SPARTON CORP
Form 10-Q
May 07, 2013

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 March 31, 2013

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 April 30, 2013, there were 10,223,874 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, 2013	June 30, 2012 (a)
Assets		
Current Assets:		
Cash and cash equivalents	$ 4,358	$ 46,950
Restricted cash	535	
Accounts receivable, net of allowance for doubtful accounts of $236 and $146, respectively	38,366	29,618
Inventories and cost of contracts in progress, net	46,928	35,102
Deferred income taxes	2,020	2,020
Prepaid expenses and other current assets	3,784	2,054
Total current assets	95,991	115,744
Property, plant and equipment, net	28,835	14,260
Goodwill	14,903	7,472
Other intangible assets, net	11,034	1,618
Deferred income taxes non-current	4,802	5,136
Other non-current assets	707	325
Total assets	$ 156,272	$ 144,555
Liabilities and Shareholders Equity		
Current Liabilities:		
Current portion of long-term debt	$ 134	$ 131
Accounts payable	20,280	17,152
Accrued salaries and wages	7,051	5,855
Accrued health benefits	1,567	1,210
Performance based payments on customer contracts	12,270	25,836
Other accrued expenses	6,536	6,213
Total current liabilities	47,838	56,397
Pension liability non-current portion	891	990
Long-term debt non-current portion	14,438	1,538
Environmental remediation non-current portion	2,896	3,142
Total liabilities	66,063	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, 10,222,050 and 10,105,759 shares issued and outstanding, respectively	12,778	12,632
Capital in excess of par value	20,229	19,579
Retained earnings	58,832	51,995
Accumulated other comprehensive loss	(1,630)	(1,718)

Total shareholders equity	90,209	82,488
Total liabilities and shareholders equity	$ 156,272	$ 144,555

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

See Notes to unaudited condensed consolidated financial statements.

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, 2013	March 31, 2012	March 31, 2013	March 31, 2012
Net sales	$ 63,880	$ 55,048	$ 178,879	$ 162,251
Cost of goods sold	53,838	45,887	150,216	136,010
Gross profit	10,042	9,161	28,663	26,241
Operating Expense:				
Selling and administrative expenses	6,803	5,509	19,650	16,455
Internal research and development expenses	341	347	889	963
Amortization of intangible assets	609	109	984	330
Restructuring/impairment charges				(59)
Other operating expenses	22	26	16	74
Total operating expense, net	7,775	5,991	21,539	17,763
Operating income	2,267	3,170	7,124	8,478
Other income (expense)				
Interest expense	(136)	(175)	(390)	(522)
Interest income	48	25	99	73
Gain on sale of investment				127
Other, net	106	113	275	346
Total other income (expense), net	18	(37)	(16)	24
Income before provision for income taxes	2,285	3,133	7,108	8,502
Provision for income taxes	802	1,128	271	3,046
Net income	$ 1,483	$ 2,005	$ 6,837	$ 5,456
Income per share of common stock:				
Basic	$ 0.15	$ 0.20	$ 0.67	$ 0.53
Diluted	$ 0.14	$ 0.20	$ 0.67	$ 0.53
Weighted average shares of common stock outstanding:				
Basic	10,225,012	10,055,459	10,198,454	10,204,444
Diluted	10,250,700	10,095,705	10,225,191	10,241,614

See Notes to unaudited condensed consolidated financial statements.

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, 2013	March 31, 2012	March 31, 2013	March 31, 2012
Net income	$ 1,483	$ 2,005	$ 6,837	$ 5,456
Other comprehensive income Change in unrecognized pension costs, net of tax	30	27	88	108
Comprehensive income	$ 1,513	$ 2,032	$ 6,925	$ 5,564

SPARTON CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(UNAUDITED)

(Dollars in thousands)

	For the Nine Months Ended	
	March 31, 2013	March 31, 2012
Cash Flows from Operating Activities:		
Net income	$ 6,837	$ 5,456
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization	3,036	1,272
Deferred income tax expense	284	3,042
Pension expense	9	21
Stock-based compensation expense	862	738
Gross profit effect of capitalized profit in inventory from acquisition	566	
Gain on sale of investment		(127)
Other	66	260
Changes in operating assets and liabilities:		
Accounts receivable	(1,359)	(8,073)
Inventories and cost of contracts in progress	(3,405)	(500)
Prepaid expenses and other assets	(1,597)	(1,156)
Performance based payments on customer contracts	(13,566)	6,600
Accounts payable and accrued expenses	1,960	(1,097)
Net cash provided by (used in) operating activities	(6,307)	6,436
Cash Flows from Investing Activities:		
Purchase of Onyx	(45,438)	
Purchases of property, plant and equipment	(2,971)	(3,383)
Change in restricted cash	(535)	
Proceeds from sale of property, plant and equipment	275	275
Proceeds from sale of investment		1,750
Net cash used in investing activities	(48,669)	(1,358)
Cash Flows from Financing Activities:		
Borrowings of long-term debt	22,400	
Repayment of long-term debt	(9,505)	(101)
Payment of debt financing costs	(445)	
Repurchase of stock	(234)	(2,997)
Proceeds from the exercise of stock options	168	152
Net cash provided by (used in) financing activities	12,384	(2,946)
Net increase (decrease) in cash and cash equivalents	(42,592)	2,132
Cash and cash equivalents at beginning of period	46,950	24,550
Cash and cash equivalents at end of period	$ 4,358	$ 26,682
Supplemental disclosure of cash flow information:		
Cash paid for interest	$ 368	$ 264
Cash paid for income taxes	$ 1,337	$ 481

See Notes to unaudited condensed consolidated financial statements.

SPARTON CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF SHAREHOLDERS EQUITY

(UNAUDITED)

(Dollars in thousands)

	Nine Months Ended March 31, 2013					
	Common Stock		Capital		Accumulated Other	
	Shares	Amount	In Excess of Par Value	Retained Earnings	Comprehensive 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	(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				6,837	88	6,925
Balance at March 31, 2013	10,222,050	$ 12,778	$ 20,229	$ 58,832	$ (1,630)	$ 90,209

	Nine Months Ended March 31, 2012					
	Common Stock		Capital		Accumulated Other	
	Shares	Amount	In Excess of Par Value	Retained Earnings	Comprehensive 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	(368,068)	(460)	(2,537)			(2,997)
Exercise of stock options	22,241	28	124			152
Stock-based compensation			738			738
Comprehensive income, net of tax				5,456	108	5,564
Balance at March 31, 2012	10,038,008	$ 12,548	$ 18,776	$ 47,943	$ (763)	$ 78,504

See Notes to unaudited condensed consolidated financial statements.

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 nine months ended March 31, 2013 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, which was financed through the use of Company cash and borrowings under the Company s new credit facility. Additional consideration of $2.19 million was paid in relation to a post-closing working capital adjustment, which was settled in the Company s fiscal 2013 third 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 long-term customers which can 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.

The Company is in the process of obtaining valuations of certain tangible 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
Additional cash consideration for post-closing working capital adjustment	2,188
Total purchase consideration	$ 45,438
Assets acquired and liabilities assumed:	
Accounts receivable, net	$ 7,189
Inventory	8,986
Other current assets	603
Property, plant and equipment	13,656
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 nine months ended March 31, 2013 are net sales of approximately $12.0 million and $18.1 million, respectively, and income (loss) before provision (benefit) for income taxes of approximately $0.1 million and $(0.5) million, respectively, resulting from the acquisition of Onyx since November 15, 2012. Included in these pre-tax results are depreciation and amortization for the three and nine months ended March 31, 2013 of approximately $1.0 million and $1.5 million, respectively.

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 nine months ended March 31, 2013.

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 Nine Months Ended**	
	March 31, 2013	**March 31, 2012**	**March 31, 2013**	**March 31, 2012**
Net sales	$ 63,880	$ 68,900	$ 197,077	$ 200,561
Income before provision for income taxes	$ 2,331	$ 3,237	$ 8,581	$ 7,238
Net income	$ 1,512	$ 2,051	$ 7,676	$ 4,547
Net income per share basic	$ 0.15	$ 0.20	$ 0.75	$ 0.45
Net income per share diluted	$ 0.15	$ 0.20	$ 0.75	$ 0.44

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 nine months ended March 31, 2013 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 nine months ended March 31, 2013. 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 nine months ended March 31, 2013. 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 nine months ended March 31, 2012 and 33%, respectively, during the three and nine months ended March 31, 2013.

Pro forma results presented above for the nine months ended March 31, 2012 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 $0.2 million for the three months ended March 31, 2012, and $0.3 million and $0.6 million for the nine months ended March 31, 2013 and 2012, 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 March 31, 2013 and June 30, 2012 (in thousands):

	March 31, 2013	June 30, 2012
Raw materials	$ 43,216	$ 32,935
Work in process	10,535	6,143
Finished goods	12,715	6,615
Total inventory and cost of contracts in progress, gross	66,466	45,693
Inventory to which the U.S. government has title due to interim billings	(19,538)	(10,591)
Total inventory and cost of contracts in progress, net	$ 46,928	$ 35,102

The Company recorded inventory write-downs totaling approximately $0.1 million and $0.1 million for the three months ended March 31, 2013 and 2012, respectively, and $0.6 million and $0.5 million for the nine months ended March 31, 2013 and 2012, respectively. These charges are included in cost of goods sold for the periods presented.

(4) Property, Plant and Equipment, Net

Property, plant and equipment, net consists of the following at March 31, 2013 and June 30, 2012 (in thousands):

	March 31, 2013	June 30, 2012
Land and land improvements	$ 1,405	$ 1,235
Buildings and building improvements	24,890	16,805
Machinery and equipment	26,206	16,082
Construction in progress	572	2,324
Total property, plant and equipment	53,073	36,446
Less accumulated depreciation	(24,238)	(22,186)
Total property, plant and equipment, net	$ 28,835	$ 14,260

Total property, plant and equipment at March 31, 2013 includes approximately $13.7 million of fixed assets acquired in the Onyx transaction. Included in construction in progress at June 30, 2012 was approximately $2.0 million related to the implementation of a new enterprise resource planning system put into service during the second quarter of fiscal 2013.

(5) Goodwill and Other Intangible Assets

Goodwill represents the excess of purchase price over the fair value of the net assets acquired in conjunction with the Company s purchases of Astro Instrumentation, LLC (Astro) in May 2006, Byers Peak, Incorporated (Byers Peak) in March 2011 and Onyx in November 2012. Goodwill related to each of these acquisitions is reflected within the Company s Medical operating segment. Changes in the carrying value of goodwill for the nine months ended March 31, 2013 and year ended June 30, 2012 and the ending composition of goodwill as of March 31, 2013 and June 30, 2012 are as follows (in thousands):

	March 31, 2013	June 30, 2012
Goodwill, beginning of period	$ 7,472	$ 7,472
Additions to goodwill during the period	7,431	
Goodwill, end of period	$ 14,903	$ 7,472

	March 31, 2013	June 30, 2012
Acquired Goodwill	$ 28,056	$ 20,625
Accumulated impairment	(13,153)	(13,153)
Goodwill	$ 14,903	$ 7,472

The addition to goodwill during the nine months ended March 31, 2013 represents goodwill created resulting from the acquisition of Onyx.

Intangible assets represent the values assigned to customer relationships acquired in conjunction with the Company s purchases of Astro, Byers Peak and Onyx as well as the values assigned to non-compete agreements acquired in conjunction with the Company s purchase of Byers Peak and Onyx. All of the Company s intangible assets are included within the Medical Segment. The amortization periods, gross carrying amounts, accumulated amortization, accumulated impairments and net carrying values of intangible assets at March 31, 2013 and June 30, 2012 are as follows (in thousands):

	Amortization Period in Months	Gross Carrying Amount	Accumulated Amortization	Accumulated Impairments	Net Carrying Value
			March 31, 2013		
Amortized intangible assets:					
Non-compete agreements	12-24	$ 358	$ (225)	$	$ 133
Customer relationships	120-180	18,100	(3,536)	(3,663)	10,901
		$ 18,458	$ (3,761)	$ (3,663)	$ 11,034
			June 30, 2012		
Amortized intangible assets:					
Non-compete agreements	24	$ 158	$ (105)	$	$ 53
Customer relationships	120-180	7,900	(2,672)	(3,663)	1,565
		$ 8,058	$ (2,777)	$ (3,663)	$ 1,618

Sparton did not incur any significant costs to renew or alter the term of its intangible assets during the nine months ended March 31, 2013. Amortization expense for the three months ended March 31, 2013 and 2012 was approximately $0.6 million and $0.1 million, respectively. Amortization expense for the nine months ended March 31, 2013 and 2012 was approximately $1.0 million and $0.3 million, respectively. Aggregate amortization expense relative to existing intangible assets for the periods shown is currently estimated to be as follows (in thousands):

Fiscal Year Ending June 30,	
2013	$ 1,571
2014	2,113
2015	1,808
2016	1,586
2017	1,364
Thereafter	3,576
Total	$ 12,018

(6) Debt

Debt consists of the following at March 31, 2013 and June 30, 2012 (in thousands):

	March 31, 2013	June 30, 2012
Industrial revenue bonds, face value	$ 1,658	$ 1,763
Less unamortized purchase discount	(86)	(94)
Industrial revenue bonds, carrying value	1,572	1,669
Borrowings under revolving credit facilities	13,000	

Total long-term debt	14,572	1,669
Less: current portion	(134)	(131)
Long-term debt, net of current portion	$ 14,438	$ 1,538

Industrial Revenue Bonds

In connection with its acquisition of Astro in May 2006, the Company assumed repayment of principal and interest on bonds originally issued to Astro by the State of Ohio. These bonds are Ohio State Economic Development Revenue Bonds, series 2002-4. Astro originally entered into the loan agreement with the State of Ohio for the issuance of these bonds to finance the construction of the Company s Ohio operating facility. The principal amount, including premium, was issued in 2002 and totaled approximately $2.9 million. These bonds have interest rates which vary, dependent on the maturity date of the bonds ranging from 5.00% to 5.45%. Due to an increase in interest rates since the original issuance of the bonds, a discount amounting to approximately $0.2 million on the date of assumption by Sparton was recorded.

The bonds carry certain sinking fund requirements generally obligating the Company to make monthly deposits of one twelfth of the annual obligation plus accrued interest. The purchase discount is being amortized ratably over the remaining term of the bonds. The Company also has an irrevocable letter of credit in the amount of approximately $0.3 million, which is renewable annually, to secure repayment of a portion of the bonds.

Short-term debt at March 31, 2013 and June 30, 2012 reflects the current portion of the Company s industrial revenue bonds.

Revolving Credit Facility

On November 15, 2012, the Company replaced its previous revolving line-of-credit facility with a new $65 million credit facility with BMO Harris Bank N.A., consisting of a $35 million revolving line-of-credit facility (the Revolving Credit) to support the Company s working capital needs and other general corporate purposes, and a $30 million acquisition loan commitment (the Acquisition Facility and together with the Revolving Credit, the Credit Facility) to finance permitted acquisitions, including the acquisition of Onyx.

The Credit Facility expires on November 15, 2017, is secured by substantially all assets of the Company and provides for up to an additional $35 million in uncommitted loans available for additional Revolving Credit loans or Acquisition loans.

Advances under the Acquisition Facility are available until November 15, 2014. Loans under the Acquisition Facility amortize in two tranches, such that loans outstanding on November 15, 2013 begin amortizing in quarterly installments equal to 2.5% of the principal amount outstanding on such date, and advances made after November 15, 2013 and outstanding on November 15, 2014 begin amortizing on the same basis.

Outstanding borrowings under the Credit Facility bear interest, at the Company s option, at either LIBOR, fixed for interest periods of one, two, three or six month periods, plus 1.25% to 2.00%, or at the bank s base rate, as defined, plus 0.25% to 1.00%, based upon the Company s Total Funded Debt/EBITDA Ratio, as defined. The Company is also required to pay commitment fees on unused portions of the Credit Facility ranging from 0.25% to 0.375%, based on the Company s Total Funded Debt/EBITDA Ratio, as defined. The effective interest rate on outstanding borrowings under the Credit Facility was 1.45% at March 31, 2013.

As a condition of the Credit Facility, the Company is subject to certain customary covenants, which it was in compliance with at March 31, 2013. The Company had $13.0 million of borrowings drawn against the Credit Facility at March 31, 2013.

At December 31, 2012 the Company had $0.5 million of restricted cash representing cash collateral for certain letters of credit outstanding issued by PNC Bank, National Association totaling $0.5 million. The Company intends to have these letters of credit issued by BMO Harris Bank N.A. under the Credit Facility during the Company s fourth quarter of fiscal 2013, eliminating the need for this cash collateral.

(7) Fair Value Measurements

The Company s long-term debt instruments, consisting of industrial revenue bonds, are carried at historical cost. As of March 31, 2013 and June 30, 2012, the fair value of the industrial revenue bonds was approximately $2.0 million and $2.1 million, respectively, compared to carrying values of approximately $1.6 million and $1.7 million, respectively. These fair values, which were derived from discounted cash flow analyses based on the terms of the contracts and observable market data, and adjustment for nonperformance risk, are classified as Level 3 in the fair value hierarchy. The fair value of accounts receivable, accounts payable and borrowings under the Company s Credit Facility approximated their carrying values at both March 31, 2013 and June 30, 2012 due to their short-term nature and the fact that the interest rates approximated market rates. In relation to the acquisition of Onyx, the Company estimated the fair value of the assets acquired and liabilities assumed at acquisition date. See Note 2 for a further discussion of these estimated fair values.

(8) Income Taxes

During the nine months ended March 31, 2013, the Company recognized a $2.1 million income tax benefit for a worthless stock and bad debt deduction with respect to its investments and advances to its 100% owned Canadian subsidiary, Sparton of Canada, Ltd. Sparton of Canada, Ltd. is the legal entity that held the Company s Canadian operations until these operations were ceased during fiscal 2009.

Excluding this discrete tax benefit recorded in the Company s fiscal second quarter, the Company recognized income tax provisions of approximately $0.8 million and $2.4 million, or approximately 35% and 33% of income before provision for income taxes, for the three and nine months ended March 31, 2013. For the three and nine months ended March 31, 2012, the Company recognized income tax provisions of approximately $1.1 million and $3.0 million, or approximately 36% of income before provision for income tax for each period. The Company s effective income tax rate for the interim periods presented is based on management s estimate of the Company s effective tax rate for the applicable year and differs from the Federal statutory income tax rate primarily due to applicable permanent differences, foreign income taxes and state income taxes. The fiscal 2013 effective rates were favorably impacted in comparison to the rate in the prior year periods by the domestic manufacturing deduction. The Company s ability to use this deduction in fiscal 2012 was more limited due to the greater use of net operating loss carryovers to offset Federal taxable income during that year.

(9) Defined Benefit Pension Plan

Approximately 400 employees and retirees of the Company are covered by a defined benefit pension plan. Effective April 1, 2009, participation and the accrual of benefits in this pension plan were frozen, at which time all participants became fully vested. The components of net periodic pension expense are as follows for the three and nine months ended March 31, 2013 and 2012 (in thousands):

	For the Three Months Ended		For the Nine Months Ended	
	March 31, 2013	**March 31, 2012**	**March 31, 2013**	**March 31, 2012**
Service cost	$	$	$	$
Interest cost	86	104	257	313
Expected return on plan assets	(128)	(140)	(385)	(420)
Amortization of prior service cost				
Amortization of unrecognized net actuarial loss	45	11	137	32
Net pension expense (income)	3	(25)	9	(75)
Pro rata recognition of lump-sum settlements		32		96
Total pension expense	$ 3	$ 7	$ 9	$ 21

The Company s policy is to fund the plan based upon legal requirements and tax regulations. During the three and nine months ended March 31, 2013, approximately $0.1 million and $0.2 million, respectively, were contributed to the pension plan, reflective of required funding and discretionary funding to ensure funding levels are in excess of 80%. During the three and nine months ended March 31, 2012, approximately $0.1 million and $0.2 million was contributed. For further information on future funding projections and other pension disclosures see Part II, Item 8, Note 9 Employee Retirement Benefit Plans of the Company s Annual Report on Form 10-K for the fiscal year ended June 30, 2012.

The following table presents the pension related classifications from accumulated other comprehensive income to the statements of income for the three and nine months ended March 31, 2013 and 2012 (in thousands):

	For the Three Months Ended		For the Nine Months Ended	
	March 31, 2013	**March 31, 2012**	**March 31, 2013**	**March 31, 2012**
Amortization of unrecognized net actuarial loss	$ 45	$ 11	$ 137	$ 32
Pro rata recognition of lump-sum settlements		32		96
Change in unrecognized pension costs	45	43	137	128
Provision for income taxes	15	16	49	20
Change in unrecognized pension costs, net of tax	$ 30	$ 27	$ 88	$ 108

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(10) Commitments and Contingencies

Environmental Remediation Sparton has been involved with ongoing environmental remediation since the early 1980 s related to one of its former manufacturing facilities, located in Albuquerque, New Mexico (Coors Road). Although the Company entered into a long-term lease of the Coors Road property that was accounted for as a sale of property during fiscal 2010, it remains responsible for the remediation obligations related to its past operation of this facility. At March 31, 2013, Sparton had accrued approximately $3.3 million as its estimate of the remaining minimum future undiscounted financial liability with respect to this matter, of which approximately $0.4 million is classified as a current liability and included on the balance sheet in other accrued expenses. The Company s minimum cost estimate is based upon existing technology and excludes certain legal costs, which are expensed as incurred. The Company s estimate includes equipment and operating and maintenance costs for onsite and offsite pump and treat containment systems, as well as continued onsite and offsite monitoring. It also includes periodic reporting requirements.

In fiscal 2003, Sparton reached an agreement with the United States Department of Energy (DOE) and others to recover certain remediation costs. Under the settlement terms, Sparton received cash and obtained some degree of risk protection as the DOE agreed to reimburse Sparton for 37.5% of certain future environmental expenses in excess of $8.4 million incurred from the date of settlement, if any, of which approximately $4.5 million has been expended as of March 31, 2013 toward the $8.4 million threshold. Uncertainties associated with environmental remediation contingencies are pervasive and often result in wide ranges of reasonably possible outcomes. Estimates developed in the early stages of remediation can vary significantly. Normally a finite estimate of cost does not become fixed and determinable at a specific point in time. Rather, the costs associated with environmental remediation become estimable over a continuum of events and activities that help to frame and define a liability. Factors which cause uncertainties for the Company include, but are not limited to, the effectiveness of the current work plans in achieving targeted results and proposals of regulatory agencies for desired methods and outcomes. It is possible that cash flows and results of operations could be materially affected by the impact of changes associated with the ultimate resolution of this contingency. At March 31, 2013, the Company estimates that it is reasonably possible, but not probable, that future environmental remediation costs associated with the Company s past operations at the Coors Road property, in excess of amounts already recorded and net of DOE reimbursement, could be up to $2.4 million before income taxes over the next eighteen years.

The Company and its subsidiaries are also involved in certain existing compliance issues with the EPA and various state agencies, including being named as a potentially responsible party at several sites. Potentially responsible parties (PRP s) can be held jointly and severally liable for the clean-up costs at any specific site. The Company s past experience, however, has indicated that when it has contributed relatively small amounts of materials or waste to a specific site relative to other PRPs, its ultimate share of any clean-up costs has been minor. Based upon available information, the Company believes it has contributed only small amounts to those sites in which it is currently viewed as a PRP and that reasonably possible losses related to these compliance issues are immaterial.

U.S. Government Audits Federal government agencies, including the Defense Contract Audit Agency (DCAA) and the Defense Contract Management Agency (DCMA), routinely audit and investigate government contracts and government contractors administrative processes and systems. These agencies review the Company s performance on contracts, pricing practices, cost structure and compliance with applicable laws, regulations and standards. They also review the adequacy of the Company s internal control systems and policies, including the Company s purchasing, accounting, estimating, compensation and management information processes and systems.

The Company implemented a new enterprise resource planning system in November, 2012 and currently remains eligible to receive cost reimbursable contracts from the U.S. Government. The DCAA recently completed an extensive audit of the cost accounting system and, while the opinion has not formally been issued to date, the Company remains confident that the costs accumulated under U.S. Government contracts are considered current, accurate and complete.

Other In addition to the foregoing, from time to time, the Company is involved in various legal proceedings relating to claims arising in the ordinary course of business. The Company is not currently a party to any other such legal proceedings, the adverse outcome of which, individually or in the aggregate, is expected to have a material adverse effect on our business, financial condition or results of operations.

(11) Stock-Based Compensation

The Company has two long-term incentive plans. The Sparton Corporation Stock Incentive Plan, as amended and restated (the 2001 Plan) was approved by the Company s shareholders on October 24, 2001. The Sparton Corporation 2010 Long-Term Incentive Plan (the 2010 Plan) was approved by the Company s shareholders on October 28, 2009.

2001 Plan. Under the 2001 Plan, the Company may grant to employees and non-employee directors incentive and non-qualified stock options, stock appreciation rights, restricted stock and other stock-based awards. All of the stock options issued to date under the 2001 Plan have either three, five or ten-year lives with either immediate vesting or vesting on an annual basis over four years beginning one year after grant date. Restricted stock awards granted to date to employees under the 2001 Plan vest annually over periods ranging from approximately 2.5 to 4.0 years, in some cases subject to achievement of certain financial performance metrics in addition to the service requirements. Unrestricted stock awards granted to date under the 2001 Plan represent annual stock grants to directors as a component of their overall compensation. The 2001 Plan s termination date with respect to the granting of new awards was October 24, 2011. The total number of shares authorized to be granted under the 2001 Plan was 970,161 shares of the Company s common stock, which equals the number of underlying awards previously made under the 2001 Plan.

2010 Plan. Under the 2010 Plan, the Company may grant to employees, officers and directors of the Company or its subsidiaries incentive and non-qualified stock options, stock appreciation rights, restricted stock or restricted stock units, performance awards and other stock-based awards, including grants of shares. Restricted stock awards granted to date to employees under the 2010 Plan vest annually over four years, subject to achievement of certain financial performance metrics in addition to the service requirements. Unrestricted stock awards granted to date under the 2010 Plan represent annual stock grants to directors as a component of their overall compensation. The 2010 Plan has a term of ten years. The total number of shares that may be awarded under the 2010 Plan is 1,000,000 shares of common stock, of which amount, 592,419 shares remain available for awards as of March 31, 2013.

The following table shows stock-based compensation expense by type of share-based award for the three and nine months ended March 31, 2013 and 2012 included in the condensed consolidated statements of operations (in thousands):

	For the Three Months Ended		For the Nine Months Ended	
	March 31, 2013	March 31, 2012	March 31, 2013	March 31, 2012
Fair value expense of stock option awards	$	$	$	$
Restricted and unrestricted stock	265	206	862	738
Total stock-based compensation	$ 265	$ 206	$ 862	$ 738

The following table shows the total remaining unrecognized compensation cost related to restricted stock grants and the fair value expense of stock option awards, as well as the weighted average remaining required service period over which such costs will be recognized as of March 31, 2013:

	Total Remaining Unrecognized Compensation Cost (in thousands)	Weighted Average Remaining Required Service Period (in years)
Fair value expense of stock option awards	$	
Restricted stock	1,301	1.97
	$ 1,301	1.97

The following is a summary of options outstanding and exercisable at March 31, 2013:

	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (in years)	Aggregate Intrinsic Value (in thousands)
Outstanding at June 30, 2012	101,076	$ 7.72		
Granted				
Exercised	(27,952)	6.00		
Forfeited	(14,670)	8.06		
Expired				
Outstanding and exercisable at March 31, 2013	58,454	$ 8.46	2.10	$ 289

The intrinsic value of options exercised during the nine months ended March 31, 2013 and 2012 was $0.2 million and less than $0.1 million respectively.

The following is a summary of activity for the nine months ended March 31, 2013 related to shares granted under the Company s long-term incentive plans:

	Shares	Weighted Average Grant Date Fair Value
Restricted shares at June 30, 2012	305,850	$ 6.44
Granted	146,108	10.90
Vested	(90,175)	6.25
Forfeited	(50,530)	7.96
Restricted shares at March 31, 2013	311,253	$ 8.34

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