STARRETT L S CO
Form 10-Q
February 03, 2016
UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D. C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended December 31, 2015

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 1-367

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

MASSACHUSETTS	04-1866480
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

121 CRESCENT STREET, ATHOL, MASSACHUSETTS	01331-1915
(Address of principal executive offices)	(Zip Code)

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

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 whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definition of "accelerated filer," "large 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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

YES
NO

Common Shares outstanding as of	January 31, 2016
Class A Common Shares	6,240,537

Class B Common Shares	775,081

THE L. S. STARRETT COMPANY

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

THE L. S. STARRETT COMPANY

Consolidated Balance Sheets

(in thousands except share data)

	December 31, 2015 (unaudited)	June 30, 2015
ASSETS		
Current assets:		
Cash	$ 18,380	$ 11,108
Short-term investments	-	7,855
Accounts receivable (less allowance for doubtful accounts of $698 and $612, respectively)	31,204	40,311
Inventories	58,262	63,003
Current deferred income tax assets	4,143	4,554
Prepaid expenses and other current assets	6,200	6,582
Total current assets	118,189	133,413
Property, plant and equipment, net	42,940	44,413
Income taxes receivable	3,103	3,383
Deferred income tax assets, net of current portion	18,782	18,803
Intangible assets, net	6,783	7,125
Goodwill	3,034	3,034
Other assets	2,170	2,101
Total assets	$ 195,001	$ 212,272
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Notes payable and current maturities of long-term debt	$ 1,516	$ 1,552
Accounts payable	8,148	9,471
Accrued expenses	5,876	7,011
Accrued compensation	3,479	5,565
Total current liabilities	19,019	23,599

Long-term debt, net of current portion	17,889	18,552
Other income tax obligations	4,680	4,607
Deferred income tax liabilities	1,489	1,548
Postretirement benefit and pension obligations	48,152	49,536
Total liabilities	91,229	97,842
Stockholders' equity:		
Class A Common stock $1 par (20,000,000 shares authorized; 6,239,083 outstanding at December 31, 2015 and 6,223,558 outstanding at June 30, 2015)	6,239	6,224
Class B Common stock $1 par (10,000,000 shares authorized; 780,474 outstanding at December 31, 2015 and 789,069 outstanding at June 30, 2015)	780	789
Additional paid-in capital	55,010	54,869
Retained earnings	97,037	98,164
Accumulated other comprehensive loss	(55,294)	(45,616)
Total stockholders' equity	103,772	114,430
Total liabilities and stockholders’ equity	$ 195,001	$212,272

See Notes to Unaudited Consolidated Financial Statements

THE L. S. STARRETT COMPANY

Consolidated Statements of Operations

(in thousands except per share data) (unaudited)

	3 Months Ended		6 Months Ended	
	12/31/2015	12/31/2014	12/31/2015	12/31/2014
Net sales	$53,671	$ 63,821	$104,709	$ 123,993
Cost of goods sold	37,672	41,657	72,858	82,686
Gross margin	15,999	22,164	31,851	41,307
% of Net sales	29.8 %	34.7 %	30.4 %	33.3 %
Selling, general and administrative expenses	14,796	18,461	30,469	36,538
Operating income	1,203	3,703	1,382	4,769
Other income (expense)	(211)	620	92	1,295
Income before income taxes	992	4,323	1,474	6,064
Income tax expense	534	1,876	1,194	2,694
Net income	$458	$ 2,447	$280	$ 3,370
Basic and diluted income per share	$0.07	$ 0.35	$0.04	$ 0.48
Weighted average outstanding shares used in per share calculations:				
Basic	7,022	6,974	7,018	6,970
Diluted	7,043	7,012	7,050	7,010
Dividends per share	$0.10	$ 0.10	$0.20	$ 0.20

See Notes to Unaudited Consolidated Financial Statements

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THE L. S. STARRETT COMPANY

Consolidated Statements of Comprehensive Income (Loss)

(in thousands) (unaudited)

	3 Months Ended		6 Months Ended	
	12/31/2015	12/31/2014	12/31/2015	12/31/2014
Net income	$458	$ 2,447	$280	$ 3,370
Other comprehensive income (loss):				
Translation gain (loss)	102	(4,820)	(9,678)	(11,768)
Pension and postretirement plans, net of tax of $0,$0,$0 and $22 respectively	-	-	-	(22)
Other comprehensive income (loss)	102	(4,820)	(9,678)	(11,790)
Total comprehensive income (loss)	$560	$ (2,373)	$(9,398)	$ (8,420)

See Notes to Unaudited Consolidated Financial Statements

THE L. S. STARRETT COMPANY

Consolidated Statements of Stockholders' Equity

For the Six Months Ended December 31, 2015

(in thousands except per share data) (unaudited)

	Common Stock Outstanding		Addi-tional Paid-in	Retained	Accumulated Other Com-prehensive	
	Class A	Class B	Capital	Earnings	Loss	Total
Balance June 30, 2015	$6,224	$789	$54,869	$98,164	$(45,616)	$114,430
Total comprehensive income (loss)	-	-	-	280	(9,678)	(9,398)
Dividends ($0.20 per share)	-	-	-	(1,407)	-	(1,407)
Repurchase of shares	(22)	(3)	(272)	-	-	(297)
Issuance of stock	22	9	341	-	-	372
Stock-based compensation	-	-	72	-	-	72
Conversion	15	(15)	-	-	-	-
Balance December 31, 2015	$6,239	$780	$55,010	$97,037	$(55,294)	$103,772

Accumulated balance consists of:	
Translation loss	$(46,978)
Pension and postretirement plans, net of taxes	(8,316)
	$(55,294)

See Notes to Unaudited Consolidated Financial Statements

THE L. S. STARRETT COMPANY

Consolidated Statements of Cash Flows

(in thousands of dollars) (unaudited)

	6 Months Ended 12/31/2015	12/31/2014
Cash flows from operating activities:		
Net income	$280	$ 3,370
Non-cash operating activities:		
Depreciation	3,052	3,959
Amortization	667	634
Stock-based compensation	227	211
Net long-term tax obligations	320	1,723
Deferred taxes	(1)	1,301
Unrealized transaction gain	44	(6)
Income on equity method investment	(73)	(116)
Working capital changes:		
Accounts receivable	4,666	5,928
Inventories	(661)	(6,158)
Other current assets	(235)	(1,468)
Other current liabilities	(1,351)	(2,986)
Postretirement benefit and pension obligations	(677)	(866)
Other	(79)	310
Net cash provided by operating activities	6,179	5,836
Cash flows from investing activities:		
Additions to property, plant and equipment	(3,611)	(2,768)
Software development	(325)	(300)
Purchase of investments	-	(45)
Proceeds from sale of investments	7,621	201
Net cash provided by (used in) investing activities	3,685	(2,912)
Cash flows from financing activities:		
Proceeds from short-term borrowings	-	921
Proceeds from long-term borrowings	750	-
Long-term debt repayments	(1,448)	(767)
Proceeds from common stock issued	217	256
Shares repurchased	(297)	(33)
Dividends paid	(1,407)	(1,396)
Net cash used in financing activities	(2,185)	(1,019)
Effect of exchange rate changes on cash	(407)	(1,999)

Net increase (decrease) in cash	7,272	(94)
Cash, beginning of period	11,108	16,233
Cash, end of period	$18,380	$ 16,139
Supplemental cash flow information:		
Interest paid	$349	$ 363
Income taxes paid, net	557	1,183

See Notes to Unaudited Consolidated Financial Statements

THE L. S. STARRETT COMPANY

Notes to Unaudited Consolidated Financial Statements

December 31, 2015

Note 1: Basis of Presentation and Summary of Significant Account Policies

The balance sheet as of June 30, 2015, which has been derived from audited financial statements, and the unaudited interim financial statements as of and for the three and six months ended December 31, 2015 and December 31, 2014, have been prepared by The L.S. Starrett Company (the "Company") in accordance with accounting principles generally accepted in the United States of America for interim financial reporting. Accordingly, they do not include all of the information and notes required by generally accepted accounting principles for complete financial statements. These unaudited financial statements, which, in the opinion of management, reflect all adjustments (including normal recurring adjustments) necessary for a fair presentation, should be read in conjunction with the financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the year ended June 30, 2015. Operating results are not necessarily indicative of the results that may be expected for any future interim period or for the entire fiscal year.

The preparation of financial statements and related disclosures in conformity with accounting principles generally accepted in the United States of America requires management to make judgments, assumptions and estimates that affect amounts reported in the consolidated financial statements and accompanying notes. Note 2 to the Company's Consolidated Financial Statements included in the Annual Report on Form 10-K for the year ended June 30, 2015 describes the significant accounting policies and methods used in the preparation of the consolidated financial statements.

Note 2: Recent Accounting Pronouncements

In May 2014, the FASB issued a new standard related to the "Revenue from Contracts with Customers" which amends the existing accounting standards for revenue recognition. The standard requires entities to recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration the entity expects to be entitled to in exchange for those goods or services. This standard is applicable for fiscal years beginning after December 15, 2017 and for interim periods within those years and early adoption is not permitted. The Company expects to adopt this standard on July 1, 2018. The Company is currently evaluating the impact of the adoption of this standard on its consolidated financial statements.

Accounting Standards Update (ASU) 2015-11, "Inventory - Simplifying the Measurement of Inventory" requires companies to measure most inventory at the lower of cost or net realizable value, thereby simplifying the current guidance under which a company must measure inventory at the lower of cost or market. This Update eliminates the need to determine replacement cost and evaluate whether said cost is within a quantitative range. This Update also further aligns U.S. GAAP and international accounting standards. For public companies, the guidance in ASU 2015-11 is effective for annual periods beginning after December 15, 2016, and interim periods thereafter. Early adoption is permitted. Management does not expect ASU 2015-11 to have a material impact on the Company's financial statements and disclosures.

Accounting Standards Update 2015-17, “Balance Sheet Classification of Deferred Taxes” requires that companies classify all deferred taxes as non-current assets or liabilities. This change is applicable for fiscal years beginning after December 15, 2016 and for interim periods within those years. There is no impact to earnings as a result of this change; however, current assets will be reduced by the amount of the current deferred tax asset as that amount will be included with the long term deferred tax asset upon adoption of this ASU.

Note 3: Stock-based Compensation

On September 5, 2012, the Board of Directors adopted The L.S. Starrett Company 2012 Long Term Incentive Plan (the “2012 Stock Plan”). The 2012 stock plan was approved by shareholders on October 17, 2012. The 2012 Stock Plan permits the granting of the following types of awards to officers, other employees and non-employee directors: stock options; restricted stock awards; unrestricted stock awards; stock appreciation rights; stock units including restricted stock units; performance awards; cash-based awards; and awards other than previously described that are convertible or otherwise based on stock. The 2012 Stock Plan provides for the issuance of up to 500,000 shares of common stock.

Options granted vest in periods ranging from one year to three years and expire ten years after the grant date. Restricted stock units (“RSU”) granted generally vest from one year to three years. Vested restricted stock units will be settled in shares of common stock. As of December 31, 2015, there were 20,000 stock options and 73,367 restricted stock units outstanding. In addition, there were 391,600 shares available for grant under the 2012 Stock Plan as of December 31, 2015.

For stock option grants the fair value of each grant is estimated at the date of grant using the Binomial Options pricing model. The Binomial Options pricing model utilizes assumptions related to stock volatility, the risk-free interest rate, the dividend yield, and employee exercise behavior. Expected volatilities utilized in the model are based on the historic volatility of the Company’s stock price. The risk free interest rate is derived from the U.S. Treasury Yield curve in effect at the time of the grant. The expected life is determined using the average of the vesting period and contractual term of the options (Simplified Method).

No stock options were granted during the six months ended December 31, 2015 and 2014.

The weighted average contractual term for stock options outstanding as of December 31, 2015 was 7 years. The aggregate intrinsic value of stock options outstanding as of December 31, 2015 was $0.1 million. Stock options exercisable as of December 31, 2015 were 20,000.

The Company accounts for stock options and RSU awards by recognizing the expense of the grant date fair value ratably over vesting periods generally ranging from one year to three years. The related expense is included in selling, general and administrative expenses.

There were 40,200 RSU awards with a fair value of $15.11 per RSU granted during the six months ended December 31, 2015. There were 9,067 RSUs settled during the six months ended December 31, 2015. The aggregate intrinsic value of RSU awards outstanding as of December 31, 2015 was $1.2 million. As of December 31, 2015 all vested awards had been issued and settled.

On February 5, 2013, the Board of Directors adopted The L.S. Starrett Company 2013 Employee Stock Ownership Plan (the "2013 ESOP"). The purpose of the plan is to supplement existing Company programs through an employer funded individual account plan dedicated to investment in common stock of the Company, thereby encouraging increased ownership of the Company while providing an additional source of retirement income. The plan is intended as an employee stock ownership plan within the meaning of Section 4975 (e) (7) of the Internal Revenue Code of 1986, as amended. U.S. employees who have completed a year of service are eligible to participate.

Compensation expense related to all stock based plans for the six month periods ended December 31, 2015 and 2014 was $0.2 million and $0.1 million, respectively. As of December 31, 2015, there was $1.1 million of total unrecognized compensation costs related to outstanding stock-based compensation arrangements. Of this cost $0.7 million relates to performance based RSU grants that are not expected to be awarded. The remaining $0.4 million is expected to be recognized over a weighted average period of 2.2 years.

Note 4: Inventories

Inventories consist of the following (in thousands):

	12/31/2015	6/30/2015
Raw material and supplies	$ 31,182	$ 32,784
Goods in process and finished parts	16,195	18,569
Finished goods	39,364	39,689
	86,741	91,042
LIFO Reserve	(28,479)	(28,039)
Inventories	$ 58,262	$ 63,003

LIFO inventories were $12.5 million and $14.6 million at December 31, 2015 and June 30, 2015, respectively, such amounts being approximately $28.5 million and $28.0 million, respectively, less than if determined on a FIFO basis. The use of LIFO, as compared to FIFO, resulted in a $0.4 million increase in cost of sales for the six months ended December 31, 2015 compared to a $0.1 million decrease for the six months ended December 31, 2014.

Note 5: Goodwill and Intangible Assets

The Company's acquisition of Bytewise in 2011 gave rise to a goodwill asset balance. The Company performed a qualitative analysis in accordance with ASU 2011-08 for its October 1, 2015 annual assessment of goodwill (commonly referred to as "Step Zero"). From a qualitative perspective, in evaluating whether it is more likely than not that the fair value of the reporting unit exceeds its respective carrying amount, relevant events and circumstances were taken into account, with greater weight assigned to events and circumstances that most affect the fair value or the carrying amounts of its assets. Items that were considered included, but were not limited to, the following: macroeconomic conditions, industry and market conditions, cost factors, overall financial performance and changes in management or key personnel. After assessing these and other factors the Company determined that it was more likely than not that the fair value of the reporting unit exceeded its carrying amount as of October 1, 2015.

Amortizable intangible assets consist of the following (in thousands):

	12/31/2015	6/30/2015
Non-compete agreement	$ 600	$ 600
Trademarks and trade names	1,480	1,480
Completed technology	2,358	2,358
Customer relationships	4,950	4,950
Software development	1,980	1,655
Other intangible assets	325	325
Total	11,693	11,368
Accumulated amortization	(4,910)	(4,243)
Total net balance	$ 6,783	$ 7,125

Amortizable intangible assets are being amortized on a straight-line basis over the period of expected economic benefit.

The estimated useful lives of the intangible assets subject to amortization are 14 years for trademarks and trade names, 8 years for non-compete agreements, 10 years for completed technology, 8 years for customer relationships and 5 years for software development.

The estimated aggregate amortization expense for the remainder of fiscal 2016 and for each of the next five years and thereafter, is as follows (in thousands):

2016 (Remainder of year)	$749
2017	1,497
2018	1,429
2019	1,350
2020	826
2021	389
Thereafter	543

Note 6: Pension and Post-retirement Benefits

Net periodic benefit costs for the Company's defined benefit pension plans consist of the following (in thousands):

	Three Months Ended		Six Months Ended	
	12/31/2015	12/31/2014	12/31/2015	12/31/2014
	(Unaudited)		(Unaudited)	
Service cost	$715	$ 694	$1,429	$ 1,388
Interest cost	1,759	1,722	3,527	3,412
Expected return on plan assets	(1,585)	(1,772)	(3,179)	(3,512)
Amortization of net loss	12	7	26	14
	$901	$ 651	$1,803	$ 1,302

Net periodic benefit costs for the Company's Postretirement Medical Plan consists of the following (in thousands):

	Three Months Ended		Six Months Ended	
	12/31/2015	12/31/2014	12/31/2015	12/31/2014
	(Unaudited)		(Unaudited)	
Service cost	$27	$ 29	$53	$ 57
Interest cost	72	61	144	122
Amortization of prior service credit	(196)	(200)	(391)	(400)
Amortization of net loss	3			