

SPARTON CORP
Form 10-Q
November 09, 2010
[Table of Contents](#)

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, 2010

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)

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Ohio
(State or other jurisdiction of

38-1054690
(I.R.S. Employer

incorporation or organization)

Identification No.)

425 N. Martingale Road, Suite 2050, Schaumburg, Illinois
(Address of principal executive offices)

60173-2213
(Zip code)

(847) 762-5800

(Registrant's telephone number, including zip code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or such shorter period that the registrant was required to submit and post such files). Yes ☐ No ☐

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

Large accelerated filer ☐

Accelerated filer ☐

Non-accelerated filer ☐ (Do not check if a smaller reporting company)

Smaller reporting company ☒

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

As of November 2, 2010, there were 10,200,534 shares of common stock, \$1.25 par value per share, outstanding.

Table of Contents

TABLE OF CONTENTS

PART I	<u>FINANCIAL INFORMATION</u>	3
ITEM 1.	<u>FINANCIAL STATEMENTS</u>	3
	<u>CONDENSED CONSOLIDATED BALANCE SHEETS AS OF SEPTEMBER 30, 2010 AND JUNE 30, 2010 (UNAUDITED)</u>	3
	<u>CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS FOR THE THREE MONTHS ENDED SEPTEMBER 30, 2010 AND 2009 (UNAUDITED)</u>	4
	<u>CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS FOR THE THREE MONTHS ENDED SEPTEMBER 30, 2010 AND 2009 (UNAUDITED)</u>	5
	<u>CONDENSED CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY FOR THE THREE MONTHS ENDED SEPTEMBER 30, 2010 AND 2009 (UNAUDITED)</u>	6
	<u>NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS</u>	7
ITEM 2.	<u>MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS</u>	22
ITEM 3.	<u>QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK</u>	34
ITEM 4.	<u>CONTROLS AND PROCEDURES</u>	35
PART II	<u>OTHER INFORMATION</u>	35
ITEM 1.	<u>LEGAL PROCEEDINGS</u>	35
ITEM 1A.	<u>RISK FACTORS</u>	35
ITEM 6.	<u>EXHIBITS</u>	36
	<u>SIGNATURES</u>	37
	CERTIFICATIONS	

Table of Contents**PART I. FINANCIAL INFORMATION****Item 1. Financial Statements.**

SPARTON CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS

(UNAUDITED)

(Dollars in thousands, except share data)

	September 30, 2010	June 30, 2010 (a)
Assets		
Current Assets:		
Cash and cash equivalents	\$ 27,281	\$ 30,589
Restricted cash	3,174	3,162
Accounts receivable, net of allowance for doubtful accounts of \$532 and \$532, respectively	20,906	17,967
Inventories and cost of contracts in progress, net	36,629	26,514
Income taxes receivable	304	296
Deferred income taxes	57	57
Property held for sale	3,900	3,900
Prepaid expenses and other current assets	1,499	1,449
Total current assets	93,750	83,934
Property, plant and equipment, net	9,547	8,924
Goodwill	19,141	19,141
Other intangible assets, net	4,693	4,803
Other non-current assets	3,028	3,059
Total assets	\$ 130,159	\$ 119,861
Liabilities and Shareholders' Equity		
Current Liabilities:		
Current portion of long-term debt	\$ 121	\$ 121
Accounts payable	16,595	13,045
Accrued salaries and wages	4,255	5,737
Accrued health benefits	1,026	989
Current portion of pension liability	238	1,139
Restructuring accrual	260	233
Advance billings on customer contracts	24,240	21,595
Other accrued expenses	5,268	3,345
Total current liabilities	52,003	46,204
Deferred income taxes - non-current	1,693	1,579
Pension liability - non-current portion	2,122	1,980
Long-term debt - non-current portion	1,766	1,796
Environmental remediation - non-current portion	3,959	4,033
Total liabilities	61,543	55,592

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Commitments and contingencies

Shareholders' Equity:

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

Common stock, \$1.25 par value; 15,000,000 shares authorized, 10,200,534 and 10,200,534 shares

outstanding, respectively	12,751	12,751
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Capital in excess of par value	19,987	19,864
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Retained earnings	39,106	35,026
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Accumulated other comprehensive loss	(3,228)	(3,372)
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Total shareholders' equity	68,616	64,269
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Total liabilities and shareholders' equity	\$ 130,159	\$ 119,861
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(a) Derived from the Company's audited financial statements as of June 30, 2010.

See Notes to unaudited condensed consolidated financial statements.

Table of Contents

SPARTON CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(UNAUDITED)

(Dollars in thousands, except share data)

	For the Three Months Ended	
	September 30, 2010	September 30, 2009
Net sales	\$ 45,767	\$ 48,104
Cost of goods sold	38,741	40,732
Gross profit	7,026	7,372
Operating Expense:		
Selling and administrative expenses	4,961	4,580
Amortization of intangible assets	110	117
Restructuring/impairment charges	77	876
Gain on acquisition	(2,400)	
Gain on sale of property, plant and equipment	(18)	
Other operating expenses	192	190
Total operating expense	2,922	5,763
Operating income	4,104	1,609
Other income (expense)		
Interest expense	(170)	(259)
Interest income	58	8
Other, net	74	81
Total other expense, net	(38)	(170)
Income before provision for (benefit from) income taxes	4,066	1,439
Provision for (benefit from) income taxes	(14)	34
Net income	\$ 4,080	\$ 1,405
Income per share of common stock:		
Basic	\$ 0.40	\$ 0.14
Diluted	\$ 0.40	\$ 0.14
Weighted average shares of common stock outstanding:		
Basic	10,200,534	9,951,507
Diluted	10,207,617	9,951,507

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See Notes to unaudited condensed consolidated financial statements.

Table of Contents

SPARTON CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(UNAUDITED)

(Dollars in thousands)

	For the Three Months Ended September 30, 2010	September 30, 2009
Cash Flows from Operating Activities:		
Net income	\$ 4,080	\$ 1,405
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	323	428
Deferred income tax expense	114	34
Pension expense	190	497
Stock-based compensation expense	123	
Non-cash restructuring/impairment charges		150
Net gain on sale of property, plant and equipment	(18)	
Gain on acquisition	(2,400)	
Other	87	60
Changes in operating assets and liabilities:		
Accounts receivable	(2,939)	13,503
Income taxes receivable	(8)	
Inventories and cost of contracts in progress	541	2,981
Prepaid expenses and other assets	(104)	145
Advance billings on customer contracts	2,645	(2,107)
Accounts payable and accrued expenses	2,363	(11,959)
Net cash provided by operating activities	4,997	5,137
Cash Flows from Investing Activities:		
Purchase of certain contract manufacturing assets of Delphi Medical	(7,803)	
Additional goodwill from SMS acquisition		(977)
Change in restricted cash	(12)	
Purchases of property, plant and equipment	(476)	(32)
Proceeds from sale of property, plant and equipment	18	
Net cash used in investing activities	(8,273)	(1,009)
Cash Flows from Financing Activities:		
Net short-term bank borrowings (repayments)		(15,500)
Repayment of long-term debt	(32)	(3,427)
Payment of debt financing costs		(744)
Net cash used in financing activities	(32)	(19,671)
Net decrease in cash and cash equivalents	(3,308)	(15,543)
Cash and cash equivalents at beginning of period	30,589	36,261
Cash and cash equivalents at end of period	\$ 27,281	\$ 20,718

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Supplemental disclosure of cash flow information:

Cash paid for interest	\$ 77	\$ 202
Cash paid (received) for income taxes	\$ (119)	\$

See Notes to unaudited condensed consolidated financial statements.

Table of Contents

SPARTON CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

(UNAUDITED)

(Dollars in thousands, except share data)

	Three Months Ended September 30, 2010					
	Common Stock		Capital		Accumulated Other Comprehensive Income (Loss)	Total
	Shares	Amount	In Excess of Par Value	Retained Earnings		
Balance at June 30, 2010	10,200,534	\$ 12,751	\$ 19,864	\$ 35,026	\$ (3,372)	\$ 64,269
Stock-based compensation			123			123
Comprehensive income, net of tax:						
Net income				4,080		4,080
Change in unrecognized pension costs					144	144
Comprehensive income						4,224
Balance at September 30, 2010	10,200,534	\$ 12,751	\$ 19,987	\$ 39,106	\$ (3,228)	\$ 68,616

	Three Months Ended September 30, 2009					
	Common Stock		Capital		Accumulated Other Comprehensive Income (Loss)	Total
	Shares	Amount	In Excess of Par Value	Retained Earnings		
Balance at June 30, 2009	9,951,507	\$ 12,439	\$ 19,671	\$ 27,586	\$ (4,801)	\$ 54,895
Net and comprehensive income				1,405		1,405
Balance at September 30, 2009	9,951,507	\$ 12,439	\$ 19,671	\$ 28,991	\$ (4,801)	\$ 56,300

See Notes to unaudited condensed consolidated financial statements.

Table of Contents

SPARTON CORPORATION AND SUBSIDIARIES

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(1) Business and Basis of Presentation

Sparton Corporation and subsidiaries (the Company or Sparton) has been in continuous existence since 1900. It was last reorganized in 1919 as an Ohio corporation. The Company is a provider of complex and sophisticated electromechanical devices with capabilities that include concept development, industrial design, design and manufacturing engineering, production, distribution, and field service. The three primary markets the Company serves are the Medical Device (Medical), Defense & Security Systems (DSS), and Electronic Manufacturing Services (EMS) industries. The Company reports its operating results under these three reportable business segments. Financial information by segment is presented in Note 16. All of the Company's facilities are registered to ISO standards, including 9001 or 13485, with most having additional certifications. The Company's products and services include products for Original Equipment Manufacturers (OEM) and Emerging Technology (ET) customers that are microprocessor-based systems that include transducers, printed circuit boards and assemblies, sensors, and electromechanical components, as well as development and design engineering services relating to these product sales. Sparton also develops and manufactures sonobuoys, 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.

The unaudited condensed consolidated balance sheets as of September 30, 2010 and June 30, 2010, the unaudited condensed consolidated statements of operations for the three months ended September 30, 2010 and 2009, the unaudited condensed consolidated statements of cash flows for the three months ended September 30, 2010 and 2009, the unaudited condensed consolidated statements of shareholders' equity for the three months ended September 30, 2010 and 2009 and related footnotes have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) for interim financial information and Rule 10-01 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. The financial information presented herein should be read in conjunction with the Company's Annual Report on Form 10-K for the fiscal year ended June 30, 2010, which includes information and disclosures not presented herein. All significant intercompany accounts and transactions have been eliminated in consolidation. Certain reclassifications of prior period amounts have been made to conform to the current year presentation. Subsequent events have been evaluated through the date these financial statements were issued. In the opinion of management, the unaudited condensed consolidated financial statements contain all of the adjustments, consisting of normal recurring adjustments, necessary to present fairly, in summarized form, the consolidated financial position, results of operations and cash flows of the Company. The results of operations for the three months ended September 30, 2010 are not indicative of the results that may be expected for the full fiscal year 2011.

(2) Acquisition of Certain Assets of Delphi Medical's Contract Manufacturing Business

On August 6, 2010, the Company completed the acquisition of certain assets related to the contract manufacturing business of Delphi Medical Systems, LLC (Delphi Medical or Delphi). The purchase price of \$8.0 million is subject to certain adjustments based on the determination of the final inventory value. Cash consideration paid at closing of approximately \$7.8 million, including a \$2.0 million escrowed holdback, was net of approximately \$0.2 million for the assumption of retained employee accruals and was financed entirely through the use of Company cash. Based on the Company's initial inventory valuation, a liability has been recorded for additional consideration to be paid to Delphi Medical upon final agreement of this valuation by both parties to the transaction. The purchase agreement provides for the recovery from Delphi Medical of an amount up to \$2.0 million, deposited in escrow at closing, for certain excess and obsolete inventory remaining on-hand at the end of the 18 month period from closing. These escrowed funds are additionally available for payment of potential seller indemnification obligations in relation to the agreement.

The acquired business, which is reported in the Company's Medical segment, provides a new and diversified customer base and provides Sparton with a geographic presence in the western United States. Delphi Medical primarily manufactures OEM medical devices including blood separation equipment, spinal surgery products and 3-D eye mapping devices. It also provides engineering and manufacturing support to a market-leading environmental sensor company whose markets include meteorology, weather critical operations and controlled environment applications.

Table of Contents

The following table represents the preliminary allocation of the total consideration to assets acquired and liabilities assumed from Delphi Medical based on Sparton's preliminary estimate of their respective fair values (in thousands):

Total purchase consideration:	
Cash	\$ 7,803
Additional accrued consideration	616
Total purchase consideration	8,419
Assets acquired and liabilities assumed:	
Inventory	10,656
Equipment	360
Employee accruals assumed	(197)
Total assets acquired and liabilities assumed	10,819
Gain on acquisition	\$ 2,400

Sparton has determined that the fair value of the assets acquired and liabilities assumed related to this acquisition exceed the total purchase consideration and as a result the Company has recorded a gain on acquisition of \$2.4 million in the three months ended September 30, 2010. Sparton believes it was able to purchase this contract manufacturing business from Delphi Medical significantly below its fair value due to Delphi's desire to liquidate this asset in a timely manner and focus on its core business.

Net sales of approximately \$5.9 million and net income of approximately \$2.4 million resulting from the acquisition of Delphi Medical since August 6, 2010 are included in the Company's Condensed Consolidated Statements of Operations for the three months ended September 30, 2010.

The following table summarizes, on a pro forma basis, the combined results of operations of the Company and the acquired contract manufacturing business of Delphi Medical as though the acquisition had occurred as of July 1, 2009. The pro forma amounts presented are not necessarily indicative of either the actual consolidated results had the acquisition occurred as of July 1, 2009 or of future consolidated operating results (in thousands, except per share amounts):

	For the Three Months Ended	
	September 30, 2010	September 30, 2009
Net sales	\$ 49,218	\$ 57,662
Net income	\$ 4,003	\$ 931
Net income per share basic	\$ 0.39	\$ 0.09
Net income per share diluted	\$ 0.39	\$ 0.09

The Company incurred legal, professional and other costs related to this acquisition aggregating approximately \$0.2 million. These costs were recognized as selling and administrative expenses of approximately \$0.1 million and \$0.1 million in the three months ended September 30, 2010 and June 30, 2010, respectively.

On August 6, 2010 and concurrent with the acquisition of Delphi Medical, the Company entered into leases for two facilities housing the operations of this contract manufacturing business. During the three months ended September 30, 2010, the Company initiated the consolidation of the operations into one facility, and has provided written notice of termination on the lease for the building which the Company will exit. It is expected that the facility consolidation will be completed in the second quarter of fiscal 2011.

Table of Contents**(3) Inventories and Cost of Contracts in Progress**

The following are the approximate major classifications of inventory, net of advance billings and related valuation allowances, at September 30, 2010 and June 30, 2010 (in thousands):

	September 30, 2010	June 30, 2010
Raw materials	\$ 35,539	\$ 25,693
Work in process	7,434	3,611
Finished goods	3,778	6,790
Total inventory and cost of contracts in progress, gross	46,751	36,094
Inventory to which the U.S. government has title due to advance billings	(7,284)	(7,411)
Reserve for obsolescence	(2,838)	(2,169)
Total inventory and cost of contracts in progress, net	\$ 36,629	\$ 26,514

(4) Property, Plant and Equipment, Net

Property, plant and equipment, net consists of the following at September 30, 2010 and June 30, 2010 (in thousands):

	September 30, 2010	June 30, 2010
Land and land improvements	\$ 1,235	\$ 1,235
Buildings and building improvements	14,625	14,514
Machinery and equipment	13,188	12,342
Construction in progress	453	574
Total property, plant and equipment	29,501	28,665
Less accumulated depreciation	(19,954)	(19,741)
Total property, plant and equipment, net	\$ 9,547	\$ 8,924

The Company currently has for sale its Bluewater Road property in Albuquerque, New Mexico. The Company classifies this property as Property held for sale.

(5) Goodwill and Other Intangible Assets

Goodwill represents the excess of purchase price over the fair value of the net assets acquired in conjunction with the Company's purchase of Astro Instrumentation, LLC (Astro) in May 2006.

Intangible assets represent the values assigned to customer relationships acquired in conjunction with the Company's purchase of Astro. The weighted average amortization period, gross carrying amount, accumulated amortization and net carrying value of intangible assets at September 30, 2010 and June 30, 2010 are as follows (in thousands):

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	Weighted Average Amortization Period	September 30, 2010		Net Carrying Value
		Gross Carrying Amount	Accumulated Amortization	
Amortized intangible assets:				
Customer relationships	180 months	\$ 6,600	\$ (1,907)	\$ 4,693

	Weighted Average Amortization Period	June 30, 2010		Net Carrying Value
		Gross Carrying Amount	Accumulated Amortization	
Amortized intangible assets:				
Customer relationships	180 months	\$ 6,600	\$ (1,797)	\$ 4,803

Table of Contents

Sparton did not incur any significant costs to renew or alter the term of its intangible assets during the three months ended September 30, 2010. Amortization expense for both the three months ended September 30, 2010 and 2009 was approximately \$0.1 million. Aggregate amortization expense relative to existing intangible assets for the periods shown is currently estimated to be as follows (in thousands):

Fiscal Year Ended June 30,	
2011	\$ 440
2012	440
2013	440
2014	440
2015	440
Thereafter	2,603
Total	\$ 4,803

(6) Other non-current assets

Other non-current assets consist of the following at September 30, 2010 and June 30, 2010 (in thousands):

	September 30, 2010	June 30, 2010
Deferred financing fees, net	\$ 621	\$ 706
Cost method investment in Cybernet Systems Corporation	1,623	1,623
Coors Road long-term lease receivable	476	468
Other	308	262
Total other non-current assets	\$ 3,028	\$ 3,059

Costs incurred in connection with the Company's revolving line-of-credit of approximately \$1.0 million were deferred and are amortized to interest expense over the three year term of the facility.

The Company holds an approximate 12% interest in Cybernet Systems Corporation (Cybernet), a developer of hardware, software, next-generation network computing, and robotics products. Beginning in February 2010, the Company accounts for its investment in Cybernet under the cost method. Previously, this investment was accounted for under the equity method.

The Company is due three equal annual payments, beginning May 1, 2011 and aggregating, approximately \$0.8 million, in relation to the long-term lease of its Coors Road property in Albuquerque, New Mexico. The \$0.8 million of future payments due have been discounted for the imputation of interest, resulting in a discounted receivable of approximately \$0.7 million. Approximately \$0.2 million of this discounted receivable is due within the next 12 months and therefore is included in prepaid expenses and other current assets on the balance sheets at September 30, 2010 and June 30, 2010.

Table of Contents**(7) Debt**

Short-term debt maturities and revolving line of credit Short-term debt at September 30, 2010 and June 30, 2010 reflects the current portion of the Company's industrial revenue bonds of approximately \$0.1 million.

The Company has \$20 million of maximum borrowing availability, subject to certain collateral restrictions, under a revolving line-of-credit facility provided in August 2009 by National City Business Credit, Inc. (now PNC Bank, National Association) to support working capital needs and other general corporate purposes. The new line-of-credit facility is secured by substantially all of the assets of the Company. Outstanding borrowings bear interest at a variable rate defined as the Bank's minimum base rate plus a specified margin, each component of which is determined separately for domestic and Eurodollar loans, but in no case less than a total rate of 7% per annum, which at September 30, 2010 was 7%. As a condition of the line-of-credit facility, the Company is subject to compliance with certain customary covenants, which the Company met at September 30, 2010. The Company had no borrowings drawn against the credit facility at both September 30, 2010 and June 30, 2010. Interest accrued related to this facility amounted to approximately \$68,000 and \$66,000 as of September 30, 2010 and June 30, 2010, respectively. The maturity date for the line-of-credit is August 14, 2012. The Company's prior line of credit was retired on August 14, 2009.

Long-term debt Long-term debt consists of the following at September 30, 2010 and June 30, 2010 (in thousands):

	September 30, 2010	June 30, 2010
Industrial revenue bonds, face value	\$ 1,997	\$ 2,029
Less unamortized purchase discount	(110)	(112)
Total long-term debt	1,887	1,917
Less: current portion	(121)	(121)
Long-term debt, net of current portion	\$ 1,766	\$ 1,796

Industrial Revenue Bonds

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

The bonds carry certain sinking fund requirements generally obligating the Company to make monthly deposits of one twelfth of the annual obligation plus accrued interest. The purchase discount is being amortized ratably over the remaining term of the bonds. Amortization expense for each of the three months ended September 30, 2010 and 2009 was approximately \$2,000. The Company also has an irrevocable letter of credit in the amount of approximately \$0.3 million, which is renewable annually, to secure repayment of a portion of the bonds.

Notes Payable Former Owners

Two notes payable with initial principal of \$3.75 million each, totaling \$7.5 million, were payable to the sellers of Astro, which is now operated under the Medical Device segment. These notes were repaid over four years, in aggregate semi-annual payments of principal and interest in the combined amount of approximately \$1.1 million on June 1 and December 1 of each year. Payments commenced on December 1, 2006. These notes each bore interest at 5.5% per annum. The notes were proportionately secured by the stock of Astro. On June 1, 2010, the Company made the final payments in satisfaction of these notes.

Table of Contents***Bank Term Loan***

The bank term loan, provided by National City Bank with an original principal of \$10.0 million, was being repaid over five years, with quarterly principal payments of \$0.5 million which commenced September 1, 2006. This loan bore interest at the variable rate of LIBOR plus 500 basis points, with interest calculated and paid quarterly along with the principal payment. The debt was secured by substantially all assets of the Company. On August 14, 2009, the Company paid off this term loan with a cash payment in connection with the replacement credit facility.

(8) Fair Value Measurements

As of September 30, 2010, the Company has no assets or liabilities which it measures and carries on its balance sheet at fair value on a recurring basis. The Company's long-term debt instruments, consisting of industrial revenue bonds at September 30, 2010, are carried at historical cost. As of September 30, 2010 and June 30, 2010, the fair value of the industrial revenue bonds was approximately \$2.4 million and \$2.3 million, respectively compared to carrying values of approximately \$1.9 million and \$1.9 million, respectively. These fair values were derived from discounted cash flow analyses based on the terms of the contracts and observable market data, including adjustment for non-performance risk. The fair value of accounts receivable and accounts payable approximated their carrying values at both September 30, 2010 and June 30, 2010.

(9) Income Taxes

The Company's effective income tax rate for the interim periods presented is based on management's estimate of the Company's effective tax rate for the applicable year and differs from the federal statutory income tax rate primarily due to applicable permanent differences, federal alternative minimum taxes, foreign income taxes, state income taxes and changes in the valuation allowance for deferred income taxes. In assessing the realizability of deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which those temporary differences become deductible.

For the three months ended September 30, 2010 and 2009, provisions for income taxes of approximately \$0.1 million and \$0.0 million, respectively, were recognized relating to the increase in the deferred tax liability associated with the amortization of goodwill for tax purposes. There was no other federal income tax expense recorded for either of the three months ended September 30, 2010 or 2009, as income generated in these periods was offset by the utilization of previously recorded net operating loss carryforwards and the reversal of the related valuation allowance. The Company additionally recorded a benefit of approximately \$0.1 million during the three months ended September 30, 2010 relating to income tax carryback refunds from the Canadian government.

(10) Defined Benefit Pension Plan

Approximately 600 employees and retirees of the Company are covered by a defined benefit pension plan. Effective April 1, 2009, participation and the accrual of benefits in this pension plan were frozen, at which time all participants became fully vested. The components of net periodic pension expense are as follows for the three months ended September 30, 2010 and 2009 (in thousands):

	For the Three Months Ended	
	September 30, 2010	September 30, 2009
Service cost	\$	\$
Interest cost	120	150
Expected return on plan assets	(74)	(71)
Amortization of prior service cost		
Amortization of unrecognized net actuarial loss	79	105
Net periodic benefit cost	125	184
Pro rata recognition of lump-sum settlements	65	313
Total periodic pension expense	\$ 190	\$ 497

Table of Contents

Lump-sum settlement charges of approximately \$0.1 million and \$0.3 million were recognized during the three months ended September 30, 2010 and 2009, respectively, in anticipation of lump-sum benefit distributions exceeding plan service and interest costs for the 2011 and 2010 fiscal years. The Company's policy is to fund the plan based upon legal requirements and tax regulations. During the three months ended September 30, 2010 and 2009, approximately \$0.8 million and \$1.8 million, respectively, was contributed to the pension plan, reflective of required funding and discretionary funding to ensure funding levels are in excess of 80%. For further information on future funding projections and other pension disclosures see Part II, Item 8, Note 8 Employee Retirement Benefit Plans of the Company's Annual Report on Form 10-K for the fiscal year ended June 30, 2010.

(11) Commitments and Contingencies

Environmental Remediation Sparton has been involved with ongoing environmental remediation since the early 1980's related to one of its former manufacturing facilities, located in Albuquerque, New Mexico (Coors Road). Although the Company entered into a long-term lease of the Coors Road property that was treated as a sale of property during the fourth quarter of fiscal 2010, it remains responsible for the remediation obligations related to its past operation of this facility. At September 30, 2010, Sparton had accrued approximately \$4.4 million as its best estimate of the remaining minimum future undiscounted financial liability with respect to this matter, of which approximately \$0.4 million is classified as a current liability and included on the balance sheet in other accrued expenses. The Company's minimum cost estimate is based upon existing technology and excludes legal and related consulting costs, which are expensed as incurred. The Company's estimate includes equipment and operating and maintenance costs for onsite and offsite pump and treat containment systems, as well as continued onsite and offsite monitoring. It also includes periodic reporting requirements.

On October 15, 2009, approximately \$3.1 million of cash was utilized to establish a trust, the Sparton Corporation Financial Assurance Trust, for remediation activity. The funds are held in Sparton's name and are invested with Sparton receiving the benefit of the investment return. As of September 30, 2010, approximately \$3.2 million was held in this trust. These funds are available for use against the \$4.4 million expected remediation liability. The trust was established to meet the United States Environmental Protection Agency's (EPA) financial assurance requirements for the fiscal year ended June 30, 2010, with trust funds to be drawn upon only should Sparton not continue to meet its financial remediation requirements. The trust was to remain in place until the Company could again satisfy the EPA financial assurance requirements through compliance with financial ratios, as was previously attained on an annual basis until fiscal year 2009. Based on the Company's financial results for fiscal year 2010, the Company was again in compliance with the financial ratios and dissolved the trust during October 2010; as such, this restricted cash is classified as current in the Consolidated Balance Sheet at September 30, 2010.

In fiscal 2003, Sparton reached an agreement with the United States Department of Energy (DOE) and others to recover certain remediation costs. Under the settlement terms, Sparton received cash and obtained some degree of risk protection as the DOE agreed to reimburse Sparton for 37.5% of certain future environmental expenses in excess of \$8.4 million incurred from the date of settlement, if any, of which approximately \$3.4 million has been incurred as of September 30, 2010 toward the \$8.4 million threshold. Uncertainties associated with environmental remediation contingencies are pervasive and often result in wide ranges of reasonably possible outcomes. Estimates developed in the early stages of remediation can vary significantly. Normally a finite estimate of cost does not become fixed and determinable at a specific point in time. Rather, the costs associated with environmental remediation become estimable over a continuum of events and activities that help to frame and define a liability. Factors which cause uncertainties for the Company include, but are not limited to, the effectiveness of the current work plans in achieving targeted results and proposals of regulatory agencies for desired methods and outcomes. It is possible that cash flows and results of operations could be materially affected by the impact of changes associated with the ultimate resolution of this contingency.

Table of Contents

Customer Relationships The Company had an action before the U.S. Court of Federal Claims to recover damages arising out of an alleged infringement by the U.S. Navy of certain patents held by Sparton and used in the production of sonobuoys. Pursuant to an agreement between the Company and counsel conducting the litigation, a significant portion of the claim will be retained by the Company's counsel in contingent fees if the litigation is successfully concluded. A trial of the matter was conducted by the court in April 2008, with a decision against Sparton filed in August 2009 and published in September 2009. In October 2009, an appeal of this unfavorable decision was filed with the Federal Circuit Court of Appeals. Based on this decision, management believes that the Company's ability to obtain any recovery with respect to the claim is greatly diminished.

Litigation On August 9, 2009, Sparton and certain subsidiaries were named as defendants in a wrongful death suit, alleging that a defective transmission shifter assembly in a 1996 Chrysler automobile caused a July 2007 death. The suit also named Chrysler LLC, Dura Automotive Systems, Inc., and Chandler Motors Company as defendants. The suit was filed in Pontotoc County Circuit Court in Mississippi. Sparton has not manufactured automotive shifter assemblies for Chrysler since December 1996, when it sold its KPI Group subsidiary to Dura Automotive Systems, Inc. The plaintiff seeks damages from the defendants for economic loss, pain and suffering, and loss of companionship, as well as punitive damages. Sparton has denied liability, has notified its insurance carriers regarding this claim, and is vigorously defending this matter. At this time, it is not possible to determine or predict the outcome of this suit, and as a result, no amounts have been accrued in the financial statements as of September 30, 2010. While no assurances can be given, the Company does not believe that this litigation, if adversely determined, would have a material adverse effect on the Company's financial position or results of operations.

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

(12) Stock-Based Compensation

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

2001 Plan. Under the 2001 Plan, the Company may grant to employees and non-employee directors incentive or non-qualified stock options, stock appreciation rights, restricted stock and other stock-based awards. All of the stock options issued to date under the 2001 Plan have either three, five or ten-year lives with either immediate vesting or vesting on an annual basis over four years beginning one year after grant date. Restricted stock awards granted to date to employees under the 2001 Plan vest annually over periods ranging from approximately 2.5 to 3 years. Unrestricted stock awards granted to date under the 2001 Plan represent fiscal year 2010 annual stock grants to directors as a component of their overall compensation. The 2001 Plan's termination date with respect to the granting of new awards is October 24, 2011. The total number of shares that may be granted under the 2001 Plan is 970,161 shares of the Company's common stock, of which amount, 57,195 shares remain available for awards as of September 30, 2010.

2010 Plan. Under the 2010 Plan, the Company may grant to employees, officers and directors of the Company or its subsidiaries incentive and non-qualified stock options, stock appreciation rights, restricted stock or restricted stock units, performance awards and other stock-based awards, including grants of shares. Restricted stock awards granted to date to employees under the 2010 Plan vest annually over four years, subject to achievement of certain financial performance metrics in addition to the service requirements. The 2010 Plan has a term of ten years. The total number of shares that may be awarded under the 2010 Plan is 1,000,000 shares of common stock, of which amount, 777,973 shares remain available for awards as of September 30, 2010.

Table of Contents

The Company did not grant any stock-based compensation awards during the three months ended September 2010 or 2009.

The following table shows stock-based compensation expense by type of share-based award for the three months ended September 30, 2010 and 2009 included in the condensed consolidated statements of operations (in thousands):

	For the Three Months Ended	
	September 30, 2010	September 30, 2009
Fair value expense of stock option awards	\$	\$ (29)
Restricted stock	123	29
Total stock-based compensation	\$ 123	\$

The following table shows the total remaining unrecognized compensation cost related to: restricted stock grants and the fair value expense of stock option awards; as well as the weighted average remaining required service period over which such costs will be recognized as of September 30, 2010:

	Total Remaining Unrecognized Compensation Cost (in thousands)	Weighted Average Remaining Required Service Period (in years)
Fair value expense of stock option awards	\$	
Restricted stock	926	2.47
	\$ 926	2.47

The following is a summary of options outstanding and exercisable at September 30, 2010:

	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (in years)	Aggregate Intrinsic Value (in thousands)
Outstanding at June 30, 2010	269,796	\$ 6.89		
Granted				
Exercised				
Forfeited				
Expired				
Outstanding at September 30, 2010	269,796	\$ 6.89	3.49	\$ 121
Exercisable at September 30, 2010	269,796	\$ 6.89	3.49	\$ 121

The following is a summary of activity for the three months ended September 30, 2010 related to shares granted under the Company's long-term incentive plans:

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		Weighted Average	
	Shares	Grant Date	Fair Value
Restricted shares at June 30, 2010	262,095	\$	4.55
Granted			
Vested			
Forfeited			
Restricted shares at September 30, 2010	262,095	\$	4.55

Table of Contents**(13) Earnings Per Share Data**

Basic earnings per share is based on the weighted average number of common shares and participating securities outstanding during the period. Diluted earnings per share include the dilutive effect of additional potential common shares issuable under our stock-based compensation plan and are determined using the treasury stock method. Unvested restricted stock awards, which contain non-forfeitable rights to dividends whether paid or unpaid, are included in the number of shares outstanding for both basic and diluted earnings per share calculations. In the event of a net loss, unvested restricted stock awards are excluded from the calculation of both basic and diluted loss per share.

Earnings per share calculations, including weighted average number of shares of common stock outstanding used in calculating basic and diluted income per share, for the three months ended September 30, 2010 and 2009 are as follows:

		For the Three Months Ended	
		September 30, 2010	September 30, 2009
Net income (in thousands)		\$ 4,080	\$ 1,405
Weighted average shares outstanding	Basic	10,200,534	9,951,507
Net effect of dilutive stock options		7,083	
Weighted average shares outstanding	Diluted	10,207,617	9,951,507
Net income per share:			
Basic		\$ 0.40	\$ 0.14
Diluted		\$ 0.40	\$ 0.14

For the three months ended September 30, 2010 and 2009, 262,095 and 93,334, respectively, unvested restricted shares were included in determining both basic and diluted earnings per share. Potential shares of common stock excluded from diluted income per share computations because their inclusion would be anti-dilutive were 158,546 and 176,409 for the three months ended September 30, 2010 and 2009, respectively.

(14) Comprehensive Income

Comprehensive income, which includes all changes in the Company's equity during the period except transactions with shareholders, consisted of the following for the three months ended September 30, 2010 and 2009 (in thousands):

		For the Three Months Ended	
		September 30, 2010	September 30, 2009
Net income		\$ 4,080	\$ 1,405
Other comprehensive income	Change in unrecognized pension costs, net of tax	144	
Comprehensive income		\$ 4,224	\$ 1,405

Table of Contents

(15) Restructuring Activities

During fiscal 2009, management initiated a full evaluation of the Company's operations and long-term business strategy. As a result, in the third quarter of fiscal 2009, management began to implement a formal turnaround plan focused on returning Sparton to profitability and the assurance of the Company's viability. These measures were designed to reduce operating costs, increase efficiencies, and improve our competitive position in response to excess capacity, the prevailing economy and the need to optimize manufacturing resources. These restructuring activities included, among other actions, plant consolidation and closures, workforce reductions, customer contract disengagements, and changes in employee pension and health care benefits.

Plant Closures

London, Ontario, Canada On March 30, 2009, Sparton announced the idling and subsequent closing of its London, Ontario, Canada, production facility. The closing was in response to market and economic conditions that had resulted in the facility being underutilized because of significantly decreased customer volumes. Twenty-four salaried and 63 hourly employees were affected, with the employees receiving severance packages consistent with Company policy. Sparton's London facility produced electronic circuit boards. Remaining customer business was transferred to Sparton's Brooksville, Florida facility, and the closure has been completed. In October 2009, the land and building were listed for sale with depreciation on these assets ceasing at that time. In June 2010, the land and building with a net book value of approximately \$0.6 million was sold for approximately \$0.1 million, resulting in a loss on sale of approximately \$0.5 million recorded within Restructuring/impairment charges in the consolidated statement of operations for the three months ended June 30, 2010.

For the fiscal year ended June 30, 2009, approximately \$3.0 million of restructuring charges were recognized in conjunction with this plant closure. For the year ended June 30, 2010, approximately \$0.2 million was recognized, exclusive of the loss on sale of facility discussed above. The Company does not expect to recognize any additional costs related to the Canadian facility closing. All cash expenditures related to this plant closure have been made as of September 30, 2010.

Jackson, Michigan On March 4, 2009, Sparton announced the closing of its Jackson, Michigan manufacturing operations. The closing was in response to the difficult economic and competitive situation in the industries served. The closing affected 39 salaried and 167 hourly employees who received severance packages consistent with Company policy. The Jackson facility had served as both the Company's headquarters and a manufacturing plant. Products manufactured in Jackson were transferred to the Company's production facilities in Brooksville, Florida, and Ho Chi Minh City, Vietnam. Customer orders were not affected by the transfer to other facilities. The closure has been complete, with actual production activities ceasing in August, 2009. Net sales for the Jackson plant were approximately \$2.9 million for the three months ended September 30, 2009. In October 2009, the land and building were listed for sale with depreciation on these assets ceasing at that time. In June 2010, the land and building with a net book value of approximately \$0.3 million was sold for approximately four thousand dollars, resulting in a loss on sale of approximately \$0.3 million recorded within Restructuring/impairment charges in the consolidated statement of operations for the three months ended June 30, 2010.

For the fiscal year ended June 30, 2009, approximately \$2.5 million of restructuring charges were recognized in connection with this plant closure. For the year ended June 30, 2010, approximately \$0.7 million was recognized, exclusive of the loss on sale of facility discussed above. The Company does not expect to recognize any additional costs related to the Jackson facility closing. Expected remaining cash expenditures related to this plant closure of approximately \$0.1 million represent future lease payments and are expected to be paid out by the end of fiscal year 2012.

Albuquerque, New Mexico On June 17, 2008, Sparton announced its commitment to close the Albuquerque, New Mexico facility of Sparton Technology, Inc., a wholly-owned subsidiary of Sparton. The Albuquerque facility primarily produced circuit boards for customers operating in the EMS market. The plant ceased production and closed in October 2008.

Table of Contents

The land and building in Albuquerque is currently being marketed for sale. The majority of other assets and equipment was relocated to other Sparton facilities. The net book value of the land and building to be sold, which as of September 30, 2010 and June 30, 2010, totaled approximately \$3.9 million, reflect facility impairment charges of approximately \$1.1 million and \$0.8 million in fiscal 2010 and 2009, respectively, against the prior carrying amount of the property. The property is reported as held-for-sale on the Company's balance sheet as a current asset. Depreciation on these assets ceased in October 2008.

Reductions in Force

On February 6, 2009, the Company announced a reduction in force. The reduction involved 6% of the approximately 1,000 employees employed at that time and affected employees at all locations other than Strongsville, Ohio and Ho Chi Minh City, Vietnam. Approximately \$0.2 million of severance cost related to this reduction in force was recognized during the three months ended March 31, 2009.

Effective April 1, 2009, the Company further reduced its workforce by an additional 2% at all locations other than Strongsville, Ohio and Ho Chi Minh City, Vietnam. Approximately \$0.1 million of severance cost related to this action was recognized during the three months ended June 30, 2009.

Relocation of Corporate Headquarters

On June 18, 2009, the Company announced the planned relocation of its Jackson, Michigan headquarters to a leased executive office in Schaumburg, Illinois during fiscal 2010. With the closing of the Jackson production facility, as discussed above, the headquarters moved to a smaller, more efficient location. In connection with this relocation, the Company recognized approximately \$1.1 million and \$0.1 million in the years ended June 30, 2010 and 2009, respectively, primarily related to employee relocation expenses. The Company does not expect to recognize any additional costs related to the relocation of its corporate headquarters. All cash expenditures related to this relocation have been made as of September 30, 2010.

Delphi Medical Contract Manufacturing Business Acquisition Related Restructuring

During the first quarter of fiscal 2011, the Company took certain cost reduction actions in relation to its acquisition of certain assets related to the contract manufacturing business of Delphi Medical. These actions included a workforce reduction at the Colorado location and the consolidation of the Colorado manufacturing facilities from two to one. The Company incurred approximately \$0.1 million in relation to these acquisition related restructuring activities in the three months ended September 30, 2010. The Company expects to incur minimal additional costs and has remaining restructuring related cash payments of approximately \$0.1 million to be paid out during the second quarter of fiscal 2011.

Table of Contents**Summary of Restructuring Charges**

The Company does not expect to incur additional costs related to restructuring activities. The table below summarizes the nature and amount of restructuring actions for the year ended June 30, 2010 and the three months ended September 30, 2010 (in thousands):

	Workforce Reduction (principally severance and retention bonuses)	Facility Closing	Lease Terminations	Production Transfer	Total
Accrual balance at June 30, 2009	\$ 375	\$	\$ 1,990	\$	\$ 2,365
Restructuring charges	350	1,188	409		1,947
Less: cash payments	(718)	(1,175)	(2,186)		(4,079)
Restructuring reversals					
Accrual balance at June 30, 2010	\$ 7	\$ 13	\$ 213	\$	\$ 233
Restructuring charges	64	13			77
Less: cash payments	(7)	(23)	(20)		(50)
Restructuring reversals					
Accrual balance at September 30, 2010	\$ 64	\$ 3	\$ 193	\$	\$ 260

During the three months ended September 30, 2009, approximately \$0.2 million of impairment related to property, plant and equipment was recorded. The impairments in this period related to facility closings and are reflected in restructuring/impairment charges for that period.

Given the significance of, and the timing of the execution of such activities, accounting for the expected cost of these actions can involve periodic reassessments of estimates made at the time the original decisions were made. We continually evaluate the adequacy of the remaining liabilities under our restructuring initiatives. Although we believe that these estimates accurately reflect the costs of our restructuring plans, actual results may differ, thereby requiring us to periodically record additional provisions or reverse a portion of such provisions.

Table of Contents

(16) Business Segments

Reportable segments are defined as components of an enterprise about which separate financial information is available that is evaluated regularly by the chief operating decision maker, or group, in assessing performance and allocating resources. The Company operates predominantly in three markets – Medical Device, Electronic Manufacturing Services and Defense & Security Systems.

The Company uses an internal management reporting system, which provides important financial data to evaluate performance and allocate the Company's resources on a segment basis. Net sales are attributed to the segment in which the product is manufactured or service is performed. A segment's performance is evaluated based upon its operating income (loss). A segment's operating income (loss) includes its gross profit on sales less its selling and administrative expenses, including allocations of certain corporate operating expenses, but excludes some corporate and other unallocated items such as, interest expense, interest income, other income (expense) and income tax expense (benefit). Allocations of certain corporate operating expenses are allocated based on the nature of the service provided. Corporate and other unallocated costs primarily represent corporate administrative expenses related to those administrative, financial and human resource activities which are not allocated to operations and excluded from segment profit. These costs are not allocated to the segments, as management excludes such costs when assessing the performance of the segments. Inter-segment transactions are generally accounted for at amounts that approximate arm's length transactions. Identifiable assets by segments are those assets that are used in each segment's operations. The accounting policies for each of the segments are the same as for the Company taken as a whole.

Medical Device (Medical) operations are comprised of contract development, design, production and distribution of complex and sophisticated medical related electromechanical devices for customers with specialized needs, specifically in the design and manufacturing process, to assure product reliability and safety in accordance with Food and Drug Administration (FDA) guidelines and approvals. This group specializes in systems and procedures targeted to the requirements of medical OEM and ET customers primarily in the In Vitro Diagnostic and Therapeutic Device segments of the Medical Device market space.

Electronic Manufacturing Services (EMS) operations are comprised of contract manufacturing, assembly, design, preproduction, prototyping and/or box build assembly for customers supporting the industrial, security sensing, medical, aerospace, defense, energy and telecommunications markets. These assemblies include flight control systems, fuel control systems for aerospace, medical diagnostics systems, security systems, detection systems, lighting and defense. Assemblies provided to this group's customers are state-of-the-art electronics, complex and legacy products (circuit card assemblies) and/or electromechanical assemblies in support of their products. EMS provides to its customers support services that include engineering services, design, material management, obsolescence analysis and management, documentation development, and process improvement. The segment strives to exceed customer's expectations of low cost and delivery performance. The common elements generally shared by EMS customers that produce the aforementioned products is the expectation of compliance to market quality certifications coupled with component cost reduction and continuous process improvements.

Defense & Security Systems (DSS) operations are comprised of design, development and production of products for a number of technologically significant programs aimed at fulfilling defense and commercial needs. Specializing in the development and production of complex electromechanical equipment, Sparton designs and manufactures sonobuoys, an anti-submarine warfare (ASW) device used by the U.S. Navy and foreign governments. This business unit also performs an engineering development function for the United States military and prime defense contractors on advanced technologies targeted as future defense products as well as replacement of current systems. The sonobuoy product line is built to the customer's demanding specifications. These products are ITAR restricted, which limits opportunities for competition.

Table of Contents

Operating results and certain other financial information about the Company's three reportable segments for the three months ended September 30, 2010 and 2009 and as of September 30, 2010 and June 30, 2010 were as follows (in thousands):

For the Three Months Ended September 30, 2010						
	Medical	EMS	DSS	Other Unallocated	Eliminations	Total
Sales	\$ 19,045	\$ 12,328	\$ 17,597	\$	\$ (3,203)	\$ 45,767
Gross profit	\$ 1,867	\$ 907	\$ 4,252	\$	\$	\$ 7,026
Operating income (loss)	\$ 2,797	\$ 97	\$ 3,322	\$ (2,112)	\$	\$ 4,104
Selling and administrative expenses	\$ 1,283	\$ 828	\$ 930	\$ 1,920	\$	\$ 4,961
Restructuring/impairment charges	\$ 77	\$	\$	\$	\$	\$ 77
Gain on sale of property, plant and equipment	\$	\$ (18)	\$	\$	\$	\$ (18)
Gain on acquisition	\$ (2,400)	\$	\$	\$	\$	\$ (2,400)
Depreciation/amortization	\$ 162	\$ 107	\$ 36	\$ 18	\$	\$ 323
Capital expenditures	\$ 2	\$ 268	\$ 178	\$ 28	\$	\$ 476

For the Three Months Ended September 30, 2009						
	Medical	EMS	DSS	Other Unallocated	Eliminations	Total
Sales	\$ 19,556	\$ 17,603	\$ 13,345	\$	\$ (2,400)	\$ 48,104
Gross profit	\$ 2,934	\$ 1,018	\$ 3,420	\$	\$	\$ 7,372
Operating income (loss)	\$ 1,864	\$ (293)	\$ 2,927	\$ (2,889)	\$	\$