SPARTON CORP
Form 10-Q
May 10, 2007

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

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

For the quarterly period ended **March 31, 2007**

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

(State or Other Jurisdiction of Incorporation or Organization)

38-1054690

(I.R.S. Employer Identification No.)

2400 East Ganson Street, Jackson, Michigan 49202

(Address of Principal Executive Offices, Zip Code)

(517) 787-8600

(Registrant s Telephone Number, Including Area Code)

Indicate by checkmark 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. [X] Yes [ ] No

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

Large accelerated filer [ ] Accelerated filer [ ] Non-accelerated filer [X]

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

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date.

Class of Common Stock	**Shares Outstanding at April 30, 2007**
$1.25 Par Value	**9,800,370**

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Part I. Financial Information
Item 1. Financial Statements (Interim, Unaudited)

SPARTON CORPORATION AND SUBSIDIARIES
Condensed Consolidated Balance Sheets (Unaudited)

	March 31, 2007	June 30, 2006
ASSETS		
Current assets:		
Cash and cash equivalents	$ 4,946,232	$ 7,503,438
Investment securities		15,969,136
Accounts receivable	21,151,784	25,108,442
Income taxes recoverable	2,320,726	
Inventories and costs of contracts in progress	52,951,608	46,892,183
Deferred income taxes	2,571,000	2,662,692
Prepaid expenses and other current assets	1,162,118	1,462,190
Total current assets	85,103,468	99,598,081
Pension asset	4,048,208	4,420,932
Property, plant and equipment net	18,139,631	17,598,906
Goodwill and other intangibles net	22,146,286	22,469,807
Other assets	5,997,170	5,970,010
Total assets	$ 135,434,763	$ 150,057,736
LIABILITIES AND SHAREOWNERS EQUITY		
Current liabilities:		
Current portion of long-term debt	$ 3,873,593	$ 3,815,833
Accounts payable	11,018,363	16,748,814
Salaries and wages	3,841,222	4,388,396
Accrued health benefits	1,316,897	1,142,693
Other accrued liabilities	6,015,271	4,996,408
Income taxes payable		308,814
Total current liabilities	26,065,346	31,400,958
Deferred income taxes noncurrent	32,000	
Long-term debt noncurrent portion	13,536,631	16,010,616
Environmental remediation noncurrent portion	5,584,288	5,795,784
Total liabilities	45,218,265	53,207,358
Shareowners Equity:		
Preferred stock, no par value; 200,000 shares authorized, none outstanding		
	12,250,463	11,740,381

Common stock, $1.25 par value; 15,000,000 shares authorized, 9,800,370 shares outstanding (9,392,305 at June 30, 2006)		
Capital in excess of par value	19,557,047	15,191,990
Retained earnings	58,363,988	70,183,104
Accumulated other comprehensive income (loss)	45,000	(265,097)
Total shareowners equity	90,216,498	96,850,378
Total liabilities and shareowners equity	$ 135,434,763	$ 150,057,736

See accompanying notes to condensed consolidated financial statements.

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SPARTON CORPORATION AND SUBSIDIARIES
Condensed Consolidated Statements of Operations (Unaudited)
March 31, 2007 and 2006

	Three months ended 2007	Three months ended 2006	Nine months ended 2007	Nine months ended 2006
Net sales	$ 47,725,992	$ 45,303,199	$ 149,099,220	$ 120,302,471
Costs of goods sold	47,030,124	40,562,528	144,193,397	110,140,742
Gross profit	695,868	4,740,671	4,905,823	10,161,729
Selling and administrative expenses	4,264,621	3,930,958	12,978,917	11,694,855
Amortization of intangibles	120,313		362,049	
EPA related environmental remediation (income) expense - net	(3,091)	29,994	(204,321)	796
Net (gain) loss on sale of property, plant and equipment	3,872	(5,693)	(201,851)	98,898
	4,385,715	3,955,259	12,934,794	11,794,549
Operating income (loss)	(3,689,847)	785,412	(8,028,971)	(1,632,820)
Other income (expense):				
Interest and investment income	74,896	293,008	145,923	820,835
Interest expense	(205,877)		(793,599)	
Equity gain in investment	75,000	3,000	68,000	2,000
Other net	(23,730)	(11,088)	(283,635)	266,176
	(79,711)	284,920	(863,311)	1,089,011
Income (loss) before income taxes	(3,769,558)	1,070,332	(8,892,282)	(543,809)
Provision (credit) for income taxes	(1,476,000)	343,000	(2,757,000)	(174,000)
Net income (loss)	$ (2,293,558)	$ 727,332	$ (6,135,282)	$ (369,809)
Earnings (loss) per share basic and diluted[(1)]	$ (0.23)	$ 0.07	$ (0.62)	$ (0.04)

(1) All share and per share information have been adjusted to reflect the impact of the

5% stock dividend declared in October 2006.

See accompanying notes to condensed consolidated financial statements.

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SPARTON CORPORATION AND SUBSIDIARIES
Condensed Consolidated Statements of Cash Flows (Unaudited)

	Nine months ended March 31, 2007	2006
Cash Flows From Operating Activities:		
Net loss	$ (6,135,282)	$ (369,809)
Adjustments to reconcile net loss to net cash (used in) provided by operating activities:		
Depreciation, amortization and accretion	1,941,812	1,490,979
Deferred income taxes		679,731
Loss on sale of investment securities	244,562	25,432
Equity gain in investment	(68,000)	(2,000)
Pension expense	372,724	410,681
Share-based compensation	187,901	253,420
(Gain) loss on sale of property, plant and equipment	(3,176)	98,898
Gain from sale of non-operating land	(198,675)	
Other, primarily changes in customer and vendor claims	47,420	(391,396)
Changes in operating assets and liabilities:		
Accounts receivable	3,956,658	5,946,443
Environmental settlement receivable		5,455,000
Income taxes recoverable	(2,320,726)	
Inventories, prepaid expenses and other current assets	(5,759,353)	1,061,929
Accounts payable and accrued liabilities	(5,604,852)	(7,032,653)
Net cash (used in) provided by operating activities	(13,338,987)	7,626,655
Cash Flows From Investing Activities:		
Additional goodwill incurred in purchase of Astro	(38,528)	
Purchases of investment securities		(7,052,763)
Proceeds from sale of investment securities	15,619,068	1,677,746
Proceeds from maturity of investment securities	465,645	2,583,602
Purchases of property, plant and equipment	(2,672,559)	(459,895)
Proceeds from sale of non-operating land	811,175	
Proceeds from sale of property, plant and equipment	7,422	
Other, principally noncurrent other assets	9,420	(26,460)
Net cash provided by (used in) investing activities	14,201,643	(3,277,770)
Cash Flows From Financing Activities:		
Repayment of long-term debt	(2,423,266)	
Proceeds from the exercise of stock options	1,346,208	571,251
Tax effect from stock transactions	183,093	70,029
Stock dividends cash paid in lieu of fractional shares	(1,977)	(3,654)
Repurchases of common stock	(2,523,920)	(270,186)
Cash dividend		(889,409)
Net cash used in financing activities	(3,419,862)	(521,969)

(Decrease) increase in cash and cash equivalents	(2,557,206)	3,826,916
Cash and cash equivalents at beginning of period	7,503,438	9,368,120
Cash and cash equivalents at end of period	$ 4,946,232	$ 13,195,036

See accompanying notes to condensed consolidated financial statements.

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SPARTON CORPORATION AND SUBSIDIARIES
Condensed Consolidated Statements of Shareowners Equity (Unaudited)

	Nine months ended March 31, 2007					
	Common Stock		Capital in excess	Retained	Accumulated other comprehensive income	
	Shares	Amount	of par value	earnings	(loss)	Total
Balance at July 1, 2006	9,392,305	$ 11,740,381	$ 15,191,990	$ 70,183,104	$ (265,097)	$ 96,850,378
Stock dividend (5% declared October 25, 2006)	466,365	582,956	3,404,465	(3,989,398)		(1,977)
Stock options exercised, net of common stock surrendered to facilitate exercise	234,444	293,056	1,053,152			1,346,208
Repurchases of common stock as part of share repurchase program	(292,744)	(365,930)	(463,554)	(1,694,436)		(2,523,920)
Share-based compensation			187,901			187,901
Tax effect of stock transactions			183,093			183,093
Comprehensive income (loss), net of tax:						
Net loss				(6,135,282)		(6,135,282)
Net unrealized gain on investment securities owned					122,686	122,686
Reclassification adjustment for net loss realized and reported in net loss					161,411	161,411
Net unrealized gain on equity investment					26,000	26,000
Comprehensive loss						(5,825,185)
Balance at March 31, 2007	9,800,370	$ 12,250,463	$ 19,557,047	$ 58,363,988	$ 45,000	$ 90,216,498

	Nine months ended March 31, 2006					
	Common Stock		Capital in excess	Retained	Accumulated other comprehensive income	
	Shares	Amount	of par value	earnings	(loss)	Total
Balance at July 1, 2005	8,830,428	$ 11,038,035	$ 10,558,757	$ 75,619,392	$ (44,198)	$ 97,171,986
Stock dividend (5% declared October 25, 2005)	446,337	557,921	3,820,645	(4,382,220)		(3,654)
Stock options exercised, net of common stock surrendered to facilitate exercise	143,294	179,118	392,133			571,251
Repurchases of common stock as part of share repurchase program	(28,237)	(35,296)	(34,199)	(200,691)		(270,186)
Cash dividend ($0.10 per share)				(889,409)		(889,409)
Share-based compensation			253,420			253,420
Tax effect of stock transactions			70,029			70,029
Comprehensive income (loss), net of tax:						
Net loss				(369,809)		(369,809)
Net unrealized loss on investment securities owned					(224,767)	(224,767)
Reclassification adjustment for net loss realized and reported in net loss					16,785	16,785
Net unrealized gain on equity investment					82,000	82,000
Comprehensive loss						(495,791)
Balance at March 31, 2006	9,391,822	$ 11,739,778	$ 15,060,785	$ 69,777,263	$ (170,180)	$ 96,407,646

See accompanying notes to condensed consolidated financial statements.

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SPARTON CORPORATION AND SUBSIDIARIES
Notes to Condensed Consolidated Financial Statements (Unaudited)

NOTE 1. BUSINESS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of presentation - The accompanying unaudited condensed consolidated financial statements of Sparton Corporation and subsidiaries (the Company) have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) for interim financial information and with the instructions to Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. All significant intercompany transactions and accounts have been eliminated. Certain reclassifications of prior year amounts have been made to conform to the current year presentation. The condensed consolidated balance sheet at March 31, 2007, and the related condensed consolidated statements of operations, cash flows and shareowners equity for the nine months ended March 31, 2007 and 2006 are unaudited, but include all adjustments (consisting only of normal recurring accruals) which the Company considers necessary for a fair presentation of such interim financial statements. Operating results for the nine months ended March 31, 2007 are not necessarily indicative of the results that may be expected for the fiscal year ending June 30, 2007.

The balance sheet at June 30, 2006, was derived from the audited financial statements at that date but does not include all of the information and footnotes required by GAAP for complete financial statements. It is suggested that these condensed consolidated financial statements be read in conjunction with the consolidated financial statements and footnotes thereto included in the Company s Annual Report on Form 10-K for the fiscal year ended June 30, 2006.

Business Acquisition - On May 31, 2006, the Company announced that a membership purchase agreement was signed, and the acquisition of Astro Instrumentation, LLC was completed. Astro was a privately owned electronic manufacturing services (EMS) provider located in Strongsville, Ohio that had been in business for approximately five years, with a sales volume for its fiscal year ended December 31, 2005, of approximately $34 million. This acquisition furthered the Company s strategy of identifying, evaluating and purchasing potential acquisition candidates in both the defense and medical device markets. The newly acquired entity was renamed Astro Instrumentation, Inc. (Astro) and incorporated in the state of Michigan. In January 2007, Astro was renamed Sparton Medical Systems, Inc. (SMS), which operates as a wholly-owned subsidiary of Sparton Corporation.

The acquisition was accounted for using the purchase method in accordance with Statement of Financial Accounting Standards (SFAS) No. 141, *Business Combinations;* accordingly, the operating results of SMS since the acquisition date have been included in the consolidated financial statements of the Company. Additional details covering this acquisition can be found in the Company s Annual Report on Form 10-K for the fiscal year ended June 30, 2006.

Shown below, and also included in the Company s condensed consolidated financial statements for the nine months ended March 31, 2007, are the sales, costs of goods sold and total assets of SMS, which were as follows:

	Total	SMS
Net sales	$ 149,099,000	$ 37,328,000
Costs of goods sold	144,193,000	33,767,000
Gross profit	$ 4,906,000	$ 3,561,000
Total assets at March 31, 2007	$ 135,435,000	$ 45,220,000

Operations - The Company operates in one line of business, electronic manufacturing services (EMS). The Company provides design and electronic manufacturing services, which include a complete range of engineering, pre-manufacturing and post-manufacturing services. Capabilities range from product design and development through aftermarket support. All of the facilities are registered to ISO standards, including 9001 or 13485, with most having additional certifications. Products and services include complete Device Manufacturing products for Original Equipment Manufacturers, transducers, printed circuit boards and assemblies, sensors, medical instruments, and electromechanical and electrochemical devices. Markets served are in the government, medical/scientific instrumentation, aerospace, and other industries, with a focus on regulated markets. The Company also develops and manufactures sonobuoys, anti-submarine warfare (ASW) devices, used by the U.S. Navy and other free-world countries. Many of the physical and technical attributes in the production of sonobuoys are the same as those required in the production of the Company s other products and assemblies.

Use of estimates - The Company s interim condensed consolidated financial statements are prepared in accordance with GAAP. These accounting principles require management to make certain estimates, judgments and assumptions. The Company believes that the estimates, judgments and assumptions upon which it relies are reasonable based upon information available to it at the time that these estimates, judgments and assumptions are made. These estimates, judgments and assumptions can affect the reported amounts of assets and liabilities as of the date of the financial statements, as well as the reported amounts of revenues and expenses during the periods presented. To the extent there are material differences between these estimates, judgments or assumptions and actual results, the financial statements will be affected. In many cases, the accounting treatment of a particular transaction is specifically dictated by GAAP and does not require management s judgment in its application. There are also areas in which management s judgment in selecting among available alternatives would not produce a materially different result.

Revenue recognition - The Company s net sales are comprised primarily of product sales, with supplementary revenues earned from engineering and design services. Standard contract terms are FOB shipping point. Revenue from product sales is generally recognized upon shipment of the goods; service revenue is recognized as the service is performed or under the percentage of completion method, depending on the nature of the arrangement. Long-term contracts relate principally to government defense contracts. These contracts are accounted for based on completed units accepted and their estimated average contract cost per unit. Costs and fees billed under cost-reimbursement-type contracts are recorded as sales. A provision for the entire amount of a loss on a contract is charged to operations as soon as the loss is identified and the amount is determinable. Shipping and handling costs are included in costs of goods sold.

Fair value of financial instruments - The fair value of cash and cash equivalents, trade accounts receivable, and accounts payable approximate their carrying value. Cash and cash equivalents consist of demand deposits and other highly liquid investments with an original term when purchased of three months or less. With respect to the Company s recently issued or assumed debt instruments, consisting of industrial revenue bonds, notes payable and bank debt relating to the May 31, 2006 acquisition of Astro Instrumentation, LLC., management believes that the fair value of these financial instruments also approximates their carrying value at March 31, 2007.

Investment securities - Investments in debt securities that are not cash equivalents or marketable equity securities have been designated as available for sale. Those securities, all of which are investment grade, are reported at fair value, with net unrealized gains and losses included in accumulated other comprehensive income or loss, net of applicable taxes. Unrealized losses that are other than temporary are recognized in earnings. The investment portfolio has maturity dates within a year or less. Realized gains and losses on investments are determined using the specific identification method.

Other investment - The Company has an active investment in Cybernet Systems Corporation, which is accounted for under the equity method, as more fully described in Note 10 of the Condensed Consolidated Financial Statements.

Market risk exposure - The Company manufactures its products in the United States, Canada, and Vietnam. Sales of the Company s products are in the U.S. and Canada, as well as other foreign markets. The Company is potentially subject to foreign currency exchange rate risk relating to intercompany activity and balances, receipts from customers, and payments to suppliers in foreign currencies. Adjustments related to the translation of the Company s Canadian and Vietnamese financial statements into U.S. dollars are included in current earnings. As a result, the Company s financial results could be affected by factors such as changes in foreign currency exchange rates or economic conditions in the domestic and foreign markets in which the Company operates. However, minimal third party receivables and payables are denominated in foreign currency and the related market risk exposure is considered to be immaterial. Historically, foreign currency gains and losses related to intercompany activity and balances have not been significant. However, due to the strengthened Canadian dollar in recent years, the impact of transaction and translation gains has increased. If the exchange rate were to materially change, the Company s financial position could be significantly affected.

The Company has financial instruments that are subject to interest rate risk, principally short-term investments. Historically, the Company has not experienced material gains or losses due to such interest rate changes. Based on the current holdings of short-term investments, the interest rate risk is not considered to be material. In addition, as a result of the May 31, 2006, Astro acquisition, the Company is obligated on bank debt with an adjustable rate of interest, as more fully discussed in Note 6 of the Condensed Consolidated Financial Statements, which would adversely impact operations should the interest rate increase.

Long-lived assets - The Company reviews long-lived assets that are not held for sale for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Impairment is determined by comparing the carrying value of the assets to their fair market value or estimated future undiscounted cash flows. If it is determined that an impairment of a long-lived asset has occurred, a current charge to income is recognized. The Company also has goodwill and other intangibles which are considered long-lived assets. While a portion of goodwill is associated with the Company s investment in Cybernet, the majority of the approximately $22 million of goodwill and other intangibles

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reflected on the Company s balance sheets as of March 31, 2007 and June 30, 2006, is associated with the recent acquisition of Astro. For a more complete discussion of goodwill and other intangibles, see Note 5 of the Condensed Consolidated Financial Statements.

Other assets - At June 30, 2006, undeveloped land located in New Mexico, with a cost of $613,000, was classified as held-for-sale and carried in other current assets in the Company s balance sheet at that date. The sale of this asset was completed in August 2006 at a gain of approximately $199,000. In addition, included in other assets as of both March 31, 2007 and June 30, 2006, was $1.8 million and $2.9 million of inventory materials for which the Company is seeking reimbursement from other parties, which is discussed further in Note 7 of the Condensed Consolidated Financial Statements.

Common stock repurchases - The Company records common stock repurchases at cost. The excess of cost over par value is first allocated to capital in excess of par value based on the per share amount of capital in excess of par value for all shares, with the remainder charged to retained earnings. Effective September 14, 2005, the Board of Directors authorized a repurchase program for the repurchase, at the discretion of management, of up to $4 million of shares of the Company s outstanding common stock in open market transactions. For the nine months ended March 31, 2007, 292,744 shares were repurchased for cash of $2,524,000. During that period, the weighted average share prices for each individual month s activity ranged from $8.43 to $8.75 per share. For the fiscal year ended June 30, 2006, the Company had purchased 39,037 shares at a cost of approximately $363,000. As of March 31, 2007, the dollar value of shares that may yet be repurchased under the program approximated $1,113,000. The program expires September 14, 2007. Repurchased shares are retired.

Supplemental cash flows information - Supplemental cash and noncash activities for the nine months ended March 31, 2007 and 2006 were as follows:

	2007	2006
Net cash paid (received) for:		
Income taxes	$ (314,000)	$ 1,395,000
Interest (including $60,000 of capitalized interest)	$ 749,000	