ESCO TECHNOLOGIES INC
Form 10-Q
August 08, 2007

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(MARK ONE)

(X) QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2007

OR

( ) TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE TRANSITION PERIOD FROM ______ TO ______

COMMISSION FILE NUMBER 1-10596

ESCO TECHNOLOGIES INC.

(Exact name of registrant as specified in its charter)

| MISSOURI | 43-1554045 |
|---|---|
| (State or other jurisdiction of incorporation or organization) | (I.R.S. Employer Identification No.) |

| 9900A CLAYTON ROAD<br>ST. LOUIS, MISSOURI | 63124-1186 |
|---|---|
| (Address of principal executive offices) | (Zip Code) |

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days. Yes X No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. Large accelerated filer X Accelerated filer ___ Non-accelerated filer ___

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

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

| Class | Outstanding at July 31, 2007 |
|---|---|
| [Common stock, $.01 par value per share] | 25,728,995 shares |

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

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

| | Three Months Ended June 30, | |
|---|---|---|
| | 2007 | 2006 |
| Net sales | $ 137,523 | 123,626 |
| Costs and expenses: | | |
| Cost of sales | 88,582 | 77,152 |
| Selling, general and administrative expenses | 30,549 | 28,385 |
| Amortization of intangible assets | 2,853 | 2,554 |
| Interest (income) expense, net | (170) | (195) |
| Other (income) and expenses, net | 2,443 | (513) |
| Total costs and expenses | 124,257 | 107,383 |
| Earnings before income taxes | 13,266 | 16,243 |
| Income tax expense | 4,412 | 5,080 |
| Net earnings | $ 8,854 | 11,163 |
| Earnings per share: | | |
| Basic | $ 0.34 | 0.43 |
| Diluted | $ 0.33 | 0.42 |

See accompanying notes to consolidated financial statements.

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

| | Nine Months Ended June 30, | |
|---|---|---|
| | 2007 | 2006 |

| | | |
|---|---|---|
| Net sales | $ 365,404 | 337,096 |
| Costs and expenses: | | |
| Cost of sales | 242,965 | 221,654 |
| Selling, general and administrative expenses | 91,348 | 78,574 |
| Amortization of intangible assets | 7,900 | 4,603 |
| Interest (income) expense, net | (725) | (1,012) |
| Other (income) and expenses, net | 1,835 | (2,440) |
| Total costs and expenses | 343,323 | 301,379 |
| Earnings before income taxes | 22,081 | 35,717 |
| Income tax expense | 4,990 | 15,006 |
| Net earnings | $ 17,091 | 20,711 |
| Earnings per share: | | |
| Basic | $ 0.66 | 0.81 |
| Diluted | $ 0.65 | 0.78 |

See accompanying notes to consolidated financial statements.

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

| | June 30, 2007 | September 30, 2006 |
|---|---|---|
| ASSETS | (Unaudited) | |
| Current assets: | | |
| Cash and cash equivalents | $ 21,884 | 36,819 |
| Accounts receivable, net | 101,579 | 83,816 |
| Costs and estimated earnings on long-term contracts, less progress billings of $6,295 and $4,405, respectively | 5,039 | 1,345 |
| Inventories | 67,994 | 50,984 |
| Current portion of deferred tax assets | 36,169 | 24,251 |
| Other current assets | 19,967 | 10,042 |
| Total current assets | 252,632 | 207,257 |
| Property, plant and equipment, net | 74,611 | 68,754 |
| Goodwill | 144,435 | 143,450 |
| Intangible assets, net | 72,468 | 59,202 |
| Other assets | 9,642 | 10,031 |
| Total assets | $ 553,788 | 488,694 |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | |
| Current liabilities: | | |
| Short-term borrowings and current | | |

| | | |
|---|---|---|
| maturities of long-term debt | $ 676 | - |
| Accounts payable | 53,448 | 39,496 |
| Advance payments on long-term contracts, less costs incurred of $15,327 and $19,532, respectively | 5,623 | 7,367 |
| Accrued salaries | 13,381 | 13,932 |
| Current portion of deferred revenue | 20,999 | 3,569 |
| Accrued other expenses | 11,981 | 11,531 |
| Total current liabilities | 106,108 | 75,895 |
| Deferred revenue | 3,477 | 7,458 |
| Pension obligations | 13,091 | 13,143 |
| Deferred tax liabilities | 22,626 | 3,750 |
| Other liabilities | 11,284 | 12,014 |
| Long-term debt | - | - |
| Total liabilities | 156,586 | 112,260 |
| Shareholders' equity: | | |
| Preferred stock, par value $.01 per share, authorized 10,000,000 shares | - | - |
| Common stock, par value $.01 per share, authorized 50,000,000 shares, issued 29,133,959 and 29,030,995 shares, respectively | 291 | 290 |
| Additional paid-in capital | 240,994 | 236,390 |
| Retained earnings | 210,137 | 193,046 |
| Accumulated other comprehensive income (loss) | 475 | (2,070) |
| | 451,897 | 427,656 |
| Less treasury stock, at cost: 3,255,166 and 3,166,026 common shares, respectively | (54,695) | (51,222) |
| Total shareholders' equity | 397,202 | 376,434 |
| Total liabilities and shareholders' equity | $ 553,788 | 488,694 |

See accompanying notes to consolidated financial statements.

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

| | Nine Months Ended June 30, | |
|---|---|---|
| | 2007 | 2006 |
| Cash flows from operating activities: | | |
| Net earnings | $ 17,091 | 20,711 |
| Adjustments to reconcile net earnings to net cash provided by operating activities: | | |
| Depreciation and amortization | 16,361 | 12,407 |
| Stock compensation expense | 4,113 | 3,660 |
| Changes in operating working capital | (28,514) | 9,824 |

| | | |
|---|---|---|
| Effect of deferred taxes | 6,959 | 2,343 |
| Change in deferred revenue and costs, net | 6,427 | 1,117 |
| Other | (2,283) | (1,020) |
| Net cash provided by operating activities | 20,154 | 49,042 |
| Cash flows from investing activities: | | |
| Acquisition of businesses, less cash acquired | (1,250) | (91,468) |
| Capital expenditures | (13,201) | (6,753) |
| Additions to capitalized software | (22,676) | (24,413) |
| Net cash used by investing activities | (37,127) | (122,634) |
| Cash flows from financing activities: | | |
| Borrowings from long-term debt | - | 52,000 |
| Principal payments on long-term debt | - | (52,000) |
| Net increase in short-term borrowings | 676 | - |
| Excess tax benefit from stock options exercised | 73 | 1,112 |
| Proceeds from exercise of stock options | 1,512 | 2,031 |
| Other | (223) | 1,223 |
| Net cash provided by financing activities | 2,038 | 4,366 |
| Net decrease in cash and cash equivalents | (14,935) | (69,226) |
| Cash and cash equivalents, beginning of period | 36,819 | 104,484 |
| Cash and cash equivalents, end of period | $ 21,884 | 35,258 |

See accompanying notes to consolidated financial statements.

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

1. BASIS OF PRESENTATION

The accompanying consolidated financial statements, in the opinion of management, include all adjustments, consisting of normal recurring accruals, necessary for a fair presentation of the results for the interim periods presented. The consolidated financial statements are presented in accordance with the requirements of Form 10-Q and consequently do not include all the disclosures required by accounting principles generally accepted in the United States of America (GAAP). For further information refer to the consolidated financial statements and related notes included in the Company's Annual Report on Form 10-K for the fiscal year ended September 30, 2006. Certain 2006 amounts have been reclassified to conform with the 2007 presentation.

The Company's business is typically not impacted by seasonality, however,

the results for the three and nine-month periods ended June 30, 2007 are not necessarily indicative of the results for the entire 2007 fiscal year.

2. EARNINGS PER SHARE (EPS)

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

| | Three Months Ended June 30, | | Nine Months Ended June 30, | |
|---|---|---|---|---|
| | 2007 | 2006 | 2007 | 2006 |
| Weighted Average Shares Outstanding - Basic | 25,941 | 25,790 | 25,904 | 25,678 |
| Dilutive Options and Restricted Shares | 552 | 651 | 578 | 740 |
| Adjusted Shares- Diluted | 26,493 | 26,441 | 26,482 | 26,418 |

Options to purchase 529,879 shares of common stock at prices ranging from $42.99 - $54.88 and options to purchase 287,486 shares of common stock at prices ranging from $42.99 - $54.88 were outstanding during the three month periods ended June 30, 2007 and 2006, respectively, but were not included in the computation of diluted EPS because the options' exercise prices were greater than the average market price of the common shares. The options expire at various periods through 2013. Approximately 19,000 and 12,000 restricted shares were excluded from the computation of diluted EPS based upon the application of the treasury stock method for the three-month period ended June 30, 2007 and 2006, respectively.

3. SHARE-BASED COMPENSATION

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

Stock Option Plans

The Company's stock option awards are generally subject to graded vesting over a three year service period. All outstanding options were granted at prices equal to fair market value at the date of grant. The options granted prior to September 30, 2003 have a ten-year contractual life from date of issuance, expiring in various periods through 2013. Beginning in fiscal 2004, the options granted have a five-year contractual life from date of issuance. Beginning with fiscal 2006 awards, the Company recognizes compensation cost on a straight-line basis over the requisite service period for the entire award. Prior to fiscal 2006, the Company calculated the pro forma compensation cost using the graded vesting method.

The fair value of each option award is estimated as of the date of grant using a Black-Scholes option pricing model. The weighted average assumptions for the periods indicated are noted below. Expected volatility is based on historical volatility of ESCO's stock calculated over the expected term of the option. The expected term was calculated in accordance with Staff Accounting Bulletin No. 107 using the simplified method for "plain-vanilla" options. The risk-free rate for the expected term of the option is based on the U.S. Treasury yield curve in effect at the date of grant.

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted-average assumptions used for grants in the three month period ended June 30, 2007 and 2006, respectively: expected dividend yield of 0% in both periods; expected volatility of 28.5% and 28.2%; risk-free interest rate of 4.6% and 5.0%; and expected term of 3.5 years in both periods. Pre-tax compensation expense related to the stock option awards was $0.7 million and $2.2 million for the three and nine-month periods ended June 30, 2007, respectively, and $0.6 million and $1.7 million for the respective prior year periods.

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

| | Shares | Weighted Avg. Price | Aggregate Intrinsic Value (in millions) | Weighted-Average Remaining Contractual Life |
|---|---|---|---|---|
| Outstanding at October 1, 2006 | 1,387,348 | $26.60 | | |
| Granted | 295,280 | $45.74 | | |
| Exercised | (76,013) | $24.49 | $ 1.8 | |
| Cancelled | (20,504) | $39.36 | | |
| Outstanding at June 30, 2007 | 1,586,111 | $30.10 | $ 15.2 | 3.3 years |
| Exercisable at June 30, 2007 | 972,335 | $21.64 | $ 15.1 | |

The weighted-average grant-date fair value of options granted during the nine-month period ended June 30, 2007 and 2006 was $12.25 and $12.11, respectively.

Performance-accelerated Restricted Share Awards

The performance-accelerated restricted shares (restricted shares) vest over five years with accelerated vesting if certain performance targets are achieved. In these cases, if it is probable that the performance condition will be met, the Company recognizes compensation cost on a straight-line basis over the shorter performance period; otherwise, it will recognize compensation cost over the longer service period. Compensation cost for all

outstanding restricted share awards is being recognized over the shorter performance period as it is probable the performance condition will be met. The restricted share award grants were valued at the stock price on the date of grant. Pre-tax compensation expense related to the restricted share awards was $0.2 million and $1.2 million for the three and nine-month periods ended June 30, 2007, respectively and $0.2 million and $1.3 million for the respective prior year periods.

The following summary presents information regarding outstanding restricted share awards as of June 30, 2007 and changes during the nine-month period then ended:

| | Shares | Weighted Avg. Price |
|---|---|---|
| Nonvested at October 1, 2006 | 155,730 | $ 34.33 |
| Granted | 63,530 | $ 45.75 |
| Vested | (51,200) | $ 24.60 |
| Cancelled | (4,000) | $ 34.80 |
| Nonvested at June 30, 2007 | 164,060 | $ 41.77 |

Non-Employee Directors Plan

Pursuant to the non-employee directors compensation plan, each non-employee director receives a retainer of 800 common shares per quarter. Pre-tax compensation expense related to the non-employee director grants was $0.2 million and $0.6 million for the three and nine-month periods ended June 30, 2007, respectively and $0.2 million and $0.7 million for the respective prior year periods.

The total share-based compensation cost that has been recognized in results of operations and included within SG&A was $1.2 million and $4.1 million for the three and nine-month periods ended June 30, 2007, respectively, and $1.0 million and $3.7 million for the three and nine-months periods ended June 30, 2006. The total income tax benefit recognized in results of operations for share-based compensation arrangements was $0.3 million and $1.0 million for the three and nine-month periods ended June 30, 2007 respectively, and $0.3 million and $1.0 million for the three and nine-month periods ended June 30, 2006. As of June 30, 2007, there was $11.0 million of total unrecognized compensation cost related to share-based compensation arrangements. That cost is expected to be recognized over a weighted-average period of 3.1 years.

4. INVENTORIES

Inventories consist of the following (in thousands):

| | June 30, 2007 | September 30, 2006 |
|---|---|---|
| Finished goods | $ 21,633 | 12,834 |
| Work in process, including long- term contracts | 17,045 | 13,211 |
| Raw materials | 29,316 | 24,939 |

| | | |
|---|---|---|
| Total inventories | $ 67,994 | 50,984 |
| | ====== | ====== |

5. COMPREHENSIVE INCOME

Comprehensive income for the three-month periods ended June 30, 2007 and 2006 was $9.8 million and $12.2 million, respectively. Comprehensive income for the nine-month periods ended June 30, 2007 and 2006 was $19.6 million and $22.1 million, respectively. For the three and nine-month periods ended June 30, 2007, the Company's comprehensive income was positively impacted by foreign currency translation adjustments of $1.0 million and $2.5 million, respectively. For the three and nine-month periods ended June 30, 2006, the Company's comprehensive income was positively impacted by foreign currency translation adjustments of $1.1 million and $1.4 million, respectively.

6. BUSINESS SEGMENT INFORMATION

The Company is organized based on the products and services that it offers. Under this organizational structure, the Company operates in three segments: Communications, Filtration/Fluid Flow and Test. The components of the Filtration/Fluid Flow segment are presented separately due to differing long-term economics.

Management evaluates and measures the performance of its operating segments based on "Net Sales" and "EBIT", which are detailed in the table below. EBIT is defined as earnings before interest and taxes.

| ($ in thousands) | Three Months ended June 30, | | Nine Months ended June 30, | |
|---|---|---|---|---|
| NET SALES | 2007 | 2006 | 2007 | 2006 |
| Communications | $ 53,943 | 49,251 | $ 133,203 | 111,623 |
| PTI | 13,704 | 11,379 | 38,439 | 33,787 |
| VACCO | 9,366 | 6,551 | 24,507 | 22,930 |
| Filtertek | 25,960 | 24,628 | 72,577 | 72,335 |
| Filtration/Fluid Flow | 49,030 | 42,558 | 135,523 | 129,052 |
| Test | 34,550 | 31,817 | 96,678 | 96,421 |
| Consolidated totals | $137,523 | 123,626 | $365,404 | 337,096 |
| | ======== | ======= | ======== | ======= |
| EBIT | | | | |
| Communications | 8,564 | 11,369 | 11,891 | 20,138 |
| PTI | 2,752 | 1,479 | 6,463 | 4,261 |
| VACCO | 2,516 | 1,388 | 5,108 | 4,720 |
| Filtertek | 1,652 | 2,330 | 3,520 | 5,026 |
| Filtration/Fluid Flow | 6,920 | 5,197 | 15,091 | 14,007 |
| Test | 2,042 | 4,034 | 8,246 | 11,288 |

| | | | | |
|---|---|---|---|---|
| Corporate | (4,430) | (4,552) | (13,872) | (10,728) |
| Consolidated EBIT | 13,096 | 16,048 | 21,356 | 34,705 |
| Add: Interest income | 170 | 195 | 725 | 1,012 |
| Earnings before income taxes | $ 13,266 | 16,243 | $ 22,081 | 35,717 |

7. OTHER (INCOME) AND EXPENSES, NET

Other (income) and expenses, net, was $2.4 million for the third quarter of 2007 compared to income of $(0.5) million for the prior year third quarter. Other (income) and expenses, net, was $1.8 million for the first nine months of 2007 compared to income of $(2.4) million for the prior year period. The principal component of other (income) and expenses, net, for the third quarter of 2007 included a $2.3 million charge within the Test segment related to the adverse arbitration award related to a delivery and installation contract completed in 2005 for a shielded communication room in an international location. The principal components of other (income) and expenses, net, for the first nine months of 2007 included a $2.3 million charge related to the arbitration award mentioned above; partially offset by $1.1 million of royalty income.

Principal components of other income, net, for the first nine months of 2006 included the following items: $1.8 million non-cash gain representing the release of a reserve related to an indemnification obligation with respect to a previously divested subsidiary; $1.6 million of royalty income; partially offset by a $0.2 million write-off of assets related to a terminated subcontract manufacturer.

8. INCOME TAX EXPENSE

The third quarter 2007 effective income tax rate was 33.3% compared to 31.3% in the third quarter of 2006. The effective income tax rate in the first nine months of 2007 was 22.6% compared to 42.0% in the prior year period. The third quarter 2007 income tax expense was impacted by the resolution of certain tax exposure items of $0.7 million, reducing the 2007 third quarter effective income tax rate by 5.0%. The third quarter 2006 income tax expense was favorably impacted by a $1.0 million research tax credit, reducing the 2006 third quarter effective income tax rate by 6.0%.

The decrease in the effective income tax rate in the first nine months of 2007 as compared to the prior year period was due to the favorable impact of the research tax credit and the resolution of certain tax exposure items mentioned above. The research tax credit and resolution of certain tax exposure items favorably impacted the effective income tax rate in the first nine months of 2007 by 14.2% and 3.0%, respectively. The effective tax rate for the first nine months of 2006 was negatively impacted by the repatriation of $28.7 million of cash held by foreign subsidiaries. The effect of the repatriation increased the effective income tax rate for the first nine months of 2006 by 4.8%. Due to the tax research credits favorably impacting the tax rate in the first half of 2007, the Company estimates the fiscal 2007 tax rate to be approximately 34%.

9. RETIREMENT PLANS

A summary of net periodic benefit expense for the Company's defined benefit plans for the three and nine-month periods ended June 30, 2007 and 2006 is

shown in the following table. Net periodic benefit cost for each period presented is comprised of the following:

| (Dollars in thousands) | Three Months Ended June 30, 2007 | Three Months Ended June 30, 2006 | Nine Months Ended June 30, 2007 | Nine Months Ended June 30, 2006 |
|---|---|---|---|---|
| Defined benefit plans | | | | |
| Interest cost | $688 | 635 | $2,063 | 1,935 |
| Expected return on assets | (700) | (696) | (2,100) | (2,046) |
| Amortization of: | | | | |
| Prior service cost | 2 | 6 | 7 | 6 |
| Actuarial loss | 85 | 55 | 255 | 305 |
| Net periodic benefit cost | $ 75 | - | $ 225 | 200 |

10. RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements" (SFAS 157). The purpose of SFAS No. 157 is to define fair value, establish a framework for measuring fair value, and enhance disclosures about fair value measurements. SFAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. The measurement and disclosure requirements are effective for the Company in the first quarter of fiscal year 2009. The adoption of SFAS 157 is not expected to have a material impact to the Company's financial position or results of operations.

In September 2006, the FASB issued SFAS No. 158, "Employer's Accounting for Defined Benefit Pension and Other Postretirement Plans" (SFAS 158), which amends SFAS 87 and SFAS 106 to require recognition of the overfunded or underfunded status of pension and other postretirement benefit plans on the balance sheet. Under SFAS 158, gains and losses, prior service costs and credits, and any remaining transition amounts under SFAS 87 and SFAS 106 that have not yet been recognized through net periodic benefit cost will be recognized in accumulated other comprehensive income, net of tax effects. The measurement date - the date at which the benefit obligation and plan assets are measured - is required to be the Company's fiscal year-end, which is the date the Company currently uses. SFAS 158 is effective for publicly-held companies for fiscal years ending after December 15, 2006. The adoption of SFAS 158 is not expected to have a material impact to the Company's financial position or results of operations.

In June 2006, the FASB issued FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes, an Interpretation of FASB Statement No. 109." This Interpretation is effective for the Company beginning October 1, 2007. This Interpretation prescribes a recognition threshold and measurement process for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. The Company is currently evaluating the adoption of this Interpretation and does not currently have an estimate of the impact on the consolidated financial statements.

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

RESULTS OF OPERATIONS

The following discussion refers to the Company's results from continuing operations, except where noted. References to the third quarters of 2007 and 2006 represent the fiscal quarters ended June 30, 2007 and 2006, respectively.

NET SALES

Net sales increased $13.9 million, or 11.2%, to $137.5 million for the third quarter of 2007 from $123.6 million for the third quarter of 2006. Net sales increased across all segments in the third quarter of 2007 compared to the prior year quarter. Net sales increased $28.3 million, or 8.4%, to $365.4 million for the first nine months of fiscal 2007 from $337.1 million for the first nine months of 2006. These increases were mainly due to the 2006 acquisitions of Hexagram and Nexus. Favorable foreign currency values resulted in approximately $0.5 million and $2.9 million of the sales increase in the third quarter of 2007 and in the first nine months of 2007, respectively.

-Communications

Net sales increased $4.7 million, or 9.6%, to $53.9 million for the third quarter of 2007 from $49.2 million for the third quarter of 2006. Net sales increased $21.6 million, or 19.4%, to $133.2 million for the first nine months of 2007 from $111.6 million in the prior year period. The sales increase in the third quarter of 2007 as compared to the prior year quarter was due to: an increase in sales of $3.7 million from Hexagram including advanced metering projects at PG&E and Kansas City; an increase in sales of $1.1 million from Nexus; a $0.9 million increase in sales of DCSI's AMR products; partially offset by a $1.0 million decrease in sales from Comtrak due to the timing of product deliveries which slipped to the fourth quarter.

The sales increase in the first nine months of 2007 as compared to the prior year period was due to: an increase in sales of $19.5 million from Hexagram (full nine months of sales compared to five months included in the prior year period) in addition to the items mentioned above; an increase in sales of $4.3 million from Nexus (full nine months of sales compared to seven months included in the prior year period); partially offset by a $1.2 million decrease in sales of DCSI's AMR products and a $1.0 million decrease in sales from Comtrak.

The decrease in sales of DCSI's AMR products of $1.2 million in the first nine months of 2007 as compared to the prior year period was mainly due to: a decrease in sales to TXU of $18.3 million, partially offset by an increase in sales to other investor-owned utilities (IOUs), such as Florida Power & Light, Duke Energy and EDESUR of $11.6 million and an increase in sales to COOP customers of $7.2 million. In the first nine months of 2007, DCSI's sales to COOP and public power (Municipal) customers were $64.2 million compared to $57.0 million in the prior year period.

Sales of Comtrak's video surveillance products were $0.5 million and $1.5 million for the third quarters of 2007 and 2006, respectively, and $3.5 million for the first nine months of 2007 as compared to $4.4 million in the prior year nine-month period.

-Filtration/Fluid Flow

Net sales increased $6.4 million, or 15.0%, to $49.0 million for the third quarter of 2007 from $42.6 million for the third quarter of 2006. Net sales increased $6.5 million to $135.5 million for the first nine months of 2007 from $129.0 million for the first nine months of 2006. The sales increase during the fiscal quarter ended June 30, 2007 as compared to the prior year quarter was mainly due to: a $2.3 million increase in commercial aerospace shipments at PTI; a sales increase of $2.7 million at VACCO driven by higher defense spares and T-700 shipments; and a net sales increase of $1.4 million at Filtertek driven primarily by its Brazilian operations. The sales increase in the first nine

months of 2007 as compared to the prior year period was mainly due to: a $4.6 million increase in commercial aerospace shipments at PTI; a $1.6 million increase in defense spares and T-700 shipments at VACCO; and a $0.3 million net sales increase at Filtertek.

-Test

For the third quarter of 2007, net sales of $34.6 million were $2.8 million, or 8.8% higher than the $31.8 million of net sales recorded in the third quarter of 2006. Net sales increased $0.2 million to $96.7 million for the first nine months of 2007 from $96.5 million for the first nine months of 2006. The sales increase in the third quarter of 2007 as compared to the prior year quarter was mainly due to: a $3.2 million increase in net sales from the Company's U.S. operations driven by milestones on a large aircraft chamber project and completion of other test chambers; a $0.6 million increase in net sales from the Company's European operations; partially offset by a $1.0 million decrease in net sales from the Company's Asian operations due to the timing of completion on several chamber projects in Japan. The sales increase for the first nine months of 2007 compared to the prior year period was due to: a $1.3 million increase in net sales from the Company's Asian operations; partially offset by a $0.7 million decrease in net sales from the Company's European operations and a $0.3 million decrease in net sales from the Company's U.S. operations both driven by the timing of sales of test chambers and components.

ORDERS AND BACKLOG

Backlog was $316.5 million at June 30, 2007 compared with $253.4 million at September 30, 2006. The Company received new orders totaling $146.4 million in the third quarter of 2007 compared to $109.1 million in the prior year quarter. New orders of $61.7 million were received in the third quarter of 2007 related to Communications products, $54.4 million related to Filtration/Fluid Flow products, and $30.3 million related to Test products.

The Company received new orders totaling $428.5 million in the first nine months of 2007 compared to $363.9 million in the prior year period (including $15.0 million of Hexagram and Nexus acquired backlog). New orders of $167.9 million were received in the first nine months of 2007 related to Communications products, $154.4 million related to Filtration/Fluid Flow products, and $106.2 million related to Test products. New orders of $144.4 million were received in the first nine months of 2006 related to Communications products (including $15.0 million of Hexagram and Nexus acquired backlog), $134.0 million related to Filtration/Fluid Flow products and $85.5 million related to Test products. See "CAPITAL RESOURCES AND LIQUIDITY - Pacific Gas & Electric" below for a discussion of PG&E contracts. The Company received orders totaling $30.1 million and $48.4 million from PG&E under these agreements during the third quarter and first nine months of fiscal 2007, respectively.

AMORTIZATION OF INTANGIBLE ASSETS

Amortization of intangible assets was $2.9 million and $7.9 million for the three and nine-month periods ended June 30, 2007, respectively, compared to $2.6 million and $4.6 million for the respective prior year periods. Amortization of intangible assets for the three and nine-month periods ended June 30, 2007 included $0.5 million and $1.7 million, respectively, of amortization of acquired intangible assets related to the Nexus and Hexagram acquisitions compared to $1.0 million and $1.9 million for the respective prior year periods. The amortization of acquired intangible assets related to Nexus and Hexagram are included in Corporate's operating results, see "EBIT - Corporate". The remaining amortization expenses consist of other identifiable intangible assets (primarily software, patents and licenses). During the three and nine-month periods ended June 30, 2007, the Company recorded $1.8 million and $4.5 million, respectively, of amortization related to DCSI's TNG capitalized software compared to $0.9

million and $1.2 million in the respective prior year periods.

SELLING, GENERAL AND ADMINISTRATIVE EXPENSES

Selling, general and administrative (SG&A) expenses for the third quarter of 2007 were $30.5 million (22.2% of net sales), compared with $28.4 million (23.0% of net sales) for the prior year quarter. For the first nine months of 2007, SG&A expenses were $91.3 million (25.0% of net sales) compared with $78.6 million (23.3% of net sales) for the prior year period. The increase in SG&A spending in the fiscal quarter ended June 30, 2007 as compared to the prior year quarter was primarily due to: a $1.7 million increase in SG&A at DCSI mainly due to an increase in headcount; and a $0.7 million increase in SG&A at Corporate.

The increase in SG&A spending in the first nine months of 2007 as compared to the prior year period was primarily due to: a $4.4 million increase in SG&A related to Hexagram (due to a full nine months of SG&A expenses compared to five months included in the prior year period); a $2.7 million increase in SG&A related to Nexus (due to a full nine months compared to seven months included in the prior year period) and an increase in headcount; an increase of $2.6 million in SG&A expenses at DCSI mainly due to an increase in headcount; an increase of $1.7 million in SG&A expenses incurred in the Test segment primarily to support growth opportunities in Asia; and a $1.3 million increase at Corporate including an increase in professional fees incurred to support a research tax credit project, an increase in stock option expense, and an increase in headcount.

OTHER (INCOME) AND EXPENSES, NET

Other (income) and expenses, net, was $2.4 million for the third quarter of 2007 compared to income of $(0.5) million for the prior year third quarter. Other (income) and expenses, net, was $1.8 million for the first nine months of 2007 compared to income of $(2.4) million for the prior year period. The principal component of other (income) and expenses, net, for the third quarter of 2007 included a $2.3 million charge within the Test segment related to the adverse arbitration award related to a delivery and installation contract completed in 2005 for a shielded communication room in an international location. The principal components of other (income) and expenses, net, for the first nine months of 2007 included a $2.3 million charge related to the arbitration award mentioned above; partially offset by $1.1 million of royalty income.

Principal components of other income, net, for the first nine months of 2006 included the following items: $1.8 million non-cash gain representing the release of a reserve related to an indemnification obligation with respect to a previously divested subsidiary; $1.6 million of royalty income; partially offset by a $0.2 million write-off of assets related to a terminated subcontract manufacturer.

EBIT

The Company evaluates the performance of its operating segments based on EBIT, defined below. EBIT was $13.1 million (9.5 % of net sales) for the third quarter of 2007 and $16.0 million (13.0% of net sales) for the third quarter of 2006. For the first nine months of fiscal 2007, EBIT was $21.4 million (5.9% of net sales) and $34.7 million (10.3% of net sales) for the first nine months of 2006. The decrease in EBIT for the third quarter of 2007 and first nine months of 2007 as compared to the prior year periods is primarily due to the decrease in margins in the Communications segment described below and a $2.3 million adverse arbitration award within the Test segment.

This Form 10-Q contains the financial measure "EBIT", which is not calculated in accordance with generally accepted accounting principles in the United States of America (GAAP). EBIT provides investors and Management with an alternative method for assessing the Company's operating results. The Company defines "EBIT"

as earnings from continuing operations before interest and taxes. Management evaluates the performance of its operating segments based on EBIT and believes that EBIT is useful to investors to demonstrate the operational profitability of the Company's business segments by excluding interest and taxes, which are generally accounted for across the entire Company on a consolidated basis. EBIT is also one of the measures Management uses to determine resource allocations within the Company and incentive compensation. The following table presents a reconciliation of EBIT to net earnings.

| ($ in thousands) | Three Months ended June 30, | | Nine Months ended June 30, | |
|---|---|---|---|---|
| | 2007 | 2006 | 2007 | 2006 |
| Consolidated EBIT | $13,096 | 16,048 | $21,356 | 34,705 |
| Add: Interest income | 170 | 195 | 725 | 1,012 |
| Less: Income taxes | 4,412 | 5,080 | 4,990 | 15,006 |
| Net earnings | $ 8,854 | 11,163 | $17,091 | 20,711 |

-Communications

EBIT in the third quarter of 2007 was $8.6 million (16.0% of net sales) compared to $11.4 million (23.2% of net sales) in the prior year quarter. For the first nine months of 2007, EBIT was $11.9 million (8.9% of net sales) compared to $20.1 million (18.0% of net sales) in the prior year period. The decrease in EBIT in the third quarter of 2007 was due to: a $3.9 million decrease in EBIT at DCSI resulting from a $0.9 increase in amortization of its TNG software, increased engineering / new product development costs, increased PG&E related program support costs, higher freight costs and an increase in headcount; a $0.5 million decrease at Comtrak due to lower sales volumes; partially offset by a $0.9 million increase at Hexagram and a $0.7 million increase at Nexus both resulting from increased sales volumes. The decrease in EBIT for the first nine months of 2007 compared to the prior year period was due to: a $10.2 million decrease in EBIT at DCSI due to an increase of $3.3 million in amortization expenses of its TNG software, increased PG&E related program support costs, higher freight costs and an increase in headcount; a $0.2 million decrease in EBIT at Comtrak; partially offset by a $1.5 million increase at Hexagram and a $0.6 million increase at Nexus both resulting from increased sales volumes.

-Filtration/Fluid Flow

EBIT was $6.9 million (14.1% of net sales) and $5.2 million (12.2% of net sales) in the third quarters of 2007 and 2006, respectively, and $15.1 million (11.1% of net sales) and $14.0 million (10.9% of net sales) in the first nine months of 2007 and 2006, respectively. For the third quarter of 2007 as compared to the prior year quarter, EBIT increased $1.7 million due to: a $1.2 million increase at PTI due to higher commercial aerospace shipments; a $1.1 million increase at VACCO resulting from increased sales volumes; partially offset by a $0.6 million decrease at Filtertek due to higher raw material and overhead costs. For the first nine months of 2007 as compared to the prior year period, EBIT increased $1.1 million due to: a $2.2 million increase at PTI due to higher commercial aerospace shipments; a $0.4 million increase at VACCO due to higher sales volumes; partially offset by a $1.5 million decrease at Filtertek due to product mix, higher raw material costs and labor costs.

-Test

EBIT in the third quarter of 2007 was $2.0 million (5.8% of net sales) as compared to $4.0 million (12.6% of net sales) in the prior year quarter. For the

first nine months of 2007, EBIT was $8.2 million (8.5% of net sales) as compared to $11.3 million (11.7% of net sales) in the prior year period. For the first nine months of 2007, EBIT was unfavorably impacted by $2.6 million of total costs associated with the arbitration judgment related to a 2005 U.S. Government project. These costs included $2.3 million of damages arising out of alleged delays in the delivery and installation of a shielded communication room in an international location (recorded in the third quarter of 2007) and approximately $0.3 million of legal costs associated with arbitrating this dispute. EBIT decreased $2.0 million and $3.1 million over the prior year quarter and nine month period, respectively, mainly due to the arbitration costs mentioned above, the timing of sales, and additional sales and marketing costs to support near-term sales growth opportunities, primarily in Asia.

-Corporate

Corporate costs included in EBIT were $4.4 million and $13.8 million for the three and nine-month periods ended June 30, 2007, respectively, compared to $4.6 million and $10.7 million for the respective prior year periods. The increase in Corporate costs in the first nine months of 2007 as compared to the prior year period was mainly due to: a $1.8 million non-cash gain recorded in the second quarter of 2006 related to an indemnification obligation with respect to a previously divested subsidiary; $0.4 million of additional professional fees incurred to support a research tax credit project; and $0.4 million of additional expense related to stock compensation; partially offset by a $0.2 million decrease in pre-tax amortization of acquired intangible assets related to Nexus and Hexagram. In the first nine months of 2007, Corporate costs included $4.1 million of pre-tax stock compensation expense and $1.7 million of pre-tax amortization of acquired intangible assets related to Nexus and Hexagram.

INTEREST INCOME, NE

Interest income, net, was $0.2 million and $0.7 million for the three and nine-month periods ended June 30, 2007, respectively, compared to interest income, net, of $0.2 million and $1.0 million for the respective prior year periods. The decrease in interest income in the first nine months of 2007 as compared to the prior year period was due to lower average cash balances on hand.

INCOME TAX EXPENSE

The third quarter 2007 effective income tax rate was 33.3% compared to 31.3% in the third quarter of 2006. The effective income tax rate in the first nine months of 2007 was 22.6% compared to 42.0% in the prior year period. The third quarter 2007 income tax expense was impacted by the resolution of certain tax exposure items of $0.7 million, reducing the 2007 third quarter effective income tax rate by 5.0%. The third quarter 2006 income tax expense was favorably impacted by a $1.0 million research tax credit, reducing the 2006 third quarter effective income tax rate by 6.0%.

The decrease in the effective income tax rate in the first nine months of 2007 as compared to the prior year period was due to the favorable impact of the research tax credit and the resolution of certain tax exposure items mentioned above. The research tax credit and resolution of certain tax exposure items favorably impacted the effective income tax rate in the first nine months of 2007 by 14.2% and 3.0%, respectively. The effective tax rate for the first nine months of 2006 was negatively impacted by the repatriation of $28.7 million of cash held by foreign subsidiaries. The effect of the repatriation increased the effective income tax rate for the first nine months of 2006 by 4.8%. Due to the tax research credits favorably impacting the tax rate in the first half of 2007, the Company estimates the fiscal 2007 tax rate to be approximately 34%.

CAPITAL RESOURCES AND LIQUIDITY

Working capital (current assets less current liabilities) increased to $146.5 million at June 30, 2007 from $131.4 million at September 30, 2006. Accounts receivable increased by $17.8 million in the first nine months of 2007, of which $12.5 million related to DCSI and $5.1 million related to the Test segment, both due to the timing and volume of sales. The $17.0 million increase in inventories at June 30, 2007 is mainly due to an $11.5 million increase within the Communications segment related to the PG&E contracts and a $2.8 million increase within the Test segment, both to support near term sales growth. Accounts payable increased by $14.0 million in the first nine months of 2007, of which $8.5 million related to DCSI due to timing of vendor invoicing.

Net cash provided by operating activities was $20.2 million and $49.0 million for the nine-month periods ended June 30, 2007 and 2006, respectively. The decrease is due to an increase in operating working capital requirements.

Capital expenditures were $13.2 million and $6.8 million in the first nine months of fiscal 2007 and 2006, respectively. Major expenditures in the current period included equipment used in the Filtration/Fluid Flow and Communications businesses.

At June 30, 2007, intangible assets, net, of $72.5 million included $60.4 million of capitalized software. Approximately $53.2 million of the capitalized software balance represents software development costs on the TNG software within the Communications segment to further penetrate the IOU market. TNG is being deployed to efficiently handle the additional levels of communications dictated by the size of the utility service territories and the frequency of meter reads that are required under time-of-use or critical peak pricing scenarios to meet the requirements of large IOUs. At June 30, 2007, the Company had approximately $5.5 million of commitments related to the development of TNG versions 2.0 and 3.0 which is expected to be spent over the next three months. Amortization of TNG expense is on a straight-line basis over seven years and began in March 2006. The Company recorded $1.8 million and $4.5 million in amortization expense related to TNG in the third quarter of 2007 and in the first nine months of 2007, respectively.

The closure and relocation of the Filtertek Puerto Rico facility was completed in March 2004. The Puerto Rico facility is included in other current assets with a carrying value of $3.6 million at June 30, 2007. The facility is being marketed for sale.

In October 2004, the Company entered into a $100 million five-year revolving bank credit facility with a $50 million increase option that has a final maturity and expiration date of October 6, 2009. At June 30, 2007, the Company had approximately $98.5 million available to borrow under the credit facility in addition to $21.9 million cash on hand. At June 30, 2007, the Company had $0.7 million of short-term borrowings, and outstanding letters of credit of $4.1 million ($0.8 million outstanding under the credit facility). Cash flow from operations and borrowings under the Company's bank credit facility are expected to meet the Company's capital requirements and operational needs for the foreseeable future.

Pacific Gas & Electric

In November 2005, DCSI entered into a contract to provide equipment, software and services to Pacific Gas & Electric (PG&E) in support of the electric portion of PG&E's AMI project with an initially anticipated contract value of up to approximately $310 million covering up to five million electric endpoints over a five year deployment period beginning in fiscal 2007. PG&E also has the right to purchase additional equipment and services to support existing and new customers

through the twenty year term of the contract. Equipment will be purchased by PG&E only upon issuance of purchase orders and release authorizations. PG&E will continue to have the right to purchase products or services from other suppliers for the electric portion of the AMI project. DCSI has agreed to deliver to PG&E versions of its newly developed TNG software as they become available and are tested. Delivery of the final version for which DCSI has committed is currently anticipated in September 2007. In accordance with U.S. generally accepted accounting standards, the Company will defer all revenue related to the DCSI arrangement until all software is delivered and acceptance criteria have been met. The contract provides for liquidated damages in the event that DCSI's late delivery of hardware or software causes a delay to PG&E's AMI master project plan or delays PG&E's realization of its business case benefits and also includes indemnification and other customary provisions. The contract may be terminated by PG&E for default, for its convenience and in the event of a force majeure lasting beyond certain prescribed periods. The Company has guaranteed the obligations of DCSI under the contract. If PG&E terminates the contract for its convenience, DCSI will be entitled to recover certain costs.

During the third quarter of 2007, PG&E announced its plans to request information and proposals from a small group of vendors in order to evaluate such vendors' ability to address potential future functionality requirements for the electric portion of its service territory currently included in DCSI's contract. In July 2007, PG&E issued requests for proposals (RFPs) to a group of vendors, including the Company, for PG&E's electric requirements. Prior to PG&E's issuance of this RFP, Hexagram agreed to provide 2,000 of its RF fixed network electric units for PG&E testing. Testing of Hexagram's electric solution is scheduled to occur in the fourth quarter of 2007. PG&E's current activities will impact the timing and/or receipt of future orders from PG&E for its electric deployment and, until PG&E completes this evaluation and determines whether it will modify its AMI project plan, the Company cannot estimate the total value or the timing of orders that may be received under the DCSI PG&E contract.

In November 2005, Hexagram entered into a contract to provide equipment, software and services to PG&E in support of the gas utility portion of PG&E's AMI project. The total anticipated contract revenue from commencement through the five-year full deployment is expected to be up to approximately $225 million. As with DCSI's contract with PG&E, equipment will be purchased only upon issuance of purchase orders and release authorizations, and PG&E will continue to have the right to purchase products or services from other suppliers for the gas utility portion of the AMI project. The contract provides for liquidated damages in the event of late deliveries, includes indemnification and other customary provisions, and may be terminated by PG&E for default, for its convenience and in the event of a force majeure lasting beyond certain prescribed periods. The Company has guaranteed the performance of the contract by Hexagram.

CRITICAL ACCOUNTING POLICIES

Management has evaluated the accounting policies used in the preparation of the Company's financial statements and related notes and believes those policies to be reasonable and appropriate. Certain of these accounting policies require the application of significant judgment by Management in selecting appropriate assumptions for calculating financial estimates. By their nature, these judgments are subject to an inherent degree of uncertainty. These judgments are based on historical experience, trends in the industry, information provided by customers and information available from other outside sources, as appropriate. The most significant areas involving Management judgments and estimates may be found in the Critical Accounting Policies section of Management's Discussion and Analysis and in Note 1 to the Consolidated Financial Statements contained in the

Company's Annual Report on Form 10-K for the fiscal year ended September 30, 2006 at Exhibit 13.

OTHER MATTERS

Contingencies

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

RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements" (SFAS 157). The purpose of SFAS No. 157 is to define fair value, establish a framework for measuring fair value, and enhance disclosures about fair value measurements. SFAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. The measurement and disclosure requirements are effective for the Company in the first quarter of fiscal year 2009. The adoption of SFAS 157 is not expected to have a material impact to the Company's financial position or results of operations.

In September 2006, the FASB issued SFAS No. 158, "Employer's Accounting for Defined Benefit Pension and Other Postretirement Plans" (SFAS 158), which amends SFAS 87 and SFAS 106 to require recognition of the overfunded or underfunded status of pension and other postretirement benefit plans on the balance sheet. Under SFAS 158, gains and losses, prior service costs and credits, and any remaining transition amounts under SFAS 87 and SFAS 106 that have not yet been recognized through net periodic benefit cost will be recognized in accumulated other comprehensive income, net of tax effects. The measurement date - the date at which the benefit obligation and plan assets are measured - is required to be the Company's fiscal year-end, which is the date the Company currently uses. SFAS 158 is effective for publicly-held companies for fiscal years ending after December 15, 2006. The adoption of SFAS 158 is not expected to have a material impact to the Company's financial position or results of operations.

In June 2006, the FASB issued FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes, an Interpretation of FASB Statement No. 109." This Interpretation is effective for the Company beginning October 1, 2007. This Interpretation prescribes a recognition threshold and measurement process for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. The Company is currently evaluating the adoption of this Interpretation and does not currently have an estimate of the impact on the consolidated financial statements.

FORWARD LOOKING STATEMENTS

Statements in this report that are not strictly historical are "forward looking" statements within the meaning of the safe harbor provisions of the federal securities laws. Forward looking statements include, but are not limited to, those relating to the estimates or projections made in connection with the Company's accounting policies, SFAS 157, SFAS 158, FASB Interpretation No. 48, annual effective tax rate, research tax credits, timing and amounts of

Communications segment commitments and expenditures, outcome of current claims and litigation, future cash flow, capital requirements and operational needs for the foreseeable future, the ultimate values and timing of revenues under the DCSI / PG&E contract and the Hexagram / PG&E contract, the future delivery and acceptance of the TNG software by PG&E, and timing of spending for TNG commitments. Investors are cautioned that such statements are only predictions, and speak only as of the date of this report. The Company's actual results in the future may differ materially from those projected in the forward-looking statements due to risks and uncertainties that exist in the Company's operations and business environment including, but not limited to: the risk factors described in Item 1A of the Company's Annual Report on Form 10-K for the fiscal year ended September 30, 2006 and Item 1A of Part II of this report, actions by PG&E's Board of Directors and PG&E's management impacting PG&E's AMI projects, changes to PG&E's AMI project plan resulting from the evaluation of other AMI vendor technologies or other factors; the timing and success of DCSI's software development efforts; the timing and content of purchase order releases under PG&E's contracts; the Company's successful performance under the PG&E contracts; weakening of economic conditions in served markets; changes in customer demands or customer insolvencies; competition; intellectual property rights; successful execution of the planned sale of the Company's Puerto Rico facility; material changes in the costs of certain raw materials including steel, copper and petroleum based resins; delivery delays or defaults by customers; termination for convenience of customer contracts; timing and magnitude of future contract awards; performance issues with key suppliers, customers and subcontractors; collective bargaining and labor disputes; changes in laws and regulations including changes in accounting standards and taxation requirements; costs relating to environmental matters; litigation uncertainty; and the Company's successful execution of internal operating plans.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Market risks relating to the Company's operations result primarily from changes in interest rates and changes in foreign currency exchange rates. There has been no material change to the Company's market risks since September 30, 2006. Refer to the Company's Annual Report on Form 10-K for the fiscal year ended September 30, 2006 for further discussion about market risk.

ITEM 4. CONTROLS AND PROCEDURES

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

PART II OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

In May 2007, an arbitrator ruled that Lindgren R.F. Enclosures, Inc. was responsible for construction delays incurred on a U.S. government contract completed in June 2005, and awarded the prime contractor damages of $2.3 million. The dispute related to a delivery and installation contract signed in 2003 for a shielded communication room in an international location. The challenging geopolitical environment of this region resulted in lengthy site access issues, material delivery (import) delays, shortages of qualified labor, and personnel security issues. The Company vigorously defended its position. The arbitration award was not appealable, and the Company has paid the award.

ITEM 1A. RISK FACTORS

In Item 1A of its Annual Report on Form 10-K for the fiscal year ended September 30, 2006, the Company reported that a significant portion of the Communications segment's business is dependent on several large contracts with customers. The largest of these are two contracts to sell electric and gas automatic meter reading systems to PG&E over a period of approximately five years. These projects, which represent a potential high source of revenue, are subject to cancellation or reduction in volume by PG&E, delays, regulatory actions and the Company's ability to develop advanced products and successfully perform the contracts. The loss of revenue which would result from cancellations, delays, reductions, regulatory actions or the Company's failure to perform in connection with these projects could have a material adverse effect on the Company's business, results of operations, and financial condition as a whole. During the third quarter of 2007, PG&E announced its plans to request information and proposals from a small group of vendors in order to evaluate such vendors' ability to address potential future functionality requirements for the electric portion of its service territory currently included in DCSI's contract. In July 2007, PG&E issued requests for proposals (RFPs) to a group of vendors, including the Company, for PG&E's electric requirements. PG&E's current activities will impact the timing and/or receipt of future orders from PG&E for its electric deployment and, until PG&E completes this evaluation and determines whether it will modify its AMI project plan, the Company cannot estimate the total value or the timing of orders that may be received under the DCSI PG&E contract.

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

In August 2006, the Company's Board of Directors authorized an open market common stock repurchase program for up to 1.2 million shares, subject to market conditions and other factors, which covers the period through September 30, 2008.

ISSUER PURCHASES OF EQUITY SECURITIES

| Period | Total Number of Shares Purchased | Average Price Paid per Share | Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs | Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs |
|---|---|---|---|---|
| April 1 to April 30, 2007 | - | | - | |
| May 1 to May 31, 2007 | - | | - | |
| June 1 to June 30, 2007 | 100,000 | $36.44 * | 100,000 | |
| Total | 100,000 | $36.44 | 100,000 | 1,100,000 |

* Payment made in July 2007

Subsequent to June 30, 2007, the Company repurchased an additional 165,000 shares for a total of 265,000 shares repurchased.

ITEM 6. EXHIBITS

a) Exhibits

| Exhibit Number | | |
|---|---|---|
| 3.1 | Restated Articles of Incorporation | Incorporated by reference to Form 10-K for the fiscal year ended September 30, 1999, at Exhibit 3(a) |
| 3.2 | Amended Certificate of Designation Preferences and Rights of Series A Participating Cumulative Preferred Stock of the Registrant | Incorporated by reference to Form 10-Q for the fiscal quarter ended March 31, 2000, at Exhibit 4(e) |
| 3.3 | Articles of Merger effective July 10, 2000 | Incorporated by reference to Form 10-Q for the fiscal quarter ended June 30, 2000, at Exhibit 3(c) |
| 3.4 | Bylaws, as amended and restated as of July 10, 2000. | Incorporated by reference to Form 10-K for the fiscal year ended September 30, 2003, at Exhibit 3.4 |
| 3.5 | Amendment to Bylaws effective as of February 2, 2007. | Incorporated by reference to Form 10-Q for the fiscal quarter ended December 31, 2006, at Exhibit 3.5 |
| 4.1 | Specimen Common Stock Certificate | Incorporated by reference to Form 10-Q for the fiscal quarter ended June 30, 2000, at Exhibit 4(a) |
| 4.2 | Specimen Rights Certificate | Incorporated by reference to Current Report on Form 8-K dated February 3, 2000, at Exhibit B to Exhibit 4.1 |
| 4.3 | Rights Agreement dated as of September 24, 1990 (as amended and Restated as of February 3, 2000) between the Registrant and Registrar and Transfer Company, as successor Rights Agent | Incorporated by reference to Current Report on Form 8-K dated February 3, 2000, at Exhibit 4.1 |

| | | |
|---|---|---|
| 4.4 | Credit Agreement dated as of October 6, 2004 among the Registrant, Wells Fargo Bank, N.A., as agent, and the lenders listed therein | Incorporated by reference to Form10-K for the fiscal year ended September 30, 2004, at Exhibit 4.4 |
| 4.5 | Consent and waiver to Credit Agreement (listed as 4.4, above) dated as of January 20, 2006 | Incorporated by reference to Current Report on Form 8-K dated February 2, 2006 at Exhibit 4.1 |
| 31.1 | Certification of Chief Executive Officer relating to Form 10-Q for period ended June 30, 2007 | |
| 31.2 | Certification of Chief Financial Officer relating to Form 10-Q for period ended June 30, 2007 | |
| 32 | Certification of Chief Executive Officer and Chief Financial Officer relating to Form 10-Q for period ended June 30, 2007 | |

SIGNATURE

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

ESCO TECHNOLOGIES INC.

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

Dated: August 8, 2007