

SPARTON CORP  
Form 10-Q  
November 16, 2009

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

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

**For the quarterly period ended September 30, 2009**

**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.)

**425 N. Martingale, Suite 2050, Schaumburg, Illinois 60173-2213**

(Address of Principal Executive Offices, Zip Code)

**(847) 762-5800**

(Registrant's Telephone Number, Including Area 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 ☐ 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 during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). \*☐ Yes ☐ No

(\* The registrant has not yet been phased into the interactive data file requirements at this time.)

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 Exchange Act Rule 12b-2). ☐ Yes ☐ 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  
\$1.25 Par Value**

**Shares outstanding at  
October 31, 2009  
9,951,507**



SPARTON CORPORATION AND SUBSIDIARIES  
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**Table of Contents****Part I. Financial Information****Item 1. Financial Statements (Interim, Unaudited)**

## SPARTON CORPORATION AND SUBSIDIARIES

## Condensed Consolidated Balance Sheets (Unaudited)

	September 30, 2009	June 30, 2009
<b>ASSETS</b>		
<b>Current assets:</b>		
Cash and cash equivalents	\$ 20,717,939	\$ 36,261,084
Accounts receivable	24,659,819	38,162,485
Inventories and costs of contracts in progress net	35,454,311	38,435,094
Deferred income taxes	35,440	35,440
Prepaid expense and other current assets	1,845,904	1,991,667
Assets held for sale	5,128,511	5,128,511
<b>Total current assets</b>	<b>87,841,924</b>	<b>120,014,281</b>
Property, plant and equipment net	9,478,309	9,833,318
Goodwill	17,693,424	17,693,424
Other intangibles net	5,152,834	5,270,147
Other non current assets	2,986,178	2,190,348
<b>Total assets</b>	<b>\$ 123,152,669</b>	<b>\$ 155,001,518</b>
<b>LIABILITIES AND SHAREOWNERS EQUITY</b>		
<b>Current liabilities:</b>		
Short-term bank borrowings	\$	\$ 15,500,000
Current portion of long-term debt	2,144,494	4,141,994
Accounts payable	17,716,764	26,418,025
Accrued salaries and wages	3,788,742	5,022,731
Accrued health benefits	1,413,394	1,578,263
Current portion of pension liability	213,600	1,097,252
Restructuring accrual	2,304,975	2,365,379
Advance billings on customer contracts	22,995,609	25,102,363
Other accrued liabilities	5,168,105	5,890,856
<b>Total current liabilities</b>	<b>55,745,683</b>	<b>87,116,863</b>
Deferred income taxes non current	1,169,002	1,135,002
Pension liability non current portion	3,644,699	4,060,503
Long-term debt non current portion	1,886,350	3,316,503
Environmental remediation non current portion	4,406,253	4,477,246
<b>Total liabilities</b>	<b>66,851,987</b>	<b>100,106,117</b>

**Shareowners equity:**

Preferred stock, no par value; 200,000 shares authorized, none outstanding

Common stock, \$1.25 par value; 15,000,000 shares authorized, 9,951,507 shares outstanding at September 30 and June 30, 2009

Capital in excess of par value

Retained earnings

Accumulated other comprehensive loss

12,439,384	12,439,384
19,670,474	19,670,296
28,991,495	27,586,392
(4,800,671)	(4,800,671)

**Total shareowners equity**

56,300,682	54,895,401
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**Total liabilities and shareowners equity**

\$	123,152,669	\$ 155,001,518
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See accompanying notes to condensed consolidated financial statements.

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SPARTON CORPORATION AND SUBSIDIARIES  
Condensed Consolidated Statements of Operations (Unaudited)  
September 30, 2009 and 2008

	Three months ended	
	2009	2008
<b>Net sales</b>	\$ 48,103,596	\$ 53,995,534
Costs of goods sold	40,683,121	51,334,642
<b>Gross profit</b>	7,420,475	2,660,892
Selling and administrative expenses	4,580,087	5,116,575
Amortization of intangibles	117,313	120,313
Restructuring/impairment charges	876,105	278,730
Other net	14,500	(1,608)
	5,588,005	5,514,010
<b>Operating income (loss)</b>	1,832,470	(2,853,118)
<b>Other income (expense):</b>		
Interest expense	(259,497)	(368,738)
Interest and investment income	8,061	13,417
Equity (loss) income in investment	(12,000)	3,000
Canadian translation gain	6,039	59,302
Other net	(135,970)	5,244
	(393,367)	(287,775)
Income (loss) before income taxes	1,439,103	(3,140,893)
Provision for income taxes	34,000	221,000
<b>Net income (loss)</b>	\$ 1,405,103	\$ (3,361,893)
<b>Income (loss) per share basic and diluted</b>	\$ 0.14	\$ (0.34)

See accompanying notes to condensed consolidated financial statements.

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## SPARTON CORPORATION AND SUBSIDIARIES

Condensed Consolidated Statements of Cash Flows (Unaudited)  
September 30, 2009 and 2008

	Three months ended	
	2009	2008
<b>Cash Flows From Operating Activities:</b>		
Net income (loss)	\$ 1,405,103	\$ (3,361,893)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Depreciation and amortization	427,587	498,673
Amortization of deferred financing costs	47,548	
Deferred income tax expense	34,000	
Equity loss (income) in investment	12,000	(3,000)
Pension expense	496,750	159,690
Share-based compensation expense	178	50,760
Non cash restructuring/impairment charges	150,684	
Net gain on sale of property, plant and equipment		(2,108)
Changes in operating assets and liabilities:		
Accounts receivable	13,502,666	1,995,764
Inventories, prepaid expenses and other current assets	3,126,546	2,239,427
Advance billings on customer contracts	(2,106,754)	
Accounts payable and accrued liabilities	(11,959,007)	(2,383,480)
<b>Net cash provided by (used in) operating activities</b>	<b>5,137,301</b>	<b>(806,167)</b>
<b>Cash Flows From Investing Activities:</b>		
Additional goodwill from SMS acquisition	(976,680)	(1,056,920)
Purchases of property, plant and equipment	(32,405)	(697,004)
Proceeds from sale of property, plant and equipment		5,505
Other, principally change in non current other assets		10,071
<b>Net cash used in investing activities</b>	<b>(1,009,085)</b>	<b>(1,738,348)</b>
<b>Cash Flows From Financing Activities:</b>		
Net short-term bank borrowings (repayments)	(15,500,000)	2,000,000
Repayment of long-term debt	(3,427,653)	(525,153)
Payment of debt financing costs	(743,708)	
<b>Net cash (used in) provided by financing activities</b>	<b>(19,671,361)</b>	<b>1,474,847</b>
Decrease in cash and cash equivalents	(15,543,145)	(1,069,668)
Cash and cash equivalents at beginning of period	36,261,084	2,928,433
<b>Cash and cash equivalents at end of period</b>	<b>\$ 20,717,939</b>	<b>\$ 1,858,765</b>

See accompanying notes to condensed consolidated financial statements.





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

Three months ended September 30, 2009

	Common Stock Shares	Amount	Capital in excess of par value	Retained earnings	Accumulated other comprehensive income (loss)	Total
Balance at July 1, 2009	9,951,507	\$ 12,439,384	\$ 19,670,296	\$ 27,586,392	\$ (4,800,671)	\$ 54,895,401
Share-based compensation			178			178
Net and comprehensive income				1,405,103		1,405,103
Balance at September 30, 2009	9,951,507	\$ 12,439,384	\$ 19,670,474	\$ 28,991,495	\$ (4,800,671)	\$ 56,300,682

Three months ended September 30, 2008

	Common Stock Shares	Amount	Capital in excess of par value	Retained earnings	Accumulated other comprehensive income (loss)	Total
Balance at July 1, 2008	9,811,507	\$ 12,264,384	\$ 19,650,481	\$ 43,592,351	\$ (4,647,462)	\$ 70,859,754
Share-based compensation			50,760			50,760
Comprehensive income (loss), net of tax:						
Net loss				(3,361,893)		(3,361,893)
Change in unrecognized pension costs					39,702	39,702
Comprehensive loss						(3,322,191)
Balance at September 30, 2008	9,811,507	\$ 12,264,384	\$ 19,701,241	\$ 40,230,458	\$ (4,607,760)	\$ 67,588,323

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 Form 10-Q and 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 September 30, 2009, and the related condensed consolidated statements of operations, cash flows and shareowners' equity for the three months ended September 30, 2009 and 2008 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 three months ended September 30, 2009 are not necessarily indicative of the results that may be expected for the fiscal year ending June 30, 2010. The terms Sparton, the Company, we, us, and our refer to Sparton Corporation and its subsidiaries. The balance sheet at June 30, 2009 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, 2009. In preparing these interim financial statements, we have evaluated, for potential recognition or disclosure, events or transactions subsequent to the most recent balance sheet date through November 16, 2009, the issuance date of these interim financial statements.

**Operations** Sparton 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 primary markets served are in the Medical Devices, Defense & Security Systems, and Electronic Manufacturing Services industries with a focus on federally regulated markets. Effective with the quarter ended September 30, 2009, Sparton began reporting our operating results under these three reportable business segments. For a more complete discussion of our segment reporting, see Note 11. 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 and Emerging Technology 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. We also develop and manufacture sonobuoys, an anti-submarine warfare (ASW) device, 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.

**Use of estimates** The Company's interim condensed 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. Costs and fees billed under cost-reimbursement-type contracts are recorded as sales. Long-term contracts relate principally to government defense contracts. These government defense contracts are accounted for based on completed units accepted and their estimated average contract cost per unit. At September 30 and June 30, 2009, current liabilities include billings in excess of costs of \$23.0 million and \$25.1 million, respectively, on government contracts. Sales related to these billings are recognized based upon completed units accepted and are not recognized upon billings. 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 reasonably determinable. Shipping and handling costs are included in costs of goods sold.

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**Accounts receivable, credit practices, and allowance for probable losses** Accounts receivable are customer obligations generally due under normal trade terms for the industry. Credit terms are granted and periodically revised based on evaluations of the customers' financial condition. The Company performs ongoing credit evaluations of its customers and although the Company does not generally require collateral, letters of credit or cash advances may be required from customers in order to support accounts receivable in certain circumstances. Historically, a majority of receivables from foreign customers have been secured by letters of credit or cash advances.

The Company maintains an allowance for probable losses on receivables for estimated losses resulting from the inability of its customers to make required payments. The allowance is estimated based on historical experience of write-offs, the level of past due amounts (i.e., amounts not paid within the stated terms), information known about specific customers with respect to their ability to make payments, and future expectations of conditions that might impact the collectibility of accounts. When management determines that it is probable that an account will not be collected, all or a portion of the amount is charged against the allowance for probable losses.

**Fair value of financial instruments** The fair value of cash and cash equivalents, trade accounts receivable, short-term bank borrowings, 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 long-term debt instruments, consisting of industrial revenue bonds and notes payable, management believes the aggregate fair value of these financial instruments reasonably approximates their carrying value at September 30, 2009.

**Other investment** In June 1999, the Company purchased a 14% interest (12% on a fully diluted basis) in Cybernet Systems Corporation (Cybernet) for \$3,000,000, which included a seat on Cybernet's three member Board of Directors. Cybernet is a developer of hardware, software, next-generation network computing, and robotics products. It is located in Ann Arbor, Michigan. The investment is accounted for under the equity method and is included in other non current assets on the balance sheets. At September 30 and June 30, 2009, the Company's investment in Cybernet amounted to \$1,904,000 and \$1,916,000, respectively, representing its equity interest in Cybernet's net assets plus \$770,000 of goodwill. The Company believes that the equity method is appropriate given Sparton's level of involvement in Cybernet. The use of the equity method requires Sparton to record its share of Cybernet's income or loss in earnings ( Equity income/loss in investment ) in Sparton's statements of operations with a corresponding increase or decrease in the investment account ( Other non current assets ) on Sparton's balance sheets.

**Market risk exposure** The Company manufactures its products in the United States and Vietnam, and ceased manufacturing in Canada during the fourth quarter of fiscal 2009. Sales of the Company's products are in the U.S. and foreign markets. The Company is subject to foreign currency exchange rate risk relating to intercompany activity and balances and to receipts from customers and payments to suppliers in foreign currencies. Also, 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 have not been significant. However, due to the greater volatility of the Canadian dollar, the impact of transaction and translation gains significantly increased in fiscal 2009. With the closure of the Canadian facility, however, it is anticipated that the impact in fiscal 2010 and future periods will decrease.

The Company has financial instruments that are subject to interest rate risk. Historically, the Company has not experienced material gains or losses due to such interest rate changes. Based on the fact that interest rates periodically adjust to market values for the line-of-credit, interest rate risk is not considered to be significant. For a further discussion on Sparton's debt, see Note 5 to the Condensed Consolidated Financial Statements.

**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 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. During the fourth quarter of fiscal 2009 an impairment charge of \$2,112,000 was recognized, primarily related to the closure of

the Jackson, Michigan facility. In the first quarter of fiscal 2010, an additional impairment of \$150,000 was recognized, \$113,000 of which was again related to the Jackson facility. The Company also has goodwill and other intangibles which are considered long-lived assets. Approximately \$22.8 million and \$23.0 million in net carrying value of goodwill and other intangibles reflected on the Company's balance sheet as of September 30 and June 30, 2009, respectively, is associated with the acquisition of Sparton Medical Systems, Inc. (SMS). For a more complete discussion of goodwill and other intangibles, see Note 4.

**Other assets** At September 30, 2009, the Company's Albuquerque and Coors Road properties were classified as held for sale and carried in other current assets in the Company's balance sheet. For a further discussion of these facilities, see Note 10. In addition, included in other current assets as of September 30 and June 30, 2009, was \$1.2 million for which the Company is seeking payment from other parties, which is described in Note 6.

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During the fourth quarter of fiscal 2009 and the three months ended September 30, 2009, the Company deferred approximately \$115,000 and \$744,000 of loan costs, respectively, incurred that were directly associated with the debt refinancing described in Note 5. This total amount of \$859,000, net of amortization of \$48,000, which is reported as interest expense for the current quarter, is included in other non current assets on our consolidated balance sheet.

**Deferred income taxes** Deferred income taxes are based on enacted income tax rates in effect on the dates temporary differences between the financial reporting and tax bases of assets and liabilities are expected to reverse and tax credit carryforwards are utilized. The effect on deferred tax assets and liabilities of a change in income tax rates is recognized in income in the period that includes the enactment date. A valuation allowance of approximately \$10 million was established at June 30, 2008 against the Company's net deferred income tax asset. During fiscal 2009 the valuation allowance was increased for additional deferred tax assets resulting from current period losses as well as an offset to the remaining net asset. The result after the valuation allowance is a net deferred tax liability associated with the amortization of goodwill. During the first quarter of fiscal 2010, a provision for income taxes was recorded but fully offset by the releasing of a portion of the valuation allowance, resulting in no net provision for income taxes relating to the profitability of the quarter. A provision for income taxes of \$34,000 was recognized during the quarter relating to the increase in the deferred tax liability associated with the amortization of goodwill for tax purposes. The Company will monitor its tax position and adjust the valuation allowance as appropriate. In the event a loss is incurred in a given quarter, the increase to the deferred tax asset will be offset by an adjustment to the valuation allowance. If future levels of taxable income in the United States are not consistent with our expectations, we may need to increase, or decrease, the valuation allowance.

**Supplemental cash flows information** Supplemental cash and noncash activities for the three months ended September 30, 2009 and 2008 were as follows:

	2009	2008
Net cash paid during the period for:		
Income taxes <sup>(1)</sup>	\$	\$ 289,000
Interest <sup>(2)</sup>	\$ 946,000	\$ 310,000

*Notes to supplemental cash flows information:*

- 1) Income taxes in fiscal 2009 consist primarily of the U.S. dollar equivalent of taxes paid to the Canadian government related to our Canadian operations.
- 2) Interest includes \$744,000 of deferred financing costs in fiscal 2010.

**New accounting standards** - On July 1, 2009, the Financial Accounting Standards Board (FASB) completed the FASB Accounting Standards Codification, *The FASB Codification* (ASC), as the single source of authoritative U.S. generally accepted accounting principles (GAAP), superseding all then existing authoritative accounting and reporting standards, except for rules and interpretive releases for the SEC under authority of federal securities laws, which are sources of authoritative GAAP for Securities and Exchange Commission registrants. ASC Topic 105 (formerly SFAS

No. 168, *The FASB Accounting Standards Codification*<sup>TM</sup> and the *Hierarchy of General Accepted Accounting Principles* - a replacement of FASB Statement No. 162), reorganized the authoritative literature comprising GAAP into a topical format. ASC is now the source of authoritative GAAP recognized by the FASB to be applied by all nongovernmental entities. ASC is effective for interim and annual periods ending after September 15, 2009. The Codification did not change GAAP and, therefore, did not impact the Company's financial statements. However, since it completely supersedes existing standards, it affected the way we reference authoritative accounting pronouncements in our financial statements and other disclosure documents. Specifically, all references in this report to new or pending financial reporting standards use the ASC Topic number.

In May 2009, the FASB issued a new accounting standard related to *Subsequent Events*, now codified in ASC Topic 855, (formerly SFAS No. 165, *Subsequent Events*) to incorporate the accounting and disclosure requirements for subsequent events into GAAP. Prior to the issuance of the new standard, these requirements were included in the auditing standards. Topic 855 introduces new terminology, defines a date through which management must evaluate subsequent events, and lists the circumstances under which an entity must recognize and disclose events or transactions occurring after the balance-sheet date but before the financial statements are issued. According to ASC Topic 855, financial statements are issued when they are widely distributed to shareholders or other users in a form and format that complies with GAAP. Subsequent events within the scope of other applicable GAAP are accounted for under those standards, including but not limited to, *Accounting for Uncertainty in Income Taxes*, *Earnings per Share*, and *Accounting for Contingencies*. ASC Topic 855 prohibits an entity from recognizing in its financial statements the effects of subsequent events that provide evidence about conditions that did not exist at the balance-sheet date. Although it introduces new terminology, ASC Topic 855 does not change the requirements for recognition and disclosure that currently exist. ASC Topic 855 requires entities to disclose the date through which subsequent events have been evaluated. Entities must also disclose the nature and financial statement effect of nonrecognized subsequent events if the omission of such disclosure would cause the financial statements to be misleading. If an entity cannot estimate the financial statement effect of these events, that fact should be disclosed along with the nature of each event. This new guidance was first adopted by Sparton in the fourth quarter of fiscal 2009, and its adoption did not have a significant impact on our consolidated financial statements.



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In December 2008, the FASB issued a new standard relating to, *Employers' Disclosures about Pensions and Other Post-retirement Benefits*, now codified in ASC Topic 715 (formerly SFAS No. 158, *Employers' Disclosure about Pensions and Other Postretirement Benefits*), to improve disclosures about plan assets in an employer's defined benefit pension or other postretirement plans, including the basis for investment allocation decisions, expanded major categories of plan assets, inputs and valuation techniques used to measure the fair value of plan assets, the effect of fair value measurements using significant unobservable inputs (Level 3) on changes in plan assets for a period, and significant concentrations of risk within plan assets. This new guidance is effective for Sparton's fiscal year ending on June 30, 2010. The other or alternative investments category as a percentage of the total plan assets of Sparton's pension plan are not significant and, therefore, management does not believe that the implementation of these additional disclosures will be a critical element in significantly enhancing users' ability to evaluate the nature and risks of invested plan assets, significant investment strategies, or the relative reliability of fair value measurements.

In November 2008, the FASB ratified EITF guidance related to *Equity Method Investment Accounting Considerations*, now codified in ASC Topic 323 (formerly EITF 08-6, *Equity Method Investment Accounting Considerations*), which is effective for Sparton in the quarter ended September 30, 2009. Implementation of this new guidance had no significant impact on our consolidated financial statements, and is not expected to have a material effect on our accounting going forward.

In June 2008, the FASB issued a new standard relating to, *Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities*, now codified in ASC Topic 260 (formerly EITF 03-6-1, *Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities*), which established that unvested share-based payment awards that contain nonforfeitable rights to dividends or dividend equivalents (whether paid or unpaid) are participating securities, as defined, and should be included in the computation of earnings per share pursuant to the two-class method. The guidance contained in ASC Topic 260 is effective for Sparton this first quarter of fiscal 2010. All prior-period earnings per share data presented was adjusted retrospectively to conform to the new provisions, with no significant impact.

In April 2008, the FASB issued guidance related to *Determination of the Useful Life of Intangible Assets*, now codified in ASC Topic 350 (formerly FSP FAS 142-3, *Determination of the Useful Life of Intangible Assets*), which amended the factors that should be considered in developing renewal or extension assumptions integral to estimating such useful lives. This guidance is applicable to Sparton's purchased or internally developed intangible assets acquired beginning on July 1, 2009 (fiscal 2010). Implementation of this new guidance had no significant impact on our consolidated financial statements. This guidance also requires certain disclosures relating to costs incurred to renew or extend the term of recognized intangible assets (see Note 4).

In December 2007, the FASB issued a new standard related to *Business Combinations*, now codified in ASC Topic 805 (formerly SFAS No. 141(R), *Business Combinations*), which requires an acquiring entity in a business combination to recognize all (and only) the assets acquired and liabilities assumed in the transaction; establishes the acquisition-date fair value as the measurement objective for all assets acquired and liabilities assumed; and requires the acquirer to disclose to investors and other users all of the information they need to evaluate and understand the nature and financial effect of the business combination. This new guidance was effective for Sparton beginning on July 1, 2009 (fiscal 2010) and is applicable only to transactions occurring after that effective date.

In December 2007, the FASB issued a new standard related to *Noncontrolling Interests in Consolidated Financial Statements*, now codified in ASC Topic 810 (formerly SFAS No. 160, *Noncontrolling Interest in Consolidated Financial Statements*), which clarifies that a noncontrolling or minority interest in a subsidiary is considered an ownership interest and, accordingly, requires all entities to report such interests in subsidiaries as equity in the consolidated financial statements. This new guidance which is effective this first quarter of fiscal 2010, is not relevant to the Company at this time, but would become so if the Company were to enter into an applicable transaction.

In February 2007, the FASB issued a new standard related to *Fair Value Option for Financial Assets and Financial Liabilities*, now codified within ASC Topic 825 (formerly SFAS No. 159, *Fair Value for Financial Assets and Financial Liabilities*), which provides reporting entities the one-time election (the fair value option) to measure financial instruments and certain other items at fair value. For items for which the fair value option has been elected, unrealized gains and losses are to be reported in earnings at each subsequent reporting date. In September 2006, the

FASB issued a new standard relating to *Fair Value Measurements*, now codified in ASC Topic 820, to eliminate the diversity in practice that exists due to the different definitions of fair value and the limited guidance for applying those definitions. ASC Topic 820 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Both new standards were effective for financial statements issued by Sparton for the first interim period of our 2009 fiscal year, which began on July 1, 2008. The adoption of this new guidance had no significant impact on the Company's consolidated financial statements. The Company did not elect the fair value option for any of its financial assets and liabilities. In February 2008, the FASB issued updated guidance, now codified in ASC Topic 820, which delays the effective date of fair value measurements until fiscal 2010 for nonfinancial assets and nonfinancial liabilities except those items recognized or disclosed at fair value on an annual or more frequently recurring basis. Effective July 1, 2009, the Company applied the new fair value measurement

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and disclosure provisions to its nonfinancial assets and liabilities measured on a nonrecurring basis. Such application did not have a material impact on the Company's consolidated results of operations or financial position. The Company measures the fair value of the following on a nonrecurring basis: (1) long-lived assets and other intangibles, which include customer relationships and non-compete agreements, and (2) the reporting unit under step one of the Company's periodic goodwill impairment test. In August, 2009, the FASB issued updated guidance which amends ASC Topic 820, *Fair Value Measurements and Disclosures*, related to the fair value measurement of liabilities, to clarify that certain techniques must be used to measure fair value in circumstances in which a quoted price in an active market for the identical liability is not available. The updated guidance, which is effective for Sparton beginning in our second quarter of fiscal 2010, is also expected to have no significant impact since, as described above, the Company has not elected the fair value option for any of our financial assets or liabilities.

**NOTE 2. INVENTORIES AND COSTS OF CONTRACTS IN PROGRESS**

Customer orders are based upon forecasted quantities of product, manufactured for shipment over defined periods. Raw material inventories are purchased to fulfill these customer requirements. Within these arrangements, customer demands for products frequently change, sometimes creating excess and obsolete inventories. When it is determined that the Company's carrying cost of such excess and obsolete inventories cannot be recovered in full, a charge is taken against income and a valuation allowance is established for the difference between the carrying cost and the estimated realizable amount. Conversely, should the disposition of adjusted excess and obsolete inventories result in recoveries in excess of these reduced carrying values, the remaining portion of the valuation allowance reserve is reversed and taken into income when such determinations are made. It is possible that the Company's financial position and results of operations could be materially affected by changes to inventory valuation allowances for excess and obsolete inventories. These valuation allowances totaled \$3,650,000 and \$3,732,000 at September 30 and June 30, 2009, respectively.

Inventories are valued at the lower of cost (first-in, first-out basis) or market and include costs related to long-term contracts. The following are the approximate major classifications of inventory, net of interim billings and related valuation allowances, at each balance sheet date:

	September 30, 2009	June 30, 2009
Raw materials	\$ 24,920,000	\$ 29,593,000
Work in process	5,448,000	5,260,000
Finished goods	5,086,000	3,582,000
	\$ 35,454,000	\$ 38,435,000

Finished goods inventories include \$3.2 and \$1.8 million, of completed, but not yet accepted, sonobuoys at September 30 and June 30, 2009, respectively. Inventories were reduced by interim billings to the U.S. government for costs incurred related to long-term contracts, thereby establishing inventory to which the U.S. government then has title, of approximately \$8.0 million and \$5.8 million, respectively, at September 30 and June 30, 2009. At September 30 and June 30, 2009, current liabilities includes billings in excess of costs of \$23.0 million and \$25.1 million, respectively, on government contracts. As these billings are in excess of cost, there is no inventory to which the government would claim title and, therefore, no offset to inventory has been made.

**NOTE 3. DEFINED BENEFIT PENSION PLAN**

**Periodic benefit cost** The Company sponsors a defined benefit pension plan covering certain salaried and hourly U.S. employees. On February 12, 2009, the Company announced that it would freeze participation and the accrual of benefits in the Sparton Corporation Pension Plan, effective April 1, 2009, at which time all participants became fully vested. As a result of this freeze, actuarial calculations for fiscal 2009 were updated with an effective date of February 28, 2009. Based on this actuarial calculation, a \$333,000 curtailment charge was recognized in fiscal 2009, related to the acceleration of all remaining prior service costs previously being amortized over future periods. In

addition, during fiscal 2009 lump-sum benefit distributions exceeded plan service and interest costs, resulting in lump-sum settlement charges totaling \$1,133,000.

The components of net periodic pension expense are as follows for the three months ended September 30:

	2009	2008
Service cost	\$	\$ 135,000
Interest cost	150,000	152,000
Expected return on plan assets	(71,000)	(187,000)
Amortization of prior service cost		25,000
Amortization of unrecognized net actuarial loss	105,000	35,000
Net periodic benefit cost	184,000	160,000
Pro rata recognition of lump-sum settlements	313,000	
Total periodic pension expense	\$ 497,000	\$ 160,000

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Based upon current actuarial calculations and assumptions the pension plan has met all funding requirements. During the first quarter of fiscal 2010, \$1,796,000 was contributed to the pension plan, reflective of required funding and discretionary funding to ensure funding levels are in excess of 80%. No payment was made during the first quarter of fiscal 2009. For further information on future funding projections and ot