20.5	6.7%	\$ 20.4	7.2%	—%
Selling and Administrative Expenses	\$ 11.8	3.9%	\$ 10.2	3.6%	16%
Operating Income	\$ 8.7	2.8%	\$ 10.2	3.6%	(15)%
Net Income	\$ 6.6		\$ 7.1		(7)%
Diluted Earnings per Share	\$ 0.26		\$ 0.27		(4)%
Open Orders	\$ 399.4		\$ 321.5		24%

(Amounts in Millions, Except for Per Share Data)	For the Six Months Ended December 31				
	2019	as a % of Net Sales	2018	as a % of Net Sales	% Change
Net Sales	\$ 620.5		\$ 549.8		13%
Gross Profit	\$ 42.7	6.9%	\$ 38.6	7.0%	11%
Selling and Administrative Expenses	\$ 22.9	3.7%	\$ 21.5	3.9%	7%
Other General Income	\$ —		\$ 0.1		
Operating Income	\$ 19.8	3.2%	\$ 17.2	3.1%	15%
Net Income	\$ 13.2		\$ 12.2		8%
Diluted Earnings per Share	\$ 0.52		\$ 0.46		13%

(Amounts in Millions)	Three Months Ended December 31			Six Months Ended December 31		
	2019	2018	% Change	2019	2018	% Change
Automotive	\$ 134.9	\$ 112.4	20%	\$ 259.3	\$ 218.3	19%
Medical	85.7	85.7	—%	187.0	167.9	11%
Industrial	66.4	62.2	7%	131.1	119.6	10%
Public Safety	14.6	17.9	(18)%	31.7	35.0	(9)%
Other	5.5	5.9	(7)%	11.4	9.0	28%
Total Net Sales	\$ 307.1	\$ 284.1	8%	\$ 620.5	\$ 549.8	13%

Second quarter and year-to-date fiscal year 2020 consolidated net sales increased compared to the second quarter and year-to-date period of fiscal year 2019 primarily due to the continued ramp-up of certain programs, new product introductions, and an overall increase in demand. By end market vertical, three of our market verticals experienced double-digit sales growth in the year-to-date period of fiscal year 2020 when compared to the year-to-date period of fiscal year 2019 and fluctuated as follows:

- Sales to customers in the automotive market increased in the second quarter of fiscal year 2020 compared to the second quarter of fiscal year 2019 largely from stronger demand in China, the favorable impact of certain contracts with customers beginning to meet the criteria to recognize revenue over time during the current quarter, and the ramp-up of certain programs for fully electric vehicles, which were partially offset by the unfavorable sales impact to our customers that support GM due to the UAW labor strike. Sales to customers increased in the year-to-date period of fiscal year 2020 compared to the year-to-date period of fiscal year 2019 with overall stronger demand, the favorable impact of certain contracts with customers beginning to meet the criteria to recognize revenue over time during the current fiscal year, and the ramp-up of certain programs for fully electric vehicles, which were partially offset by the unfavorable sales impact to our customers that support GM due to the UAW labor strike.
- Sales to customers in the medical market were flat in the second quarter of fiscal year 2020 compared to the second quarter of fiscal year 2019 but increased in the year-to-date period of fiscal year 2020 compared to the year-to-date period of fiscal year 2019 primarily due to increased demand for existing products.
- Sales to customers in the industrial market improved in the second quarter and year-to-date period of the current fiscal year when compared to the second quarter and year-to-date period of fiscal year 2019 from increased demand for smart metering products, which was partially offset by lower end market demand for climate control products. Sales to customers in the industrial market also improved in the year-to-date period of fiscal year 2020 compared to the year-to-date period of fiscal year 2019 from sales generated through the recent GES acquisition that was completed at the beginning of the second quarter of fiscal year 2019.
- Sales to customers in the public safety market decreased in the second quarter and year-to-date period of fiscal year 2020 compared to the second quarter and year-to-date period of fiscal year 2019 due to lower overall demand and the phase out of certain programs.

A significant amount of sales to Nexteer Automotive, Philips, and ZF accounted for the following portions of our net sales:

	Three Months Ended		Six Months Ended	
	December 31		December 31	
	2019	2018	2019	2018
Nexteer Automotive	17%	12%	15%	11%
Philips	14%	14%	14%	15%
ZF	*	11%	*	12%

* amount is less than 10% of total

Open orders were up 24% as of December 31, 2019 compared to December 31, 2018 as open orders in the automotive market significantly increased, which in part is due to the continued ramp-up of new programs and certain key customers placing orders with increased lead times, partially offset by a decline in open orders in the medical market. Open orders are the aggregate sales price of production pursuant to unfulfilled customer orders, which may be canceled by the customer subject to contractual termination provisions. Substantially all of the open orders as of December 31, 2019 are expected to be filled within the next twelve months. Open orders at a point in time may not be indicative of future sales trends due to the contract nature of our business.

Second quarter fiscal year 2020 gross profit as a percent of net sales declined when compared to the second quarter of fiscal year 2019 primarily due to unfavorable product mix and the unfavorable impact from the decline in sales to our customers that support GM due to the UAW labor strike, which more than offset any leverage gained on higher revenue. Year-to-date fiscal year 2020 gross profit as a percent of net sales declined slightly compared to year-to-date fiscal year 2019.

Selling and administrative expenses increased as a percent of net sales and in absolute dollars in the second quarter of fiscal year 2020 when compared to the second quarter of fiscal year 2019. The current quarter selling and administrative expenses increased primarily from an increase in the fair value of the liability for the supplemental employee retirement plan ("SERP") and higher consulting fees for human resource strategies, which were partially offset by lower stock-based compensation.

For the first half of fiscal year 2020, selling and administrative expenses increased in absolute dollars but decreased as a percent of sales when compared to the first half of fiscal year 2019 primarily from an increase in the fair value of the SERP liability and higher amortization expense directly resulting from the finite-lived intangible assets acquired with the GES acquisition, which were partially offset by lower stock-based compensation.

Other General Income in the first six months of fiscal year 2019 included \$0.1 million of pre-tax income resulting from a payment received related to the settlement of a class action lawsuit in which Kimball Electronics was a class member. No Other General Income was recorded during the first six months of fiscal year 2020.

Other Income (Expense) consisted of the following:

(Amounts in Thousands)	Three Months Ended		Six Months Ended	
	December 31		December 31	
	2019	2018	2019	2018
Interest income	\$ 7	\$ 17	\$ 25	\$ 23
Interest expense	(1,149)	(1,090)	(2,357)	(1,479)
Foreign currency/derivative gain (loss)	770	45	(343)	(655)
Gain (loss) on SERP investments	502	(626)	480	(507)
Foreign government subsidies	65	105	65	571
Other	(52)	(44)	(129)	(100)
Other income (expense), net	\$ 143	\$ (1,593)	\$ (2,259)	\$ (2,147)

Interest expense has increased in the first half of fiscal year 2020 compared to the first half of fiscal year 2019 due to increased borrowings on the credit facilities. The foreign currency/derivative gain (loss) resulted from net foreign currency exchange rate movements during the period. The revaluation to fair value of the SERP investments recorded in Other Income (Expense) is offset by the revaluation of the SERP liability recorded in Selling and Administrative Expenses, and thus there is no effect on net income.

Our income before income taxes and effective tax rate were comprised of the following U.S. and foreign components:

(Amounts in Thousands)	For the Six Months Ended			
	December 31, 2019		December 31, 2018	
	Income Before Taxes	Effective Tax Rate	Income Before Taxes	Effective Tax Rate
United States	\$ 886	74.5%	\$ 7,843	13.3%
Foreign	16,654	22.0%	7,254	25.8%
Total	\$ 17,540	24.7%	\$ 15,097	19.3%

When compared to the statutory rate, the domestic effective tax rate and the consolidated effective tax rate for the first six months of fiscal year 2020 were unfavorably impacted by a valuation allowance adjustment on a domestic tax credit and a discrete income tax adjustment related to the excess tax expense on stock-based compensation granted during the period, which were partially offset by an adjustment for the U.S. research and development tax credit.

When compared to the statutory rate, the domestic effective tax rate and the consolidated effective tax rate for the first six months of fiscal year 2019 were favorably impacted by adjustments to provisions related to Tax Reform prior to the end of the measurement period, discrete income tax adjustments related to the U.S. research and development tax credit, the excess tax benefit on stock-based compensation granted during the period, and provision to return adjustments.

Comparing the balance sheet as of December 31, 2019 to June 30, 2019, Receivables decreased \$29.2 million primarily due to increased utilization of our accounts receivable factoring arrangements. Contract assets, which reflect the unbilled accounts receivable that occur when we recognize revenue over time, increased \$15.1 million as a result of increased production volumes and certain contracts with customers beginning to meet the criteria to recognize revenue over time during the current quarter. Goodwill has increased \$1.8 million due to purchase accounting measurement period adjustments associated with the GES acquisition. Borrowings under credit facilities decreased \$6.8 million largely from repayments on the U.S. primary credit facility. Accrued expenses decreased \$7.2 million primarily due to a significant portion of accrued incentive compensation being paid during the first half of fiscal year 2020.

Liquidity and Capital Resources

Working capital at December 31, 2019 was \$281.4 million compared to working capital of \$280.4 million at June 30, 2019. The current ratio was 2.1 at December 31, 2019 and 2.0 at June 30, 2019. The debt-to-equity ratio was 0.3 at both December 31, 2019 and June 30, 2019. Our short-term liquidity available, represented as cash and cash equivalents plus the unused amount of our credit facilities, some of which are uncommitted, totaled \$120.0 million at December 31, 2019 and \$110.7 million at June 30, 2019.

Cash Conversion Days (“CCD”) are calculated as the sum of Days Sales Outstanding (“DSO”) plus Contract Asset Days (“CAD”) plus Production Days Supply on Hand (“PDSOH”) less Accounts Payable Days (“APD”). CCD is a metric used to measure the efficiency of managing working capital. CCD for the quarter ended December 31, 2019 was 76 days, which decreased from the quarter ended June 30, 2019 and was flat with the quarter ended December 31, 2018. The following table summarizes our CCD for the quarterly periods indicated.

	Three Months Ended		
	December 31, 2019	June 30, 2019	December 31, 2018
DSO	54	59	58
CAD	18	15	14
PDSOH	66	64	72
APD	62	61	68
CCD	76	77	76

We define DSO as the average of monthly trade accounts and notes receivable divided by an average day’s net sales, CAD as the average monthly contract assets divided by an average day’s net sales, PDSOH as the average of monthly gross inventory divided by an average day’s cost of sales, and APD as the average of monthly accounts payable divided by an average day’s cost of sales.

Cash Flows

The following table reflects the major categories of cash flows for the first six months of fiscal years 2020 and 2019.

(Amounts in millions)	Six Months Ended	
	December 31	
	2019	2018
Net cash provided by (used for) operating activities	\$ 39.3	\$ (4.4)
Net cash used for investing activities	\$ (22.0)	\$ (52.5)
Net cash (used for) provided by financing activities	\$ (13.9)	\$ 47.3

Cash Flows from Operating Activities

Net cash provided by operating activities for the first six months of fiscal year 2020 was largely driven by net income adjusted for non-cash items. Net cash used for operating activities in the first six months of fiscal year 2019 was primarily driven by cash used from changes in operating assets and liabilities which more than offset the cash provided by net income adjusted for non-cash items. Changes in operating assets and liabilities provided \$7.9 million of cash in the first six months of fiscal year 2020 and used \$31.0 million of cash in the first six months of fiscal year 2019.

The cash provided of \$7.9 million from changes in operating assets and liabilities in the first six months of fiscal year 2020 is primarily due to a decrease in accounts receivable, which provided cash of \$28.9 million primarily due to the increased utilization of accounts receivable factoring arrangements. Partially offsetting cash provided by accounts receivable was an increase in contract assets, which used cash of \$15.1 million as a result of increased production volumes and certain contracts with customers beginning to meet the criteria to recognize revenue over time during the current fiscal year, and cash used of \$8.0 million as accrued expenses and taxes payable decreased, driven by a significant portion of accrued incentive compensation being paid during the first half of fiscal year 2020.

The cash used of \$31.0 million from changes in operating assets and liabilities in the first six months of fiscal year 2019 is largely due to an increase in inventory, which used cash of \$36.6 million primarily to support increased production volumes and open orders, from a change in customers’ forecasts, and from additional purchases to help mitigate the potential impact from component shortages.

Partially offsetting this usage was an increase in accounts payable, which provided cash of \$12.3 million largely resulting from the increased inventory purchases to support increased production volumes.

Cash Flows from Investing Activities

For the first six months of fiscal years 2020 and 2019, net cash used for investing activities was \$22.0 million and \$52.5 million, respectively. During the first six months of fiscal year 2020, we reinvested \$22.1 million into capital investments for the future primarily for machinery and equipment for capacity purposes and to support new business awards. During the first six months of fiscal year 2019, we invested \$43.9 million for the GES acquisition. See [Note 2 - Acquisition](#) of Notes to Condensed Consolidated Financial Statements for more information on cash paid, net of cash acquired, and the purchase price allocation to assets acquired and liabilities assumed for this acquisition. Also during the first six months of fiscal year 2019, we reinvested \$9.2 million into capital investments for the future primarily for machinery and equipment for capacity purposes and to support new business awards, replacement of older machinery and equipment, and improvements to our facilities.

Cash Flows from Financing Activities

For the first six months of fiscal year 2020, net cash used by financing activities of \$13.9 million resulted from net payments on our primary credit facility of \$10.1 million, repurchases of our common stock under an authorized stock repurchase plan, and the remittance of tax withholdings on share-based payments, which were only partially offset by additional borrowings on our Netherlands credit facility. For the first six months of fiscal year 2019, net cash provided by financing activities of \$47.3 million resulted from net borrowings on our primary credit facility of \$78.4 million, partially offset by repurchases of our common stock under an authorized stock repurchase plan, the remittance of tax withholdings on share-based payments, and debt issuance costs. The borrowings on our primary credit facility in the first half of fiscal year 2019 were used to primarily fund the GES acquisition that occurred on October 1, 2018 in addition to other domestic cash needs. Also included in the financing activities for the first half of fiscal year 2019 were \$10.4 million of payments on the Vietnam credit facility that was assumed with the GES acquisition.

Credit Facilities

The Company maintains a U.S. primary credit facility (the “primary facility”) that has a maturity date of July 27, 2023 and allows for up to \$150 million in borrowings, with an option to increase the amount available for borrowing to \$225 million at the Company’s request, subject to the consent of each lender participating in such increase.

The proceeds of the loans on the primary credit facility are to be used for working capital and general corporate purposes of the Company including capital expenditures and potential acquisitions. A portion of the credit facility, not to exceed \$15 million of the principal amount, will be available for the issuance of letters of credit. A commitment fee on the unused portion of the principal amount of the credit facility is payable at a rate that ranges from 20.0 to 25.0 basis points per annum as determined by the Company’s ratio of consolidated total indebtedness to adjusted consolidated EBITDA.

The interest rate on borrowings is dependent on the type of borrowings and will be one of following two options:

- the London Interbank Offered Rate (“LIBOR”) in effect two business days prior to the advance (adjusted upwards to reflect bank reserve costs) for such interest period as defined in the agreement, plus the Eurocurrency Loans spread which can range from 125.0 to 175.0 basis points based on the Company’s ratio of consolidated total indebtedness to adjusted consolidated EBITDA; or
- the Alternate Base Rate (“ABR”), which is defined as the highest of the fluctuating rate per annum equal to the higher of
 - a. JPMorgan’s prime rate;
 - b. 1% per annum above the Adjusted LIBOR Rate (as defined in the Credit Agreement); or
 - c. 1/2 of 1% per annum above the Federal Funds Effective Rate (as defined in the Credit Agreement);

plus the ABR Loans spread which can range from 25.0 to 75.0 basis points based on the Company’s ratio of consolidated total indebtedness to adjusted consolidated EBITDA.

At December 31, 2019, we had \$112.7 million in borrowings under the primary facility and \$0.4 million in letters of credit against the primary facility. Borrowings under the primary facility were used as the primary source of funding for the GES acquisition as well as for domestic cash needs. At December 31, 2019, \$91.5 million of the borrowings were classified as long-term as the Company intends, and has the ability, to refinance for a period longer than twelve months. At June 30, 2019, we had \$122.8 million in short-term borrowings under the primary facility and \$0.4 million in letters of credit against the primary facility.

The Company's financial covenants under the primary credit facility require:

- a ratio of consolidated total indebtedness minus unencumbered U.S. cash on hand in the United States in excess of \$15 million to adjusted consolidated EBITDA, determined as of the end of each of its fiscal quarters for the then most recently ended four fiscal quarters, to not be greater than 3.0 to 1.0, and
- a fixed charge coverage ratio, determined as of the end of each of its fiscal quarters for the then most recently ended four fiscal quarters, to not be less than 1.1 to 1.0.

We were in compliance with the financial covenants during the six-month period ended December 31, 2019.

Kimball Electronics has foreign credit facilities available to satisfy short-term cash needs at specific foreign locations rather than funding from intercompany sources. These foreign credit facilities can be canceled at any time by either the bank or us. As of December 31, 2019, we maintained the following foreign credit facilities:

- A Thailand overdraft credit facility which allows for borrowings up to 90 million Thai Baht (approximately \$3.0 million at December 31, 2019 exchange rates). We had no borrowings under this foreign credit facility as of December 31, 2019 or June 30, 2019.
- An uncommitted credit facility for one of our China operations, which allows for borrowings up to \$7.5 million that can be drawn in either U.S. dollars or China Renminbi. We had no borrowings outstanding under this foreign credit facility as of December 31, 2019 or June 30, 2019.
- An uncommitted revolving credit facility for our Netherlands subsidiary, which allows for borrowings of up to 9.2 million Euro (approximately \$10.3 million at December 31, 2019 exchange rates) that can be drawn in Euro, U.S. dollars, or other optional currency. We had \$6.7 million in borrowings outstanding under this Netherlands revolving credit facility as of December 31, 2019 and \$3.4 million as of June 30, 2019.
- An uncommitted revolving credit facility for our Poland operation, which allows for borrowings of up to 15 million Euro (approximately \$16.8 million at December 31, 2019 exchange rates) that can be drawn in Euro, U.S. dollars, or Polish Zloty. We had no borrowings under this foreign credit facility as of December 31, 2019 or June 30, 2019.

Factoring Arrangements

The Company may utilize accounts receivable factoring arrangements with third-party financial institutions in order to extend terms for the customer without negatively impacting our cash flow. These arrangements in all cases do not contain recourse provisions which would obligate us in the event of our customers' failure to pay. Receivables are considered sold when they are transferred beyond the reach of Kimball Electronics and its creditors, the purchaser has the right to pledge or exchange the receivables, and we have surrendered control over the transferred receivables. In the six months ended December 31, 2019 and 2018, we sold, without recourse, \$142.4 million and \$127.3 million of accounts receivable, respectively. See [Note 1 - Business Description and Summary of Significant Accounting Policies](#) of Notes to Condensed Consolidated Financial Statements for more information regarding the factoring arrangements.

Future Liquidity

We believe our principal sources of liquidity from available funds on hand, cash generated from operations, and the availability of borrowing under our credit facilities will be sufficient to meet our working capital and other operating needs for at least the next 12 months. The unused borrowings in USD equivalent under all of our credit facilities totaled \$67.8 million at December 31, 2019. We expect to continue to invest in capital expenditures prudently, particularly for projects, including potential acquisitions, that would help us continue our development as a multifaceted manufacturing solutions provider.

The GES acquisition completed on October 1, 2018 was accounted for as a business combination. As of December 31, 2019, the Company has recorded a net adjusted purchase price of \$42.4 million, which includes a reduction for an estimated net working capital adjustment of \$7.6 million. We have paid cash, net of the cash acquired, of \$43.9 million, and a net receivable due from the seller has been recognized for \$3.8 million. While the net working capital adjustment continues to be disputed by the sellers of GES, the purchase price is considered final as a result of the twelve-month measurement period ending on September 30, 2019.

At December 31, 2019, our capital expenditure commitments were approximately \$2.1 million, consisting primarily of commitments for capacity purposes in anticipation of future growth, including new program wins, and replacement purposes. We anticipate our available liquidity will be sufficient to fund these capital expenditures.

At December 31, 2019, our foreign entities held cash totaling \$51.1 million. In December 2017, the U.S. Tax Cuts and Jobs Act (“Tax Reform”) was enacted into law by the United States. Tax Reform imposed a one-time deemed repatriation tax on accumulated unremitted foreign earnings. The Company has made reasonable estimates of certain effects and, therefore, has recorded provisions for net deferred tax assets at the new applicable rate and the one-time deemed repatriation tax on accumulated unremitted foreign earnings. As of December 31, 2019, the remaining provision recorded for the one-time deemed repatriation tax was \$9.8 million recorded in Long-term income taxes payable on the Condensed Consolidated Balance Sheet. The Company expects to pay this tax payable with available liquidity. Most of these accumulated unremitted foreign earnings have been invested in active non-U.S. business operations, and it is not anticipated such earnings will be remitted to the United States. Our intent is to permanently reinvest these funds outside of the United States. However, if such funds were repatriated, a portion of the funds remitted would be subject to applicable non-U.S. income and withholding taxes.

On October 21, 2015, the Company’s Board of Directors approved a resolution to authorize an 18-month stock repurchase plan (the “Plan”) to allow the repurchase of up to \$20 million of common stock. Then, separately on each of September 29, 2016, August 23, 2017, and November 8, 2018, the Board extended and increased the Plan to allow the repurchase of up to an additional \$20 million worth of common stock with no expiration date, which brought the total authorized stock repurchases under the Plan to \$80 million. The Plan may be suspended or discontinued at any time. The extent to which the Company repurchases its shares, and the timing of such repurchases, will depend upon a variety of factors, including market conditions, regulatory requirements, and other corporate considerations, as determined by the Company’s management team. The Company expects to finance the purchases with existing liquidity. The Company has repurchased \$74.0 million of common stock under the Plan through December 31, 2019.

Our ability to generate cash from operations to meet our liquidity obligations could be adversely affected in the future by factors such as general economic and market conditions, lack of availability of raw material components in the supply chain, a decline in demand for our services, loss of key contract customers, unsuccessful integration of acquisitions and new operations, the ability of Kimball Electronics to generate profits, and other unforeseen circumstances. In particular, should demand for our customers’ products and, in turn, our services decrease significantly over the next 12 months, the available cash provided by operations could be adversely impacted.

The preceding statements include forward-looking statements under the Private Securities Litigation Reform Act of 1995. Certain factors could cause actual results to differ materially from forward-looking statements.

Fair Value

During the second quarter of fiscal year 2020, no level 1 or level 2 financial instruments were affected by a lack of market liquidity. For level 1 financial assets, readily available market pricing was used to value the financial instruments. Our foreign currency derivative assets and liabilities, which were classified as level 2, were independently valued using observable market inputs such as forward interest rate yield curves, current spot rates, and time value calculations. To verify the reasonableness of the independently determined fair values, these derivative fair values were compared to fair values calculated by the counterparty banks. Our own credit risk and counterparty credit risk had an immaterial impact on the valuation of the foreign currency derivatives. See [Note 8 - Fair Value](#) of Notes to Condensed Consolidated Financial Statements for additional information.

Contractual Obligations

There have been no material changes outside the ordinary course of business to Kimball Electronics’ summary of contractual obligations under the caption, “Contractual Obligations” in the section entitled “Management’s Discussion and Analysis of Financial Condition and Results of Operations” of our Annual Report on Form 10-K for the year ended June 30, 2019.

Off-Balance Sheet Arrangements

In limited circumstances, we receive banker's acceptance drafts from customers to one of our China operations. In turn, we may transfer the acceptance drafts to a supplier in settlement of current accounts payable. These drafts contain certain recourse provisions afforded to the transferee under laws of The People's Republic of China, and if exercised, our China operation would be required to satisfy the obligation with the transferee as the draft would revert back to our China operation. No transferee has exercised their recourse rights against us. We also have standby letters of credit entered into in the normal course of business.

These arrangements do not have a material current effect and are not reasonably likely to have a material future effect on our financial condition, results of operations, liquidity, capital expenditures, or capital resources. See [Note 1 – Business Description and Summary of Significant Accounting Policies](#) of Notes to Condensed Consolidated Financial Statements for more information on the banker's acceptance drafts and [Note 6 - Commitments and Contingent Liabilities](#) of Notes to Condensed Consolidated Financial Statements for more information on standby letters of credit. We do not have material exposures to trading activities of non-exchange traded contracts.

The preceding statements are forward-looking statements under the Private Securities Litigation Reform Act of 1995. Certain factors could cause actual results to differ materially from forward-looking statements.

Critical Accounting Policies

Kimball Electronics' Condensed Consolidated Financial Statements have been prepared in accordance with accounting principles generally accepted in the United States of America. These principles require the use of estimates and assumptions that affect amounts reported and disclosed in the Condensed Consolidated Financial Statements and related notes. Actual results could differ from these estimates and assumptions. Management uses its best judgment in the assumptions used to value these estimates, which are based on current facts and circumstances, prior experience, and other assumptions that are believed to be reasonable.

There have been no material changes to our critical accounting policies since our Annual Report on Form 10-K for the year ended June 30, 2019. For further information regarding our critical accounting policies, refer to "Note 1 - Business Description and Summary of Significant Accounting Policies" of Notes to Consolidated Financial Statements and "Critical Accounting Policies" in the section entitled "Management's Discussion and Analysis of Financial Condition and Results of Operations" in our Annual Report on Form 10-K for the year ended June 30, 2019.

New Accounting Standards

See [Note 1 - Business Description and Summary of Significant Accounting Policies](#) of Notes to Condensed Consolidated Financial Statements for information regarding New Accounting Standards.

Forward-Looking Statements

Certain statements contained within this document are considered forward-looking under the Private Securities Litigation Reform Act of 1995. The statements may be identified by the use of words such as "believes," "anticipates," "expects," "intends," "plans," "projects," "estimates," "forecasts," "seeks," "likely," "future," "may," "might," "should," "would," "will," and similar expressions. These forward-looking statements are subject to risks and uncertainties including, but not limited to, successful integration of acquisitions and new operations, adverse changes in the global economic conditions, the geopolitical environment, significant reductions in volumes and order patterns from key contract customers, loss of key customers or suppliers within specific industries, financial stability of key customers and suppliers, availability or cost of raw materials and components, impact related to tariffs and other trade barriers, increased competitive pricing pressures, foreign exchange fluctuations, changes in the regulatory environment, or similar unforeseen events. Additional cautionary statements regarding other risk factors that could have an effect on the future performance of Kimball Electronics are contained in our Annual Report on Form 10-K for the year ended June 30, 2019. See Item [1A - Risk Factors](#) of this Quarterly Report on Form 10-Q for the quarter ended December 31, 2019 for revised risk factors.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

There were no material changes in our exposure to market risks for changes in foreign currency exchange rates and interest rates as compared to the fiscal year ended June 30, 2019. Comprehensive disclosures of quantitative and qualitative market risk can be found in our Annual Report on Form 10-K for the year ended June 30, 2019.

Item 4. Controls and Procedures

- (a) Evaluation of disclosure controls and procedures.

Kimball Electronics maintains controls and procedures designed to ensure that information required to be disclosed in the reports that are filed or submitted under the Securities Exchange Act of 1934 is recorded, processed, summarized, and reported within the time periods specified in the rules and forms of the Securities and Exchange Commission and that such information is accumulated and communicated to management, including the Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. Based upon their evaluation of those controls and procedures performed as of December 31, 2019, our Chief Executive Officer and Chief Financial Officer concluded that the disclosure controls and procedures were effective.

- (b) Changes in internal control over financial reporting.

There have been no changes in our internal control over financial reporting that occurred during the quarter ended December 31, 2019 that have materially affected, or that are reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

We may, from time to time, be involved in legal proceedings arising in the normal course of business. Other than proceedings incidental to our business, we are not a party to, nor is any of our property the subject of, any material pending legal proceedings and no such proceedings are, to our knowledge, threatened against us.

Item 1A. Risk Factors

We are subject to various risks and uncertainties in the course of our business. A comprehensive disclosure of risk factors related to Kimball Electronics can be found in our Annual Report on Form 10-K. We are including the following revised risk factors to update and supersede the corresponding risk factors disclosed in our Annual Report on Form 10-K for the year ended June 30, 2019, and the revised risk factors should be read in conjunction with the risk factors disclosed in our Annual Report on Form 10-K for the year ended June 30, 2019. There have been no other material changes to the risk factors disclosed in our Form 10-K for the year ended June 30, 2019.

Natural disasters or other catastrophic events may impact our production schedules and, in turn, negatively impact profitability.

Natural disasters or other catastrophic events, including severe weather, terrorist attacks, power interruptions, and fires, could disrupt operations and likewise our ability to produce or deliver products. Our manufacturing operations require significant amounts of energy, including natural gas and oil, and governmental regulations may control the allocation of such fuels to Kimball Electronics. Employees are an integral part of our business, and events such as a pandemic could reduce the availability of employees reporting for work. For example, the recent outbreak of the coronavirus in China has impacted and could further impact our operations in our two China facilities, as well as the shipments in and out of China and the availability of critical components, as a result of the restrictions being imposed by China and other countries, including on business operations and travel, in an effort to halt the spread of the virus. In the event we experience a temporary or permanent interruption in our ability to produce or deliver product, revenues could be reduced, and business could be materially adversely affected. In addition, catastrophic events, or the threat thereof, can adversely affect U.S. and world economies, and could result in delayed or lost revenue for our services. In addition, any continuing disruption in our computer systems could adversely affect the ability to receive and process customer orders, manufacture products, and ship products on a timely basis, and could adversely affect relations with customers, potentially resulting in reduction in orders from customers or loss of customers. We maintain insurance to help protect us from costs relating to some of these matters, but such may not be sufficient or paid in a timely manner to us in the event of such an interruption.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

The following table contains information about our purchases of equity securities during the three months ended December 31, 2019.

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plan	Maximum Dollar Value of Shares that May Yet Be Purchased Under the Plan ⁽¹⁾⁽²⁾
October 1, 2019 - October 31, 2019	178,547	\$ 14.71	178,547	\$ 5,977,717
November 1, 2019 - November 30, 2019	—	\$ —	—	\$ 5,977,717
December 1, 2019 - December 31, 2019	—	\$ —	—	\$ 5,977,717
Total	<u>178,547</u>	\$ 14.71	<u>178,547</u>	

(1) On October 21, 2015, our Board of Directors (the “Board”) approved an 18-month stock repurchase plan (the “Plan”), authorizing the repurchase of up to \$20 million worth of our common stock.

(2) Separately on each of September 29, 2016, August 23, 2017, and November 8, 2018, the Board extended and increased the Plan to allow the repurchase of up to an additional \$20 million worth of common stock with no expiration date, which brought the total authorized stock repurchases under the Plan to \$80 million.

Item 6. Exhibits

Exhibits (numbered in accordance with Item 601 of Regulation S-K)

- 3.1 [Amended and Restated Articles of Incorporation of the Company \(Incorporated by reference to Exhibit 3.1 to the Company's Form 8-K filed November 12, 2019, File No. 001-36454\)](#)
- 3.2 [Amended and Restated By-Laws of the Company \(Incorporated by reference to Exhibit 3.2 to the Company's Form 8-K filed November 12, 2019, File No. 001-36454\)](#)
- 31.1^(a) [Certification filed by Chief Executive Officer pursuant to Rule 13a-14\(a\)/15d-14\(a\), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002](#)
- 31.2^(a) [Certification filed by Chief Financial Officer pursuant to Rule 13a-14\(a\)/15d-14\(a\), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002](#)
- 32.1^{(a)(b)} [Certification furnished by the Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002](#)
- 32.2^{(a)(b)} [Certification furnished by the Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002](#)

- 101.INS^(a) XBRL Instance Document
- 101.SCH^(a) XBRL Taxonomy Extension Schema Document
- 101.CAL^(a) XBRL Taxonomy Extension Calculation Linkbase Document
- 101.DEF^(a) XBRL Taxonomy Extension Definition Linkbase Document
- 101.LAB^(a) XBRL Taxonomy Extension Label Linkbase Document
- 101.PRE^(a) XBRL Taxonomy Extension Presentation Linkbase Document

^(a) Filed herewith

^(b) In accordance with Item 601(b)(32)(ii) of Regulation S-K, the certifications furnished in Exhibit 32.1 and 32.2 will not be deemed "filed" for purposes of Section 18 of the Exchange Act. Such certifications will not be deemed to be incorporated by reference into any filing under the Securities Act or the Exchange Act, except to the extent that the registrant specifically incorporates it by reference.

SIGNATURES

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

KIMBALL ELECTRONICS, INC.

By: /s/ DONALD D. CHARRON

Donald D. Charron
Chairman of the Board,
Chief Executive Officer
February 6, 2020

By: /s/ MICHAEL K. SERGESKETTER

Michael K. Sergesketter
Vice President,
Chief Financial Officer
February 6, 2020

Exhibit 31.1

**CERTIFICATION PURSUANT TO
RULE 13a-14(a)/15d-14(a),
AS ADOPTED PURSUANT TO
SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, Donald D. Charron, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Kimball Electronics, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: February 6, 2020

/s/ DONALD D. CHARRON

DONALD D. CHARRON
Chairman of the Board,
Chief Executive Officer

Exhibit 31.2

**CERTIFICATION PURSUANT TO
RULE 13a-14(a)/15d-14(a),
AS ADOPTED PURSUANT TO
SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002**

I, Michael K. Sergesketter, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Kimball Electronics, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: February 6, 2020

/s/ MICHAEL K. SERGESKETTER

MICHAEL K. SERGESKETTER
Vice President,
Chief Financial Officer

Exhibit 32.1

**CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report of Kimball Electronics, Inc. (the "Company") on Form 10-Q for the period ended December 31, 2019 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Donald D. Charron, Chairman of the Board and Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934;
and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: February 6, 2020

/s/ DONALD D. CHARRON

DONALD D. CHARRON
Chairman of the Board,
Chief Executive Officer

Exhibit 32.2

**CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Quarterly Report of Kimball Electronics, Inc. (the "Company") on Form 10-Q for the period ended December 31, 2019 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Michael K. Sergesketter, Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934;
and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: February 6, 2020

/s/ MICHAEL K. SERGESKETTER

MICHAEL K. SERGESKETTER
Vice President,
Chief Financial Officer