

STARRETT L S CO  
Form 10-K  
September 12, 2012

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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

\_\_\_\_\_  
FORM 10-K  
\_\_\_\_\_

(check one)

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934  
For the fiscal year ended June 30, 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 No. 1-367

\_\_\_\_\_  
THE L.S. STARRETT COMPANY  
(Exact name of registrant as specified in its charter)  
\_\_\_\_\_

MASSACHUSETTS  
(State or other jurisdiction of  
incorporation or organization)

04-1866480  
(I.R.S. Employer  
Identification No.)

121 CRESCENT STREET, ATHOL, MASSACHUSETTS  
(Address of principal executive offices)

01331  
(Zip Code)

Registrant's telephone number, including area code 978-249-3551  
\_\_\_\_\_

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

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Title of each class	Name of each exchange on which registered
Class A Common - \$1.00 Per Share Par Value	New York Stock Exchange
Class B Common - \$1.00 Per Share Par Value	Not applicable

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Indicate by check mark if the Registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.  
Yes  No

Indicate by check mark if the Registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes  No

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 Web site, 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 for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or amendment to this Form 10-K.

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  Smaller Reporting Company   
(Do not check if a smaller reporting company)

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

The Registrant had 5,977,176 and 782,620 shares, respectively, of its \$1.00 par value Class A and B common stock outstanding on December 31, 2011. On December 31, 2011, the last business day of the Registrant's second fiscal quarter, the aggregate market value of the common stock held by nonaffiliates was approximately \$76,312,794.

There were 6,025,871 and 764,814 shares, respectively, of the Registrant's \$1.00 par value Class A and Class B common stock outstanding as of August 31, 2012.

The exhibit index is located on pages 52-54.

#### DOCUMENTS INCORPORATED BY REFERENCE

The Registrant intends to file a definitive Proxy Statement for the Company's 2012 Annual Meeting of Stockholders within 120 days of the end of the fiscal year ended June 30, 2012. Portions of such Proxy Statement are incorporated by reference in Part III.

## THE L.S. STARRETT COMPANY

## FORM 10-K

FOR THE YEAR ENDED JUNE 30, 2012

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## PART I

### Item 1 - Business

#### General

Founded in 1880 by Laroy S. Starrett and incorporated in 1929, the Company is engaged in the business of manufacturing over 5,000 different products for industrial, professional and consumer markets. As a global manufacturer with major subsidiaries in Brazil (1956), Scotland (1958) and China (1997), the Company offers its broad array of products to the market through multiple channels of distribution throughout the world. The Company's products include precision tools, non-contact industrial measurement systems, electronic gages, gage blocks, optical vision and laser measuring equipment, custom engineered granite solutions, tape measures, levels, chalk products, squares, band saw blades, hole saws, hacksaw blades, jig saw blades, reciprocating saw blades, M1® lubricant and precision ground flat stock. The Company's financial reporting is based upon one business segment.

Starrett® is brand recognized around the world for precision, quality and innovation.

#### Products

The Company's tools and instruments are sold throughout North America and in over 100 other countries. By far the largest consumer of these products is the metalworking industry including aerospace, medical, and automotive but other important consumers are marine and farm equipment shops, do-it-yourselfers and tradesmen such as builders, carpenters, plumbers and electricians.

For 132 years the Company has been a recognized leader in providing measurement solutions consisting of hand measuring tools and precision instruments such as micrometers, vernier calipers, height gages, depth gages, electronic gages, dial indicators, steel rules, combination squares, custom and non-contact gaging and many other items. Skilled personnel, superior products, manufacturing expertise, innovation and unmatched service has earned the Company its reputation as the "Best in Class" provider of measuring application solutions for industry. During 2012 the Company has expanded its reach with new product introductions. These include a range of force measurement, surface roughness testers and roundness test equipment and IP67 water resistant electronic indicators. The Company also entered the in process gaging field with the acquisition of Bytewise measurement systems which makes state of the art laser measurement equipment and software for shop floor applications.

The Company's saw product lines enjoy strong global brand recognition and market share. These products encompass a breadth of uses. The Company introduced several new products in the recent past including its ADVANZ carbide tipped products and its VERSATIX products with a patent pending tooth geometry designed for the cutting of structurals and small solids. These new product lines were enhanced through the global introduction of new support programs and marketing collateral. These actions are aimed at positioning Starrett for global growth in wide band products for production applications as well as product range expansions for shop applications. A full line of complementary saw products, including hack, jig, reciprocating saw blades and hole saws provide cutting solutions for the building trades and are offered primarily through construction, electrical, plumbing and retail distributors.

#### Personnel

At June 30, 2012, the Company had 1,928 employees, approximately 53% of whom were domestic. This represents a net decrease from June 30, 2011 of 23 employees. The headcount change included an increase of 37 domestically and a decrease of 60 internationally.

None of the Company's operations are subject to collective bargaining agreements. In general, the Company considers relations with its employees to be excellent. Domestic employees hold a large share of Company stock resulting from various stock purchase plans. The Company believes that this dual role of owner-employee has strengthened

employee morale over the years.

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### Competition

The Company is competing on the basis of its reputation as the best in class for quality, precision and innovation combined with its commitment to customer service and strong customer relationships. To that end, Starrett is increasingly focusing on providing customer centric solutions. Although the Company is generally operating in highly competitive markets, the Company's competitive position cannot be determined accurately in the aggregate or by specific market since none of its competitors offer all of the same product lines offered by the Company or serve all of the markets served by the Company.

The Company is one of the largest producers of mechanics' hand measuring tools and precision instruments. In the United States, there are three major foreign competitors and numerous small companies in the field. As a result, the industry is highly competitive. During fiscal 2012, there were no material changes in the Company's competitive position. The Company's products for the building trades, such as tape measures and levels, are under constant margin pressure due to a channel shift to large national home and hardware retailers. The Company is responding to such challenges by expanding its manufacturing operations in China. Certain large customers offer private labels ("own brand") that compete with Starrett branded products. These products are often sourced directly from low cost countries.

Saw products encounter competition from several domestic and international sources. The Company's competitive position varies by market segment and country. Continued research and development, new patented products and processes, strategic acquisitions and investments and strong customer support have enabled the Company to compete successfully in both general and performance oriented applications.

### Foreign Operations

The operations of the Company's foreign subsidiaries are consolidated in its financial statements. The subsidiaries located in Brazil, Scotland and China are actively engaged in the manufacturing and distribution of precision measuring tools, saw blades, optical and vision measuring equipment and hand tools. Subsidiaries in Canada, Australia, New Zealand, Mexico, Germany and Singapore are engaged in distribution of the Company's products. The Company expects its foreign subsidiaries to continue to play a significant role in its overall operations. A summary of the Company's foreign operations is contained in Note 15 to the Company's fiscal 2012 financial statements under the caption "OPERATING DATA" found in Item 8 of this Form 10-K.

### Orders and Backlog

The Company generally fills orders from finished goods inventories on hand. Sales order backlog of the Company at any point in time is not significant. Total inventories amounted to \$69.9 million at June 30, 2012 and \$58.8 million at June 30, 2011.

### Intellectual Property

When appropriate, the Company applies for patent protection on new inventions and currently owns a number of patents. Its patents are considered important in the operation of the business, but no single patent is of material importance when viewed from the standpoint of its overall business. The Company relies on its continuing product research and development efforts, with less dependence on its current patent position. It has for many years maintained engineers and supporting personnel engaged in research, product development and related activities. The expenditures for these activities during fiscal years 2012, 2011 and 2010 were approximately \$2.2 million, \$1.9 million and \$1.3 million, respectively.

The Company uses trademarks with respect to its products and considers its trademark portfolio as one of its most valuable assets. All of the Company's important trademarks are registered and rigorously enforced.

### Environmental



Compliance with federal, state, local, and foreign provisions that have been enacted or adopted regulating the discharge of materials into the environment or otherwise relating to protection of the environment is not expected to have a material effect on the capital expenditures, earnings and competitive position of the Company. Specifically, the Company has taken steps to reduce, control and treat water discharges and air emissions. The Company takes seriously its responsibility to the environment, has embraced renewable energy alternatives and is ready to bring a new hydro – generation facility on line at its Athol, MA plant to reduce its carbon foot print and energy costs, an investment in excess of \$1.0 million.

### Strategic Activities

Globalization has had a profound impact on product offerings and buying behaviors of industry and consumers in North America and around the world, forcing the Company to adapt to this new, highly competitive business environment. The Company continuously evaluates most aspects of its business, aiming for new world-class ideas to set itself apart from its competition.

Our strategic concentration is on global brand building and providing unique customer value propositions through technically supported application solutions for our customers. Our job is to recommend and produce the best suited standard product or to design and build custom solutions. The combination of the right tool for the job with value added service gives us a competitive advantage. The Company continues its focus on lean manufacturing, plant consolidations, global sourcing, new software and hardware technologies, and improved logistics to optimize its value chain.

The execution of these strategic initiatives has expanded the Company's manufacturing and distribution in developing economies, resulting in international sales revenues totaling 55% of consolidated sales for fiscal 2012.

### SEC Filings and Certifications

The Company makes its public filings with the Securities and Exchange Commission ("SEC"), including its Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and all exhibits and amendments to these reports, available free of charge at its website, [www.starrett.com](http://www.starrett.com), as soon as reasonably practicable after the Company files such material with the SEC. Information contained on the Company's website is not part of this Annual Report on Form 10-K.

### Item 1A – Risk Factors

#### SAFE HARBOR STATEMENT UNDER THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995

This Annual Report on Form 10-K and the Company's 2012 Annual Report to Stockholders, including the President's letter, contain forward-looking statements about the Company's business, competition, sales, gross margins, capital expenditures, foreign operations, plans for reorganization, interest rate sensitivity, debt service, liquidity and capital resources, and other operating and capital requirements. In addition, forward-looking statements may be included in future Company documents and in oral statements by Company representatives to security analysts and investors. The Company is subject to risks that could cause actual events to vary materially from such forward-looking statements, including the following risk factors:

**Risks Related to Financial Reporting:** If the Company or its independent registered public accounting firm are unable to affirm the effectiveness of internal control over financial reporting in future years, the market value of the Company's common stock could be adversely affected. The Company's independent registered public accounting firm did audit and report on internal controls over financial reporting as of June 30, 2012 and June 30, 2011. For the year ended June 30, 2011, a material weakness in internal controls in income tax analysis and reporting was identified. Management has implemented the remediation steps outlined in the Annual Report on Form 10-K for fiscal 2012, and resolved this financial reporting issue.

**Risks Related to the Economy:** The Company's results of operations are materially affected by the conditions in the global economy. As a result of the global economic recession, U.S. and foreign economies have experienced significant declines in employment, household wealth, consumer spending, and lending. Businesses, including the Company and its customers, faced weakened demand for their products and services, difficulty obtaining access to financing, increased funding costs, and barriers to expanding operations. While the Company's results of operations in fiscal 2010 were negatively impacted by the global economic recession, business activity improved for the Company in fiscal 2011 and continued to grow in fiscal 2012. The Company can provide no assurance that the past two fiscal

year improvements will continue or that its future results of operations will improve.

**Risks Related to Reorganization:** The Company continues to evaluate consolidation and reorganization of some of its manufacturing and distribution operations. There can be no assurance that the Company will be successful in these efforts or that any consolidation or reorganization will result in revenue increases or cost savings to the Company. The implementation of these reorganization measures may disrupt the Company's manufacturing and distribution activities, could adversely affect operations, and could result in asset impairment charges and other costs that will be recognized if and when reorganization or restructuring plans are implemented or obligations are incurred.

**Risks Related to Technology:** Although the Company's strategy includes investment in research and development of new and innovative products to meet technology advances, there can be no assurance that the Company will be successful in competing against new technologies developed by competitors.

**Risks Related to Foreign Operations:** Approximately 55% of the Company's sales and 66% of net assets related to foreign operations for fiscal 2012. Foreign operations are subject to special risks that can materially affect the sales, profits, cash flows and financial position of the Company, including taxes and other restrictions on distributions and payments, currency exchange rate fluctuations, political and economic instability, inflation, minimum capital requirements and exchange controls. The Company's Brazilian operations can be very volatile, changing from year to year due to the political situation, currency risk and the economy. As a result, the future performance of the Brazilian operations may be difficult to forecast.

**Risks Related to Industrial Manufacturing Sector:** The market for most of the Company's products is subject to economic conditions affecting the industrial manufacturing sector, including the level of capital spending by industrial companies and the general movement of manufacturing to low cost foreign countries where the Company does not have a substantial market presence. Accordingly, economic weakness in the industrial manufacturing sector may, and in some cases has, resulted in decreased demand for certain of the Company's products, which adversely affects sales and performance. Economic weakness in the consumer market will also adversely impact the Company's performance. In the event that demand for any of the Company's products declines significantly, the Company could be required to recognize certain costs as well as asset impairment charges on long-lived assets related to those products.

**Risks Related to Competition:** The Company's business is subject to direct and indirect competition from both domestic and foreign firms. In particular, low cost foreign sources have created severe competitive pricing pressures. Under certain circumstances, including significant changes in U.S. and foreign currency relationships, such pricing pressures tend to reduce unit sales and/or adversely affect the Company's margins.

**Risks Related to Insurance Coverage:** The Company carries liability, property damage, workers' compensation, medical and other insurance policies that management considers adequate for the protection of its assets and operations. There can be no assurance, however, that the coverage limits of such policies will be adequate to cover all claims and losses. Such uncovered claims and losses could have a material adverse effect on the Company. Depending on the risk, deductibles can be as high as 5% of the loss or \$500,000.

**Risks Related to Raw Material and Energy Costs:** Steel is the principal raw material used in the manufacture of the Company's products. The price of steel has historically fluctuated on a cyclical basis and has often depended on a variety of factors over which the Company has no control. The cost of producing the Company's products is also sensitive to the price of energy. The selling prices of the Company's products have not always increased in response to raw material, energy or other cost increases, and the Company is unable to determine to what extent, if any, it will be able to pass future cost increases through to its customers. The Company's inability to pass increased costs through to its customers could materially and adversely affect its financial condition or results of operations.

**Risks Related to Overall Stock Market Performance:** Currently, the Company's U.S. defined benefit pension plan is underfunded. The Company will be required to provide an additional \$1.5 million to the domestic pension fund in fiscal 2013. The Company could be required to fund the domestic plan in the future. The Company's UK plan, which is also underfunded, required Company contributions during fiscal 2010, 2011 and 2012.

**Risks Related to Acquisitions:** Acquisitions involve special risks, including the potential assumption of unanticipated liabilities and contingencies, difficulty in assimilating the operations and personnel of the acquired businesses, disruption of the Company's existing business, dissipation of the Company's limited management resources, and impairment of relationships with employees and customers of the acquired business as a result of changes in ownership and management. While the Company believes that strategic acquisitions can improve its competitiveness and profitability, the failure to successfully integrate and realize the expected benefits of such acquisitions could have an adverse effect on the Company's business, financial condition and operating results.

Risks Related to Investor Expectations: The Company's share price remained relatively stable in fiscal 2012. The price rose steadily through the first three quarters of fiscal 2012 before declining in the fourth quarter. The Company's earnings may not continue to grow at rates similar to the growth rates achieved in recent years and may fall short of either a prior quarter or investors' expectations. If the Company fails to meet the expectations of securities analysts or investors, the Company's share price may decline.

Risks Related to the Company's Credit Facility: Under the Company's credit facility with TD Bank, N.A., the Company is required to comply with certain financial covenants. While the Company believes that it will be able to comply with the financial covenants in future periods, its failure to do so would result in defaults under the credit facility unless the covenants are amended or waived. An event of default under the credit facility, if not waived, could prevent additional borrowing and could result in the acceleration of the Company's indebtedness. The Credit Facility matured on April 30, 2012 and was renewed thru April 30, 2015. As of June 30, 2012 the Company was in compliance with three of the four covenants, however, due to the increase in the pension liability, the Company was not in compliance with the tangible net worth covenant. The Company received a waiver for default of the tangible net worth covenant and, on September 7, 2012 amended its agreement with TD Bank replacing the tangible net worth covenant with a covenant that specifies a maximum ratio of funded debt to EBITDA. The Company expects to be able to meet this revised covenant in future periods.

**Risks Related to Information Systems:** The efficient operation of the Company's business is dependent on its information systems, including its ability to operate them effectively and to successfully implement new technologies, systems, controls and adequate disaster recovery systems. In addition, the Company must protect the confidentiality of data of its business, employees, customers and other third parties. The failure of the Company's information systems to perform as designed or its failure to implement and operate them effectively could disrupt the Company's business or subject it to liability and thereby harm its profitability. For those reasons, the Company implemented a new Enterprise Resource Planning (ERP) system in fiscal 2010 at its principal North American locations.

**Risks Related to Litigation and Changes in Laws, Regulations and Accounting Rules:** Various aspects of the Company's operations are subject to federal, state, local or foreign laws, rules and regulations, any of which may change from time to time. Generally accepted accounting principles may change from time to time, as well. In addition, the Company is regularly involved in various litigation matters that arise in the ordinary course of business. Litigation, regulatory developments and changes in accounting rules and principles could adversely affect the Company's business operations and financial performance.

**Item 1B – Unresolved Staff Comments**

None.

**Item 2 - Properties**

The Company's principal plant and its corporate headquarters are located in Athol, MA on approximately 15 acres of Company-owned land. The plant consists of 25 buildings, mostly of brick construction of varying dates, with approximately 535,000 square feet.

The Company's Webber Gage Division in Cleveland, OH, owns and occupies two buildings totaling approximately 50,000 square feet.

The Company-owned facility in Mt. Airy, NC consists of one building totaling approximately 320,000 square feet. It is occupied by the Company's Saw Division, Ground Flat Stock Division and a distribution center. A separate 36,000 square foot building which formerly housed the distribution center was vacated in November 2008 and is currently listed for sale.

A manufacturing and warehousing facility in North Charleston encompassing 173,000 square feet was closed in fiscal 2005 and the building was sold in fiscal 2011.

The Company's subsidiary in Itu, Brazil owns and occupies several buildings totaling 209,000 square feet.

The Company's subsidiary in Jedburgh, Scotland owns and occupies a 175,000 square foot building.

A wholly owned manufacturing subsidiary in The People's Republic of China leases a 133,000 square foot building in Suzhou. In fiscal 2012, the Company closed a 5,000 square foot Shanghai distribution center and sales office, consolidated the distribution into the Suzhou facility and leased a new sales office in Shanghai.

The Tru-Stone Division owns and occupies a 106,000 square foot facility in Waite Park, MN.

The Kinematic Engineering Division occupies a 18,000 square foot leased facility in Laguna Hills, CA.

The Bytewise Division occupies a 10,000 square foot leased facility in Columbus, GA.

In addition, the Company operates warehouses and/or sales-support offices in the U.S., Canada, Australia, New Zealand, Mexico, Germany, Singapore and Japan.

In the Company's opinion, all of its property, plants and equipment are in good operating condition, well maintained and adequate for its needs.

Item 3 - Legal Proceedings

The Company is, in the ordinary course of business, from time to time involved in litigation that is not considered material to its financial condition or operations.

Item 4 – Mine Safety Disclosures

Not applicable.

## PART II

## Item 5 - Market for the Company's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

The Company's Class A common stock is traded on the New York Stock Exchange. Quarterly dividend and high/low closing market price information is presented in the table below. The Company's Class B common stock is generally nontransferable, except to lineal descendants, and thus has no established trading market, but it can be converted into Class A common stock at any time. The Class B common stock was issued on October 5, 1988, and the Company has paid the same dividends thereon as have been paid on the Class A common stock since that date. On June 30, 2012, there were approximately 1,410 registered holders of Class A common stock and approximately 1,167 registered holders of Class B common stock.

Quarter Ended	Dividends	High	Low
September 2010	\$ 0.06	\$ 12.48	\$ 10.00
December 2010	0.08	12.88	10.36
March 2011	0.08	14.94	11.38
June 2011	0.10	14.32	10.25
September 2011	0.10	12.77	10.28
December 2011	0.10	13.40	10.47
March 2012	0.10	14.56	12.30
June 2012	0.10	13.37	10.75

The Company's dividend policy is subject to periodic review by the Board of Directors. Based upon economic conditions, the Board of Directors decided to maintain the quarterly dividend at \$0.10 for all quarters of fiscal 2012.

## ISSUER PURCHASES OF EQUITY SECURITIES