SPARTON CORP
Form 10-Q
February 03, 2014
Table of Contents

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

FORM 10-Q

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

For the quarterly period ended December 31, 2013

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 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 ý 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 ý 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 ý
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 ý

As of January 31, 2014, there were 10,124,422 shares of common stock, $1.25 par value per share, outstanding.

TABLE OF CONTENTS

Table of Contents

PART I. FINANCIAL INFORMATION
Item 1. Financial Statements.
SPARTON CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
(UNAUDITED)
(Dollars in thousands, except per share amounts)

	December 31, 2013	June 30, 2013 (a)
Assets		
Current Assets:		
Cash and cash equivalents	$1,009	$6,085
Accounts receivable, net of allowance for doubtful accounts of $107 and $61, respectively	44,806	49,572
Inventories and cost of contracts in progress, net	52,393	46,334
Deferred income taxes	3,054	2,951
Prepaid expenses and other current assets	3,844	1,731
Total current assets	105,106	106,673
Property, plant and equipment, net	28,627	28,904
Goodwill	30,156	14,767
Other intangible assets, net	11,756	10,713
Deferred income taxes — non-current	3,931	4,075
Other non-current assets	2,980	790
Total assets	$182,556	$165,922
Liabilities and Shareholders’ Equity		
Current Liabilities:		
Current portion of long-term debt	$141	$136
Accounts payable	16,885	19,596
Accrued salaries and wages	6,648	6,329
Accrued health benefits	1,586	1,793
Performance based payments on customer contracts	19,111	20,902
Other accrued expenses	7,180	6,733
Total current liabilities	51,551	55,489
Pension liability — non-current portion	275	274
Long-term debt — non-current portion	26,331	11,403
Environmental remediation — non-current portion	2,541	2,684
Total liabilities	80,698	69,850
Commitments and contingencies		
Shareholders’ Equity:		
Preferred stock, no par value; 200,000 shares authorized, none issued	—	—
Common stock, $1.25 par value; 15,000,000 shares authorized, 10,124,422 and 10,095,716 shares issued and outstanding, respectively	12,656	12,619
Capital in excess of par value	18,689	18,751
Retained earnings	71,727	65,957
Accumulated other comprehensive loss	(1,214)	(1,255)
Total shareholders’ equity	101,858	96,072
Total liabilities and shareholders’ equity	$182,556	$165,922

(a) Derived from the Company’s audited financial statements as of June 30, 2013.
See Notes to unaudited condensed consolidated financial statements.

SPARTON CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(UNAUDITED)
(Dollars in thousands, except per share amounts)

	For the Three Months Ended		For the Six Months Ended	
	December 31, 2013	December 31, 2012	December 31, 2013	December 31, 2012
Net sales	$84,562	$67,254	$158,760	$118,055
Cost of goods sold	69,585	55,159	131,589	97,960
Gross profit	14,977	12,095	27,171	20,095
Operating Expense:				
Selling and administrative expenses	8,687	7,375	16,332	12,847
Internal research and development expenses	402	243	791	548
Amortization of intangible assets	636	273	1,234	375
Restructuring charges	—	—	188	—
Other operating expenses	(5)	4	(8)	(6)
Total operating expense, net	9,720	7,895	18,537	13,764
Operating income	5,257	4,200	8,634	6,331
Other income (expense):				
Interest expense	(202)	(173)	(360)	(254)
Interest income	—	23	2	51
Other, net	165	59	337	169
Total other expense, net	(37)	(91)	(21)	(34)
Income before provision for income taxes	5,220	4,109	8,613	6,297
Provision for (benefit from) income taxes	1,736	(732)	2,843	(1)
Net income	$3,484	$4,841	$5,770	$6,298
Income per share of common stock:				
Basic	$0.34	$0.47	$0.57	$0.62
Diluted	$0.34	$0.47	$0.57	$0.62
Weighted average shares of common stock outstanding:				
Basic	10,115,255	10,229,320	10,093,973	10,185,464
Diluted	10,147,518	10,248,424	10,123,542	10,206,913

See Notes to unaudited condensed consolidated financial statements.

SPARTON CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(UNAUDITED)
(Dollars in thousands)

	For the Three Months Ended		For the Six Months Ended	
	December 31, 2013	December 31, 2012	December 31, 2013	December 31, 2012
Net income	$3,484	$4,841	$5,770	$6,298
Other comprehensive income (loss) - Change in unrecognized pension costs, net of tax:				
Amortization of unrecognized net actuarial loss, net of tax benefit of $7 and $30 for the three months ended December 31, 2013 and 2012, respectively, and net of tax benefit of $23 and $34 for the six months ended December 31, 2013 and 2012, respectively	11	51	41	58
Pro rata recognition of lump-sum settlements, net of tax expense of $10 for the three months ended December 31, 2012	—	(15)	—	—
Other comprehensive income, net of tax	11	36	41	58
Comprehensive income	$3,495	$4,877	$5,811	$6,356

Table of Contents

SPARTON CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)
(Dollars in thousands)

	For the Six Months Ended December 31, 2013	December 31, 2012
Cash Flows from Operating Activities:		
Net income	$5,770	$6,298
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization	3,640	1,472
Deferred income tax expense	239	760
Stock-based compensation expense	917	597
Gross profit effect of capitalized profit in inventory from acquisition	108	566
Excess tax benefit of stock-based compensation	(496)	—
Other	44	47
Changes in operating assets and liabilities:		
Accounts receivable	8,097	(4,306)
Inventories and cost of contracts in progress	2,441	(1,845)
Prepaid expenses and other assets	(1,702)	(2,798)
Performance based payments on customer contracts	(1,791)	(6,592)
Accounts payable and accrued expenses	(4,791)	(3,128)
Net cash provided by (used in) operating activities	12,476	(8,929)
Cash Flows from Investing Activities:		
Purchase of Onyx	—	(43,250)
Purchase of certain assets of Creonix	105	—
Purchase of certain assets and liabilities of Aydin Displays, Inc.	(15,000)	—
Purchase of Beckwood	(15,300)	—
Purchases of property, plant and equipment	(1,412)	(1,602)
Change in restricted cash	—	(535)
Proceeds from sale of property, plant and equipment	68	—
Net cash used in investing activities	(31,539)	(45,387)
Cash Flows from Financing Activities:		
Short-term bank borrowings, net	—	14,000
Borrowings of long-term debt	41,000	—
Repayment of long-term debt	(26,071)	(70)
Payment of debt financing costs	—	(408)
Repurchase of stock	(1,559)	(234)
Proceeds from the exercise of stock options	121	144
Excess tax benefit from stock-based compensation	496	—
Net cash provided by financing activities	13,987	13,432
Net decrease in cash and cash equivalents	(5,076)	(40,884)
Cash and cash equivalents at beginning of period	6,085	46,950
Cash and cash equivalents at end of period	$1,009	$6,066
Supplemental disclosure of cash flow information:		
Cash paid for interest	$320	$258

Cash paid for income taxes	$2,963	$1,603
Supplemental disclosure of non-cash investing activities:		
Accounts payable recognized in relation to acquisition purchase consideration adjustments	$393	$2,188

See Notes to unaudited condensed consolidated financial statements.

6

SPARTON CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY
(UNAUDITED)
(Dollars in thousands)

	Six Months Ended December 31, 2013					
	Common Stock		Capital In Excess of Par Value	Retained Earnings	Accumulated Other Comprehensive Loss	Total
	Shares	Amount				
Balance at June 30, 2013	10,095,716	$12,619	$18,751	$65,957	$ (1,255)	$96,072
Issuance of stock	94,811	119	(119)	—	—	—
Forfeiture of restricted stock	(3,344)	(4)	4	—	—	—
Repurchase of stock	(76,880)	(96)	(1,463)	—	—	(1,559)
Exercise of stock options	14,119	18	103	—	—	121
Stock-based compensation	—	—	917	—	—	917
Excess tax benefit from stock-based compensation	—	—	496	—	—	496
Comprehensive income, net of tax				5,770	41	5,811
Balance at December 31, 2013	10,124,422	12,656	18,689	71,727	(1,214)	101,858

	Six Months Ended December 31, 2012					
	Common Stock		Capital In Excess of Par Value	Retained Earnings	Accumulated Other Comprehensive Loss	Total
	Shares	Amount				
Balance at June 30, 2012	10,105,759	$12,632	$19,579	$51,995	$ (1,718)	$82,488
Cumulative impact of change in accounting principle	—	—	—	492	—	492
Balance at June 30, 2012 - as adjusted	10,105,759	12,632	19,579	52,487	(1,718)	82,980
Issuance of stock	159,433	199	(199)	—	—	—
Forfeiture of restricted stock	(39,811)	(50)	50	—	—	—
Repurchase of stock	(20,564)	(25)	(209)	—	—	(234)
Exercise of stock options	24,304	30	114	—	—	144
Stock-based compensation	—	—	597	—	—	597
Comprehensive income, net of tax	—	—	—	6,298	58	6,356
Balance at December 31, 2012	10,229,121	12,786	19,932	58,785	(1,660)	89,843

See Notes to unaudited condensed consolidated financial statements.

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, design and manufacturing engineering, production, distribution, and field service. The Company serves the Medical & Biotechnology, Military & Aerospace and Industrial & Commercial markets through three reportable business segments; Medical Device (“Medical”), Complex Systems (“CS”) and Defense & Security Systems (“DSS”). 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, anti-submarine warfare (“ASW”) devices 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 financial statements 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, 2013, 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 and six months ended December 31, 2013 are not necessarily indicative of the results that may be expected for the full fiscal year 2014.

(2) Change in Accounting Principle
In the first quarter of fiscal 2014, the Company voluntarily changed its revenue recognition policy related to DSS sonobuoy sales to the U.S. Navy and foreign government customers under long-term contracts that require lot acceptance testing. The new policy continues to recognize revenue under the percentage of completion method, but changes the measurement of progress under these contracts from a completed units accepted basis (whereby revenue was recognized for each lot of sonobuoys produced when that lot was formally accepted by the customer) to a units-of-production basis (whereby revenue is recognized when production and internal testing of each lot of sonobuoys is completed). The Company now has significant experience in producing sonobuoys to customer specifications and internal testing to assess compliance with those specifications and, as such, now has an adequate history of continuous customer acceptance of all sonobuoys produced. Accordingly, the Company believes the new method is preferable primarily because it eliminates delays in revenue and related cost of goods sold recognition due to timing of customer testing and acceptance delays. Such delays commonly occur due to customer circumstances that are unrelated to the product produced. Under the new policy, the revenue and related costs of goods sold of these manufactured sonobuoy lots will more closely match the period in which the product was produced and the related revenue earned, thereby better reflecting the economic activity of the DSS segment. Additionally, this new method provides better matching of periodic operating expenses incurred during production.

8

Table of Contents

For the three months ended December 31, 2013, this change in accounting policy decreased DSS and consolidated net sales and gross profit by $2.5 million and $0.7 million, respectively, and basic and diluted income per share each by $0.04. For the six months ended December 31, 2013, this change in accounting policy (decreased) increased DSS and consolidated net sales and gross margin by $(0.3) million and $0.4 million, respectively, and increased basic and diluted income per share each by $0.03. The following tables present the effects of the retrospective application of this voluntary change in accounting principle (Dollars in thousands, except share amounts):

Consolidated Statement of Income Data:

	For the Three Months Ended December 31, 2012		
	As Originally Reported	Adjustment	As Restated
Net Sales	$65,979	$1,275	$67,254
Cost of goods sold	54,571	588	55,159
Gross profit	11,408	687	12,095
Income before provision for income taxes	3,422	687	4,109
Provision for (benefit from) income taxes	(979)	247	(732)
Net income	4,401	440	4,841
Income per share of common stock - Basic	0.43	0.04	0.47
Income per share of common stock - Diluted	0.43	0.04	0.47
Weighted average shares outstanding - Basic	10,229,320		10,229,320
Weighted average shares outstanding - Diluted	10,248,424		10,248,424

Consolidated Statement of Income Data:

	For the Six Months Ended December 31, 2012		
	As Originally Reported	Adjustment	As Restated
Net Sales	$114,999	$3,056	$118,055
Cost of goods sold	96,378	1,582	97,960
Gross profit	18,621	1,474	20,095
Income before provision for income taxes	4,823	1,474	6,297
Provision for (benefit from) income taxes	(531)	530	(1)
Net income	5,354	944	6,298
Income per share of common stock - Basic	0.53	0.09	0.62
Income per share of common stock - Diluted	0.52	0.10	0.62
Weighted average shares outstanding - Basic	10,185,464		10,185,464
Weighted average shares outstanding - Diluted	10,206,913		10,206,913

Consolidated Balance Sheet Data:

	As of June 30, 2013		
	As Originally Reported	Adjustment	As Restated
Inventory	$46,334	$—	$46,334
Deferred income taxes	3,167	(216)	2,951
Performance based payments on customer contracts	21,504	(602)	20,902
Retained earnings	65,571	386	65,957

Table of Contents

(3) Acquisitions

Beckwood Services, Inc. — On December 11, 2013, the Company completed the acquisition of Beckwood Services, Inc. ("Beckwood") in a $15.3 million all-cash transaction, subject to certain post-closing adjustments and financed through the use of cash on hand and borrowings under the Company's Credit Facility. At December 31, 2013, the Company has recorded additional estimated contingent consideration of accounts receivable of less than $0.1 million in relation to a post-closing working capital adjustment, which is expected to be settled in the third quarter of the Company's fiscal 2014 year. The transaction includes an approximate $1.5 million escrowed holdback which is available to fund the working capital adjustment and potential seller indemnification obligations in relation to the acquisition agreement.

The acquired business, which is part of the Company's Complex Systems segment and which is expected to add $18 million in annualized revenue, develops electronic or electro-mechanical controls and electronic assemblies. Their customer profile includes international Fortune 1000 manufacturers of industrial control systems, analytical instruments, measuring and detecting equipment and military, defense and Homeland Security equipment.

The Company is in the process of obtaining valuations of certain tangible and intangible assets and liabilities and expects to complete the purchase price allocation in fiscal year 2014 after these valuations are finalized. The following table represents the preliminary allocation of the total consideration to assets acquired and liabilities assumed in the acquisition of Beckwood based on Sparton's preliminary estimate of their respective fair values (in thousands):

Total purchase consideration:		
Cash	$15,300	
Estimated additional consideration payable for post-closing working capital adjustment	36	
Total purchase consideration	$15,336	
Assets acquired and liabilities assumed:		
Accounts receivable, net	$1,157	
Inventory	2,008	
Deferred income taxes	213	
Other current assets	122	
Property, plant and equipment	110	
Goodwill	13,353	
Deferred income taxes - non-current	7	
Other long-term assets	8	
Accounts payable	(977	)
Other current liabilities	(665	)
Total assets acquired and liabilities assumed	$15,336	

Total purchase consideration has been allocated to the tangible assets acquired and liabilities assumed based on their provisionally estimated fair values at the acquisition date. It is possible that acquired assets may additionally include customer relationships and the Beckwood name. The Company was unable at December 31, 2013 to assign provisionally estimated fair values to these potential assets. The Beckwood acquisition has preliminarily resulted in approximately $13 million of goodwill, which will be adjusted downward or upward based on the final values assigned to all acquired assets and liabilities. The Company believes that any goodwill remaining after the valuations are finalized will primarily relate to strategic fit, resulting synergies and the acquired workforce that this business brings to existing operations. Goodwill associated with this acquisition is not expected to be deductible for tax purposes and has been assigned entirely to the Company's Complex Systems segment.

Included in the Company's Condensed Consolidated Statements of Income for the three and six months ended December 31, 2013 are net sales of approximately $0.8 million and income before provision from income taxes of approximately $0.1 million, resulting from the acquisition of Beckwood since December 11, 2013.

The Company incurred legal, professional and other costs related to this acquisition aggregating approximately $0.1 million. These costs were recognized as selling and administrative expenses in the three months ended December 31, 2013.

Aydin Displays, Inc. — On August 30, 2013, the Company completed the acquisition of certain assets and liabilities of Aydin Displays, Inc. ("Aydin Displays" or “Aydin”) in a $15.0 million all-cash transaction, subject to certain post-closing adjustments and financed through the use of borrowings under the Company's Credit Facility. At December 31, 2013, the Company has recorded additional estimated contingent consideration of accounts receivable of $0.4 million in relation to a post-closing working capital adjustment, which is expected to be settled during the Company's fiscal 2014 year. Additional acquisition consideration of up to $6.6 million is contingent upon Aydin attaining certain performance thresholds during the twelve month period following the transaction. The transaction includes an approximate $1.2 million escrowed holdback which is available to fund the working capital adjustment and potential seller indemnification obligations in relation to the acquisition agreement.

The acquired business, which is part of the Company's DSS segment and which is expected to add $18 million in annualized revenue, develops enhanced flat panel display and touch-screen solutions with application-critical performance criteria including ruggedization, high resolution, color accuracy, response/refresh times, sunlight readability and other criteria such as magnetic interference and emanations security for the Military & Aerospace and Civil Marine markets. These products are currently specified in the U.S. Navy P8A Poseidon ASW aircraft behind-the-cockpit control center, the command and control centers of many U.S. Navy ships, Federal Aviation Administration air traffic control systems, and cockpit command centers for various civil marine applications. The acquired business will continue to operate as Aydin Displays.

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

Total purchase consideration:		
Cash	$15,000	
Estimated additional consideration payable for post-closing working capital adjustment	357	
Total purchase consideration	$15,357	
Assets acquired and liabilities assumed:		
Accounts receivable, net	$2,279	
Inventory	6,601	
Other current assets	895	
Property, plant and equipment	582	
Intangible asset - customer relationships	1,500	
Intangible asset - trade names and trademarks	180	
Intangible asset - unpatented technology	650	
Goodwill	2,036	
Other long-term assets - favorable leasehold	590	
Other long-term assets	1,702	
Accounts payable	(1,215	)
Other current liabilities	(443	)
Total assets acquired and liabilities assumed	$15,357	

Total purchase consideration has been preliminarily allocated to the tangible assets acquired and liabilities assumed based on their provisionally estimated fair values at the acquisition date. Additional acquisition consideration of up to $6.6 million is contingent upon Aydin attaining certain performance thresholds. The Company has assigned no fair value to this contingent liability. The Aydin acquisition has preliminarily resulted in approximately $2 million of goodwill, which is expected to be deductible for tax purposes and has been assigned entirely to the Company’s DSS segment. The Company believes goodwill primarily relates to strategic fit, resulting synergies and the acquired workforce that this business brings to existing operations. The provisional fair values of acquired identifiable assets have been determined to be Level 3 under the fair value hierarchy and have been estimated based on projected future cash flows and customer attrition rates, discounted using an estimated weighted average cost of capital. The customer relationships are being amortized using an accelerated methodology over fifteen years. Trade names and trademarks are being amortized using a straight-line methodology over ten years. The unpatented technology is being amortized using an accelerated methodology over seven years. The favorable leasehold is reflected in other long-term assets on the consolidated balance sheet and is being amortized on a straight-line basis over the five year life of the lease. Amortization related to Aydin unpatented technology and favorable leasehold is reflected within cost of goods sold on the consolidated statement of income.

Included in the Company’s Condensed Consolidated Statements of Income for the three and six months ended December 31, 2013 are net sales of approximately $4.0 million and $5.2 million, respectively, and loss before benefit from income taxes of less than $0.1 million and approximately $0.1 million, respectively, resulting from the acquisition of Aydin since August 30, 2013.

The Company incurred legal, professional and other costs related to this acquisition aggregating approximately $0.0 million and $0.2 million for the three and six months ended December 31, 2013, respectively. These costs were recognized as selling and administrative expenses.

A portion of Aydin's revenue is derived from contracts to manufacture video displays and other related products to a buyer’s specification under long-term contracts. Revenue and profit is recognized under these contracts using the percentage of completion method based on units shipped to estimated total costs at completion. Certain upfront engineering costs in relation to long-term contracts are capitalized and amortized over the life of the contract.

Creonix, LLC — On June 6, 2013, the Company completed the acquisition of certain assets related to the contract manufacturing business of Creonix, LLC (“Creonix”) in a $2.0 million all-cash transaction, after settlement of a $0.1 million working capital adjustment during the second quarter of the Company's fiscal 2014 year. The transaction was financed through the use of borrowings under the Company's credit facility. The transaction includes an approximate $0.3 million escrowed holdback which is available to fund the working capital adjustment and potential seller indemnification obligations in relation to the acquisition agreement.

The acquired business, which is reported in the Company's Complex Systems segment, provides the Company with the capability of cable and wire harness engineering and assembly. Additionally, the acquisition provides further expansion into the Industrial and Military & Aerospace markets, diversifies Sparton's customer base and increases utilization of the Company's existing assets through the expected consolidation of this business into Complex Systems's Brooksville, Florida plant during the first six months of fiscal 2014. Creonix primarily manufactures products and components for battery monitoring, high speed optical imaging, neuromuscular incapacitation, imaging and wiring assemblies for military applications, and electrical grid transformer protection systems.

During the six months ended December 31, 2013, the Company finalized the inventory adjustment under the Creonix asset purchase agreement resulting in a decrease in the previously recorded related receivable from the seller. This measurement period increase in total purchase consideration resulted in the retrospective elimination of the previously recognized gain on acquisition recorded in the fourth quarter of fiscal 2013 of less than $0.1 million and resulting in the recognition of approximately $0.1 million of goodwill. The Company's June 30, 2013 balance sheet has been restated to reflect this adjustment. The following table presents the final allocation of the total consideration to assets acquired and liabilities assumed from Creonix based on Sparton’s estimate of their respective fair values (in thousands):

Total purchase consideration:	
Cash	$2,100
Reduction in cash consideration in relation to working capital adjustment	(105)
Total purchase consideration	$1,995
Assets acquired and liabilities assumed:	
Inventory	$1,321
Equipment	304
Intangible assets — customer relationships	270
Goodwill	100
Total assets acquired and liabilities assumed	$1,995

Table of Contents

Pro Forma Results — The following table summarizes, on a pro forma basis, the combined results of operations of the Company and the acquired businesses of Aydin and Beckwood as though the acquisitions had occurred as of July 1, 2012. The pro forma amounts presented are not necessarily indicative of either the actual consolidated results had the acquisition occurred as of July 1, 2012 or of future consolidated operating results (in thousands, except per share amounts):

	For the Three Months Ended		For the Six Months Ended	
	December 31, 2013	December 31, 2012	December 31, 2013	December 31, 2012
Net sales	$87,662	$76,519	$168,743	$138,059
Income before provision for income taxes	$5,625	$4,800	$9,710	$7,636
Net income	$3,749	$5,391	$6,516	$7,429
Net income per share — basic	$0.37	$0.53	$0.65	$0.73
Net income per share — diluted	$0.37	$0.53	$0.64	$0.73

Pro forma results presented above reflect: (1) incremental depreciation relating to fair value adjustments to property, plant and equipment; (2) amortization adjustments relating to fair value estimates of intangible assets; (3) elimination of Aydin and Beckwood interest expense relating to debt paid off in conjunction with the transaction; and (4) incremental interest expense on assumed indebtedness and amortization of capitalized financing costs incurred in connection with the transactions as though the transactions occurred as of July 1, 2012.

Additionally, acquisition related expenses of approximately $0.3 million recognized as selling and administrative expenses in the six months ended December 31, 2013 are reflected in the pro forma results above as though they were recognized during the six months ended December 31, 2012 and have been removed from the pro forma results for the year ended June 30, 2013. Similarly, the capitalization of approximately $0.3 million of gross profit recognized as part of the purchase accounting for Aydin, of which $0.1 million has been recognized as additional cost of goods sold during the six months ended December 31, 2013, is reflected in the pro forma results above as though it was recognized during fiscal 2013 and has been removed from the pro forma results for the six months ended December 31, 2013.

Pro forma adjustments described above have been tax effected using Sparton's effective rate during the respective periods.

(4) Inventories and Cost of Contracts in Progress

The following are the major classifications of inventory, net of interim billings, at December 31, 2013 and June 30, 2013 (in thousands):

	December 31, 2013	June 30, 2013
Raw materials	$42,344	$43,550
Work in process	15,434	10,170
Finished goods	8,368	7,793
Total inventory and cost of contracts in progress, gross	66,146	61,513
Inventory to which the U.S. government has title due to interim billings	(13,753)	(15,179)
Total inventory and cost of contracts in progress, net	$52,393	$46,334

The Company recorded inventory write-downs of approximately $0.2 million for both of the three and six months ended December 31, 2013. For the three and six months ended December 31, 2012, the Company recorded inventory write-downs of approximately $0.5 million. These charges are included in cost of goods sold for the periods presented.

Table of Contents

(5) Property, Plant and Equipment, Net

Property, plant and equipment, net consists of the following at December 31, 2013 and June 30, 2013 (in thousands):

	December 31, 2013	June 30, 2013
Land and land improvements	$1,429	$1,405
Buildings and building improvements	25,695	24,920
Machinery and equipment	29,035	27,183
Construction in progress	827	767
Total property, plant and equipment	56,986	54,275
Less accumulated depreciation		