

SPARTON CORP
Form 10-Q
May 06, 2014
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

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

For the quarterly period ended March 31, 2014

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 1-1000

Sparton Corporation
(Exact name of registrant as specified in its charter)

Ohio 38-1054690
(State or other jurisdiction of (I.R.S. Employer
incorporation or organization) Identification No.)

425 N. Martingale Road, Suite 2050, 60173-2213
Schaumburg, Illinois (Zip code)
(Address of principal executive offices)
(847) 762-5800
(Registrant's telephone number, including zip code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or such shorter period that the registrant was required to submit and post such files). Yes No

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

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

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

As of April 30, 2014, there were 10,126,275 shares of common stock, \$1.25 par value per share, outstanding.

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements.

SPARTON CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
(UNAUDITED)

(Dollars in thousands, except per share amounts)

	March 31, 2014	June 30, 2013 (a)
Assets		
Current Assets:		
Cash and cash equivalents	\$7,502	\$6,085
Accounts receivable, net of allowance for doubtful accounts of \$108 and \$61, respectively	46,259	49,572
Inventories and cost of contracts in progress, net	51,466	46,334
Deferred income taxes	2,779	2,951
Prepaid expenses and other current assets	3,999	1,731
Total current assets	112,005	106,673
Property, plant and equipment, net	28,562	28,904
Goodwill	28,653	14,767
Other intangible assets, net	20,975	10,713
Deferred income taxes — non-current	102	4,075
Other non-current assets	2,924	790
Total assets	\$193,221	\$165,922
Liabilities and Shareholders' Equity		
Current Liabilities:		
Current portion of long-term debt	\$1,737	\$136
Accounts payable	20,425	19,596
Accrued salaries and wages	8,098	6,329
Accrued health benefits	1,433	1,793
Performance based payments on customer contracts	7,444	20,902
Other accrued expenses	10,188	6,733
Total current liabilities	49,325	55,489
Pension liability — non-current portion	233	274
Long-term debt — non-current portion	34,700	11,403
Environmental remediation — non-current portion	2,468	2,684
Total liabilities	86,726	69,850
Commitments and contingencies		
Shareholders' Equity:		
Preferred stock, no par value; 200,000 shares authorized, none issued	—	—
Common stock, \$1.25 par value; 15,000,000 shares authorized, 10,126,275 and 10,095,716 shares issued and outstanding, respectively	12,658	12,619
Capital in excess of par value	19,057	18,751
Retained earnings	75,973	65,957
Accumulated other comprehensive loss	(1,193	) (1,255
Total shareholders' equity	106,495	96,072
Total liabilities and shareholders' equity	\$193,221	\$165,922

(a) Derived from the Company's audited financial statements as of June 30, 2013.
See Notes to unaudited condensed consolidated financial statements.

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SPARTON CORPORATION AND SUBSIDIARIES
 CONDENSED CONSOLIDATED STATEMENTS OF INCOME
 (UNAUDITED)
 (Dollars in thousands, except per share amounts)

	For the Three Months Ended		For the Nine Months Ended	
	March 31, 2014	March 31, 2013	March 31, 2014	March 31, 2013
Net sales	\$83,931	\$65,148	\$242,691	\$183,203
Cost of goods sold	67,505	55,023	199,094	152,983
Gross profit	16,426	10,125	43,597	30,220
Operating Expense:				
Selling and administrative expenses	8,807	6,803	25,139	19,650
Internal research and development expenses	213	341	1,004	889
Amortization of intangible assets	1,089	609	2,323	984
Restructuring charges	—	—	188	—
Other operating (income) expenses	(6	) 22	(14	) 16
Total operating expense, net	10,103	7,775	28,640	21,539
Operating income	6,323	2,350	14,957	8,681
Other income (expense):				
Interest expense	(187	) (136	) (547	) (390
Interest income	—	48	2	99
Other, net	124	106	461	275
Total other income (expense), net	(63	) 18	(84	) (16
Income before provision for income taxes	6,260	2,368	14,873	8,665
Provision for income taxes	2,014	832	4,857	831
Net income	\$4,246	\$1,536	\$10,016	\$7,834
Income per share of common stock:				
Basic	\$0.42	\$0.15	\$0.99	\$0.77
Diluted	\$0.42	\$0.15	\$0.99	\$0.77
Weighted average shares of common stock outstanding:				
Basic	10,124,587	10,225,012	10,104,029	10,198,454
Diluted	10,150,253	10,250,700	10,127,811	10,225,191

See Notes to unaudited condensed consolidated financial statements.

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SPARTON CORPORATION AND SUBSIDIARIES
 CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
 (UNAUDITED)
 (Dollars in thousands)

	For the Three Months Ended		For the Nine Months Ended	
	March 31, 2014	March 31, 2013	March 31, 2014	March 31, 2013
Net income	\$4,246	\$1,536	\$10,016	\$7,834
Other comprehensive income - Change in unrecognized pension costs, net of tax:				
Amortization of unrecognized net actuarial loss, net of tax benefit of \$11 and \$15 for the three months ended March 31, 2014 and 2013, respectively, and	21	30	62	88
net of tax benefit of \$34 and \$49 for the nine months ended March 31, 2014 and 2013, respectively				
Other comprehensive income, net of tax	21	30	62	88
Comprehensive income	\$4,267	\$1,566	\$10,078	\$7,922

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SPARTON CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)
(Dollars in thousands)

	For the Nine Months Ended		
	March 31, 2014	March 31, 2013	
Cash Flows from Operating Activities:			
Net income	\$ 10,016	\$ 7,834	
Adjustments to reconcile net income to net cash provided by (used in) operating activities:			
Depreciation and amortization	5,910	3,036	
Deferred income tax expense	545	844	
Stock-based compensation expense	1,287	862	
Gross profit effect of capitalized profit in inventory from acquisitions	256	566	
Excess tax benefit of stock-based compensation	(496)) —	
Other	66	75	
Changes in operating assets and liabilities:			
Accounts receivable	7,426	(1,359))
Inventories and cost of contracts in progress	3,497	(3,405))
Prepaid expenses and other assets	(1,196)	) (1,597))
Performance based payments on customer contracts	(13,458)	) (15,123))
Accounts payable and accrued expenses	1,358	1,960)
Net cash provided by (used in) operating activities	15,211	(6,307))
Cash Flows from Investing Activities:			
Purchase of Onyx	—	(45,438))
Purchase of certain assets of Creonix	105	—)
Purchase of certain assets and liabilities of Aydin Displays	(15,502)) —)
Purchase of Beckwood	(15,346)) —)
Purchase of Aubrey, net of acquired cash	(4,817)))
Purchases of property, plant and equipment	(2,253)	) (2,971))
Change in restricted cash	—	(535))
Proceeds from sale of property, plant and equipment	69	275)
Net cash used in investing activities	(37,744)	) (48,669))
Cash Flows from Financing Activities:			
Short-term bank borrowings, net	—	22,400)
Borrowings of long-term debt	53,000	—)
Repayment of long-term debt	(28,108)	) (9,505))
Payment of debt financing costs	—	(445))
Repurchase of stock	(1,559)	) (234))
Proceeds from the exercise of stock options	121	168)
Excess tax benefit from stock-based compensation	496	—)
Net cash provided by financing activities	23,950	12,384)
Net increase (decrease) in cash and cash equivalents	1,417	(42,592))
Cash and cash equivalents at beginning of period	6,085	46,950)
Cash and cash equivalents at end of period	\$ 7,502	\$ 4,358)
Supplemental disclosure of cash flow information:			

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Cash paid for interest	\$465	\$368
Cash paid for income taxes	\$4,734	\$1,337
See Notes to unaudited condensed consolidated financial statements.		

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SPARTON CORPORATION AND SUBSIDIARIES
 CONDENSED CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY
 (UNAUDITED)
 (Dollars in thousands)

	Nine Months Ended March 31, 2014					Accumulated Other Comprehensive Total Loss	
	Common Stock		Capital In Excess of Par Value	Retained Earnings			
	Shares	Amount					
Balance at June 30, 2013	10,095,716	\$ 12,619	\$ 18,751	\$ 65,957	\$ (1,255	)	\$ 96,072
Issuance of stock	96,664	121	(121)	—		—
Forfeiture of restricted stock	(3,344	) (4	) 4	—	—		—
Repurchase of stock	(76,880	) (96	) (1,463	)	—		(1,559
Exercise of stock options	14,119	18	103	—	—		121
Stock-based compensation	—	—	1,287	—	—		1,287
Excess tax benefit from stock-based compensation	—	—	496	—	—		496
Comprehensive income, net of tax				10,016	62		10,078
Balance at March 31, 2014	10,126,275	12,658	19,057	75,973	(1,193	)	106,495
	Nine Months Ended March 31, 2013						
	Common Stock		Capital In Excess of Par Value	Retained Earnings	Accumulated Other Comprehensive Total Loss		
	Shares	Amount					
Balance at June 30, 2012	10,105,759	\$ 12,632	\$ 19,579	\$ 51,995	\$ (1,718	)	\$ 82,488
Cumulative impact of change in accounting principle	—	—	—	492	—		492
Balance at June 30, 2012 - as adjusted	10,105,759	12,632	19,579	52,487	(1,718	)	82,980
Issuance of stock	159,433	199	(199)	—		—
Forfeiture of restricted stock	(50,530	) (63	) 63	—	—		—
Repurchase of stock	(20,564	) (25	) (209	)	—		(234
Exercise of stock options	27,952	35	133	—	—		168
Stock-based compensation	—	—	862	—	—		862
Comprehensive income, net of tax	—	—	—	7,834	88		7,922
Balance at March 31, 2013	10,222,050	12,778	20,229	60,321	(1,630)	91,698

See Notes to unaudited condensed consolidated financial statements.

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SPARTON CORPORATION AND SUBSIDIARIES

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(1) Business and Basis of Presentation

Sparton Corporation and subsidiaries (the “Company” or “Sparton”) has been in continuous existence since 1900. It was last reorganized in 1919 as an Ohio corporation. The Company is a provider of complex and sophisticated electromechanical devices with capabilities that include concept development, design and manufacturing engineering, production, distribution, and field service. The Company serves the Medical & Biotechnology, Military & Aerospace and Industrial & Commercial markets through three reportable business segments; Medical Device (“Medical”), Complex Systems (“CS”) and Defense & Security Systems (“DSS”). Financial information by segment is presented in Note 16. All of the Company's facilities are certified to one or more of the ISO standards, including 9001 and 13485, with most having additional certifications based on the needs of the customers they serve. The Company's products and services include products for Original Equipment Manufacturers (“OEM”) and Emerging Technology (“ET”) customers that are microprocessor-based systems that include transducers, printed circuit boards and assemblies, sensors, and electromechanical components, as well as development and design engineering services relating to these product sales. Sparton also develops and manufactures sonobuoys, anti-submarine warfare (“ASW”) devices used by the United States Navy and other free-world countries. Many of the physical and technical attributes in the production of sonobuoys are similar to those required in the production of the Company's other electrical and electromechanical products and assemblies.

The unaudited condensed financial statements and related footnotes have been prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”) for interim financial information and Rule 10-01 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. The financial information presented herein should be read in conjunction with the Company’s Annual Report on Form 10-K for the fiscal year ended June 30, 2013, which includes information and disclosures not presented herein. All significant intercompany accounts and transactions have been eliminated in consolidation. Certain reclassifications of prior period amounts have been made to conform to the current year presentation. Subsequent events have been evaluated through the date these financial statements were issued. In the opinion of management, the unaudited condensed consolidated financial statements contain all of the adjustments, consisting of normal recurring adjustments, necessary to present fairly, in summarized form, the consolidated financial position, results of operations and cash flows of the Company. The results of operations for the three and nine months ended March 31, 2014 are not necessarily indicative of the results that may be expected for the full fiscal year 2014.

(2) Change in Accounting Principle

In the first quarter of fiscal 2014, the Company voluntarily changed its revenue recognition policy related to DSS sonobuoy sales to the U.S. Navy and foreign government customers under long-term contracts that require lot acceptance testing. The new policy continues to recognize revenue under the percentage of completion method, but changes the measurement of progress under these contracts from a completed units accepted basis (whereby revenue was recognized for each lot of sonobuoys produced when that lot was formally accepted by the customer) to a units-of-production basis (whereby revenue is recognized when production and internal testing of each lot of sonobuoys is completed). The Company now has significant experience in producing sonobuoys to customer specifications and internal testing to assess compliance with those specifications and, as such, now has an adequate history of continuous customer acceptance of all sonobuoys produced. Accordingly, the Company believes the new method is preferable primarily because it eliminates delays in revenue and related cost of goods sold recognition due to timing of customer testing and acceptance delays. Such delays commonly occur due to customer circumstances that are unrelated to the product produced. Under the new policy, the revenue and related costs of goods sold of these manufactured sonobuoy lots will more closely match the period in which the product was produced and the related revenue earned, thereby better reflecting the economic activity of the DSS segment. Additionally, this new method provides better matching of periodic operating expenses incurred during production.

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For the three months ended March 31, 2014, this change in accounting policy increased DSS and consolidated net sales and gross profit by \$3.5 million and \$0.9 million, respectively, basic income per share by \$0.06 and diluted income per share by \$0.07. For the nine months ended March 31, 2014, this change in accounting policy increased DSS and consolidated net sales and gross margin by \$3.2 million and \$1.3 million, respectively, and increased basic and diluted income per share each by \$0.09. The following tables present the effects of the retrospective application of this voluntary change in accounting principle (Dollars in thousands, except share amounts):

Consolidated Statement of Income Data:

	For the Three Months Ended March 31, 2013		
	As Originally Reported	Adjustment	As Restated
Net Sales	\$63,880	\$1,268	\$65,148
Cost of goods sold	53,838	1,185	55,023
Gross profit	10,042	83	10,125
Income before provision for income taxes	2,285	83	2,368
Provision for income taxes	802	30	832
Net income	1,483	53	1,536
Income per share of common stock - Basic	0.15	—	0.15
Income per share of common stock - Diluted	0.14	0.01	0.15
Weighted average shares outstanding - Basic	10,225,012		10,225,012
Weighted average shares outstanding - Diluted	10,250,700		10,250,700

Consolidated Statement of Income Data:

	For the Nine Months Ended March 31, 2013		
	As Originally Reported	Adjustment	As Restated
Net Sales	\$178,879	\$4,324	\$183,203
Cost of goods sold	150,216	2,767	152,983
Gross profit	28,663	1,557	30,220
Income before provision for income taxes	7,108	1,557	