SPARTON CORP
Form 10-Q
February 05, 2013
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

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

For the quarterly period ended December 31, 2012

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 incorporation or organization)	**(I.R.S. Employer Identification No.)**
425 N. Martingale Road, Suite 2050, Schaumburg, Illinois	**60173-2213**
(Address of principal executive offices)	**(Zip code)**

(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 x 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 x No ¨

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

Large accelerated filer	¨	Accelerated filer	x
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 x

As of January 31, 2013, there were 10,229,121 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)

	December 31, 2012	June 30, 2012 (a)
Assets		
Current Assets:		
Cash and cash equivalents	$ 6,066	$ 46,950
Restricted cash	535	
Accounts receivable, net of allowance for doubtful accounts of $334 and $146, respectively	40,821	29,618
Inventories and cost of contracts in progress, net	45,367	35,102
Deferred income taxes	2,020	2,020
Prepaid expenses and other current assets	5,251	2,054
Total current assets	100,060	115,744
Property, plant and equipment, net	28,913	14,260
Goodwill	14,903	7,472
Other intangible assets, net	11,643	1,618
Deferred income taxes non-current	4,874	5,136
Other non-current assets	701	325
Total assets	$ 161,094	$ 144,555
Liabilities and Shareholders Equity		
Current Liabilities:		
Short-term bank borrowings	$ 14,000	$
Current portion of long-term debt	131	131
Accounts payable	17,033	17,152
Accrued salaries and wages	5,417	5,855
Accrued health benefits	1,564	1,210
Current portion of pension liability	115	323
Advance billings on customer contracts	20,718	25,836
Other accrued expenses	8,273	5,890
Total current liabilities	67,251	56,397
Pension liability non-current portion	985	990
Long-term debt non-current portion	1,473	1,538
Environmental remediation non-current portion	2,978	3,142
Total liabilities	72,687	62,067
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, 10,229,121 and 10,105,759 shares issued and outstanding, respectively	12,786	12,632
Capital in excess of par value	19,932	19,579
Retained earnings	57,349	51,995
Accumulated other comprehensive loss	(1,660)	(1,718)
Total shareholders equity	88,407	82,488
Total liabilities and shareholders equity	$ 161,094	$ 144,555

(a) Derived from the Company s audited financial statements as of June 30, 2012.

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 December 31, 2012	For the Three Months Ended December 31, 2011	For the Six Months Ended December 31, 2012	For the Six Months Ended December 31, 2011
Net sales	$ 65,979	$ 55,370	$ 114,999	$ 107,203
Cost of goods sold	54,571	46,634	96,378	90,123
Gross profit	11,408	8,736	18,621	17,080
Operating Expense:				
Selling and administrative expenses	7,375	5,535	12,847	10,946
Internal research and development expenses	243	218	548	616
Amortization of intangible assets	273	110	375	221
Restructuring/impairment charges		(59)		(59)
Other operating expenses	4	13	(6)	48
Total operating expense, net	7,895	5,817	13,764	11,772
Operating income	3,513	2,919	4,857	5,308
Other income (expense)				
Interest expense	(173)	(175)	(254)	(347)
Interest income	23	24	51	48
Gain on sale of investment		127		127
Other, net	59	116	169	233
Total other income (expense), net	(91)	92	(34)	61
Income before provision for income taxes	3,422	3,011	4,823	5,369
Provision for (benefit from) income taxes	(979)	1,069	(531)	1,918
Net income	$ 4,401	$ 1,942	$ 5,354	$ 3,451
Income per share of common stock:				
Basic	$ 0.43	$ 0.19	$ 0.53	$ 0.34
Diluted	$ 0.43	$ 0.19	$ 0.52	$ 0.33
Weighted average shares of common stock outstanding:				
Basic	10,229,320	10,287,797	10,185,464	10,278,127
Diluted	10,248,424	10,325,029	10,206,913	10,319,275

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 Six Months Ended	
	December 31, 2012	December 31, 2011	December 31, 2012	December 31, 2011
Net income	$ 4,401	$ 1,942	$ 5,354	$ 3,451
Other comprehensive income (loss) Change in unrecognized pension costs, net of tax	36	(4)	58	81
Comprehensive income	$ 4,437	$ 1,938	$ 5,412	$ 3,532

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SPARTON CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(UNAUDITED)

(Dollars in thousands)

	For the Six Months Ended December 31, 2012	For the Six Months Ended December 31, 2011
Cash Flows from Operating Activities:		
Net income	$ 5,354	$ 3,451
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization	1,472	831
Deferred income tax expense	230	1,914
Pension expense	6	14
Stock-based compensation expense	597	532
Gross profit effect of capitalized profit in inventory from acquisition	566	
Gain on sale of investment		(127)
Other	41	174
Changes in operating assets and liabilities:		
Accounts receivable	(4,306)	(515)
Inventories and cost of contracts in progress	(1,845)	207
Prepaid expenses and other assets	(2,798)	(1,191)
Advance billings on customer contracts	(5,118)	5,865
Accounts payable and accrued expenses	(3,128)	(3,436)
Net cash provided by (used in) operating activities	(8,929)	7,719
Cash Flows from Investing Activities:		
Purchase of Onyx	(43,250)	
Purchases of property, plant and equipment	(1,602)	(1,917)
Change in restricted cash	(535)	
Proceeds from sale of investment		1,750
Net cash used in investing activities	(45,387)	(167)
Cash Flows from Financing Activities:		
Short-term bank borrowings, net	14,000	
Repayment of long-term debt	(70)	(66)
Payment of debt financing costs	(408)	
Repurchase of stock	(234)	(1,476)
Proceeds from the exercise of stock options	144	50
Net cash provided by (used in) financing activities	13,432	(1,492)
Net increase (decrease) in cash and cash equivalents	(40,884)	6,060
Cash and cash equivalents at beginning of period	46,950	24,550
Cash and cash equivalents at end of period	$ 6,066	$ 30,610
Supplemental disclosure of cash flow information:		
Cash paid for interest	$ 258	$ 176
Cash paid for income taxes	$ 1,603	$ 464
Supplemental disclosure of non-cash investing activities:		

Accrued acquisition related working capital adjustment	$ 2,188	$

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)

	Six Months Ended December 31, 2012					
	Common Stock		Capital In Excess	Retained	Accumulated Other Comprehensive	
	Shares	Amount	of Par Value	Earnings	Loss	Total
Balance at June 30, 2012	10,105,759	$ 12,632	$ 19,579	$ 51,995	$ (1,718)	$ 82,488
Issuance of stock	159,433	199	(199)			
Forfeiture of restricted stock	(39,811)	(50)	50			
Repurchase of stock	(20,564)	(25)	(209)			(234)
Exercise of stock options	24,304	30	114			144
Stock-based compensation			597			597
Comprehensive income, net of tax				5,354	58	5,412
Balance at December 31, 2012	10,229,121	$ 12,786	$ 19,932	$ 57,349	$ (1,660)	$ 88,407

	Six Months Ended December 31, 2011					
	Common Stock		Capital In Excess	Retained	Accumulated Other Comprehensive	
	Shares	Amount	of Par Value	Earnings	Loss	Total
Balance at June 30, 2011	10,236,484	$ 12,796	$ 20,635	$ 42,487	$ (871)	$ 75,047
Issuance of stock	160,641	201	(201)			
Forfeiture of restricted stock	(13,290)	(17)	17			
Repurchase of stock	(188,055)	(235)	(1,241)			(1,476)
Exercise of stock options	10,000	12	38			50
Stock-based compensation			532			532
Comprehensive income, net of tax				3,451	81	3,532
Balance at December 31, 2011	10,205,780	$ 12,757	$ 19,780	$ 45,938	$ (790)	$ 77,685

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, industrial design, design and manufacturing engineering, production, distribution, and field service. The Company serves the Medical, Military & Aerospace and Industrial & Instrumentation 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 13. All of the Company s facilities are registered to ISO standards, including 9001 or 13485, with most having additional certifications. 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, 2012, 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 six months ended December 31, 2012 are not necessarily indicative of the results that may be expected for the full fiscal year 2013.

(2) Acquisition of Onyx EMS, LLC

On November 15, 2012, the Company completed the acquisition of Onyx EMS, LLC (Onyx) in a $43.25 million all-cash transaction, subject to certain post-closing adjustments and financed through the use of Company cash and borrowings under the Company s new credit facility. At December 31, 2012, the Company has recorded additional consideration of $2.19 million in relation to a post-closing working capital adjustment, which will be settled in the Company s third fiscal quarter. The transaction includes an approximate $4.3 million escrowed holdback which is available to fund potential seller indemnification obligations in relation to the acquisition agreement.

The acquired business, which is reported in the Company s Medical segment, provides further expansion regionally into the Minneapolis medical device corridor, diversifying the Company s customer base through both existing programs and a strong business development pipeline, and increases the number of complex sub-assembly and full device programs within Sparton. Additionally, Onyx brings solid, long-term customer relationships that will utilize Sparton s expanded list of service offerings such as our low cost country footprint in Vietnam and full engineering design capabilities. Onyx primarily manufactures medical devices for OEM and emerging technology companies, including products for cardiovascular diagnostics, hearing assistance, patient temperature and warming, point-of-care diagnostics, and surgical equipment used in intraosseous medicine. Onyx also produces products such as precision measurement instruments for monitoring air quality and pollution, commercial fire and smoke alarm systems, sensing tools, test fixtures, and complex LED assemblies.

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The Company is in the process of obtaining valuations of certain tangible and intangible assets and expects to complete the purchase price allocation in fiscal year 2013 after these valuations are finalized. The following table represents the preliminary allocation of the total consideration to assets acquired and liabilities assumed in the acquisition of Onyx based on Sparton s preliminary estimate of their respective fair values (in thousands):

Total purchase consideration:	
Cash	$ 43,250
Estimated payable for post-closing working capital adjustment	2,188
Total purchase consideration	$ 45,438
Assets acquired and liabilities assumed:	
Accounts receivable, net	$ 6,897
Inventory	8,986
Other current assets	403
Property, plant and equipment	14,148
Intangible assets customer relationships	10,200
Intangible assets non-compete agreements	200
Goodwill	7,431
Accounts payable	(1,654)
Other current liabilities	(1,173)
Total assets acquired and liabilities assumed	$ 45,438

Total purchase consideration has been preliminarily allocated to the tangible and identifiable intangible assets acquired and liabilities assumed based on their provisionally estimated fair values at the acquisition date. The Onyx acquisition has preliminarily resulted in approximately $7.4 million of goodwill, which is expected to be deductible for tax purposes and which has been assigned entirely to the Company s Medical segment. The Company believes goodwill primarily relates to the complementary strategic fit, including regional expansion into the Minneapolis medical device corridor, resulting synergies and the acquired workforce that this business brings to existing operations. The provisional fair values of acquired identifiable intangible assets have been determined to be Level 3 under the fair value hierarchy and have been estimated based on future cash flows and customer attrition rates, discounted using an estimated weighted average cost of capital. The customer relationships are being amortized using an accelerated methodology over ten years. The non-compete agreements are being amortized on a straight-line basis over one year as the ratable decline in value over time is most consistent with the contractual nature of these assets.

Included in the Company s Condensed Consolidated Statements of Operations for the three and six months ended December 31, 2012 are net sales of approximately $6.1 million and loss before benefit from income taxes of approximately $0.6 million resulting from the acquisition of Onyx since November 15, 2012.

The Company incurred legal, professional and other costs related to this acquisition aggregating approximately $0.3 million. These costs were recognized as selling and administrative expenses in the three months ended December 31, 2012.

The following table summarizes, on a pro forma basis, the combined results of operations of the Company and Onyx as though the acquisition had occurred as of July 1, 2011. The pro forma amounts presented are not necessarily indicative of either the actual consolidated results had the acquisition occurred as of July 1, 2011 or of future consolidated operating results (in thousands, except per share amounts):

	For the Three Months Ended		**For the Six Months Ended**	
	December 31, 2012	**December 31, 2011**	**December 31, 2012**	**December 31, 2011**
Net sales	$ 71,648	$ 68,038	$ 133,197	$ 131,661
Income before provision for (benefit from) income taxes	$ 4,098	$ 2,483	$ 6,250	$ 4,001
Net income	$ 4,774	$ 1,539	$ 6,164	$ 2,496
Net income per share basic	$ 0.47	$ 0.15	$ 0.61	$ 0.24

Net income per share diluted	$ 0.47	$ 0.15	$ 0.60	$ 0.24

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Pro forma results presented above reflect: (1) incremental depreciation relating to fair value adjustments to property, plant and equipment; (2) amortization relating to fair value estimates of intangible assets; (3) elimination of Onyx interest expense relating to debt paid off in conjunction with the transaction; and (4) incremental interest expense on assumed indebtedness and amortization of capitalized financing costs incurred in connection with the transaction as though the transaction occurred as of July 1, 2011.

Additionally, acquisition related expenses of approximately $0.3 million recognized as selling and administrative expenses in the three months ended December 31, 2012 are reflected in the pro forma results above as though they were recognized during the three months ended September 30, 2011 and have been removed from the pro forma results for the three months ended December 31, 2012. Similarly, the capitalization of approximately $0.6 million of gross profit recognized as part of the purchase accounting for Onyx, which was fully recognized as additional cost of goods sold in the Company s fiscal 2013 second quarter statement of income is reflected in the pro forma results above as though it was recognized during the three months ended September 30, 2011 and has been removed from the pro forma results for the three months ended December 31, 2012. The non-cash capitalization of profit as part of the fair value accounting for the acquired inventory of Onyx will not impact margin percentage in future quarters.

Pro forma adjustments described above have been tax effected using Sparton s effective rate during the respective periods of approximately 36.0% during the three and six months ended December 31, 2011 and 32.0% during the three and six months ended December 31, 2012.

Pro forma results presented above for the three and six months ended December 31, 2011 include significant and unusual write-downs of inventory of approximately $0.3 million and accounts receivable of approximately $0.4 million related to an Onyx customer, which was excluded from the acquisition.

The pre-acquisition results of Onyx included in the pro forma results above include a fee from the former owner of approximately $0.1 million and $0.2 million for the three months ended December 31, 2012 and 2011, respectively, and $0.3 million and $0.4 million for the six months ended December 31, 2012 and 2011, respectively, to cover the compensation of certain management personnel and other services that were performed by the former owner including treasury, cash management, tax, risk and benefit management and in house legal services. The Company estimates that it will incur approximately $0.1 million quarterly in relation to providing these types of services going forward.

(3) Inventories and Cost of Contracts in Progress

The following are the major classifications of inventory, net of interim billings, at December 31, 2012 and June 30, 2012 (in thousands):

	December 31, 2012	June 30, 2012
Raw materials	$ 39,989	$ 32,935
Work in process	7,803	6,143
Finished goods	8,948	6,615
Total inventory and cost of contracts in progress, gross	56,740	45,693
Inventory to which the U.S. government has title due to interim billings	(11,373)	(10,591)
Total inventory and cost of contracts in progress, net	$ 45,367	$ 35,102

The Company recorded inventory write-downs totaling approximately $0.5 million and $0.3 million for the three months ended December 31, 2012 and 2011, respectively, and $0.5 million and $0.4 million for the six months ended December 31, 2012 and 2011, respectively. These charges are included in cost of goods sold for the periods presented.

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(4) Property, Plant and Equipment, Net

Property, plant and equipment, net consists of the following at December 31, 2012 and June 30, 2012 (in thousands):

	December 31, 2012	June 30, 2012
Land and land improvements	$ 1,405	$ 1,235
Buildings and building improvements	20,663	16,805
Machinery and equipment	25,803	16,082
Construction in progress	4,325	2,324
Total property, plant and equipment	52,196	36,446
Less a		