

KEY TRONIC CORP  
Form 10-Q  
May 15, 2006  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
**Washington, D.C. 20549**  
**FORM 10-Q**

**☐ QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**  
For the quarterly period ended April 1, 2006

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 0-11559

**KEY TRONIC CORPORATION**

(Exact name of registrant as specified in its charter)

<b>Washington</b> (State or other jurisdiction of Incorporation or organization)	<b>91-0849125</b> (I.R.S. Employer Identification No.)
<b>N. 4424 Sullivan Road, Spokane Valley, Washington</b> (Address of principal executive offices)	<b>99216</b> (Zip Code)
<b>(509) 928-8000</b>	

(Registrant's telephone number, including area code)

N/A

(Former name, former address and former fiscal year, if changed since last report)

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 during the past 90 days. Yes  No

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

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

At May 1, 2006, 9,708,913 shares of common stock, no par value (the only class of common stock), were outstanding.

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\* Items are not applicable

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## PART I: FINANCIAL INFORMATION

**Item 1: Financial Statements**

## KEY TRONIC CORPORATION AND SUBSIDIARIES

## CONSOLIDATED BALANCE SHEETS

(Unaudited)

	April 1, 2006	July 2, 2005
	(in thousands)	
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 1,791	\$ 1,463
Trade receivables, less allowance for doubtful accounts of \$28 and \$60	23,373	24,191
Inventories	30,419	29,712
Other	3,520	3,482
<b>Total current assets</b>	<b>59,103</b>	<b>58,848</b>
Property, plant and equipment - net	10,103	10,011
Other assets:		
Restricted cash	946	1,158
Real estate	1,693	1,693
Other (net of accumulated amortization of \$32 and \$696)	847	426
Goodwill	765	765
<b>Total other assets</b>	<b>4,251</b>	<b>4,042</b>
<b>Total assets</b>	<b>\$ 73,457</b>	<b>\$ 72,901</b>
<b>Liabilities and shareholders' equity</b>		
Current liabilities:		
Accounts payable	\$ 22,001	\$ 25,475
Accrued compensation and vacation	3,687	5,241
Current portion of long-term obligations	689	735
Litigation settlement - short-term		812
Other	3,602	3,579
<b>Total current liabilities</b>	<b>29,979</b>	<b>35,842</b>
Long-term liabilities:		
Revolving loan	11,366	7,412
Other	1,772	2,008
<b>Total long-term liabilities</b>	<b>13,138</b>	<b>9,420</b>
<b>Total liabilities</b>	<b>43,117</b>	<b>45,262</b>

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### Commitments and contingencies (Note 8)

#### Shareholders' equity:

Common stock, no par value - shares authorized 25,000; issued and outstanding 9,709 and 9,694	38,489	38,426
Accumulated deficit	(8,149)	(10,787)
<b>Total shareholders' equity</b>	<b>30,340</b>	<b>27,639</b>
<b>Total liabilities and stockholders' equity</b>	<b>\$ 73,457</b>	<b>\$ 72,901</b>

See accompanying notes to consolidated financial statements.

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## KEY TRONIC CORPORATION AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF EARNINGS

(Unaudited)

	Third Quarters Ended	
	April 1, 2006	April 2, 2005
	(in thousands, except per share amounts)	
Net sales	\$ 45,567	\$ 49,726
Cost of sales	41,590	45,676
<b>Gross profit on sales</b>	<b>3,977</b>	<b>4,050</b>
Operating expenses:		
Research, development and engineering	698	713
Selling	529	556
General and administrative	1,559	1,724
Total operating expenses	2,786	2,993
Operating income	1,191	1,057
Interest expense	224	296
Income before income tax provision	917	761
Income tax benefit		(91)
Net income	\$ 917	\$ 852
Earnings per share - basic	\$ 0.09	\$ 0.09
Weighted average shares outstanding - basic	9,705	9,687
Earnings per share - diluted	\$ 0.09	\$ 0.09
Weighted average shares outstanding - diluted	10,064	9,901

See accompanying notes to consolidated financial statements.

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## KEY TRONIC CORPORATION AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF EARNINGS

(Unaudited)

	Nine Months Ended	
	April 1, 2006	April 2, 2005
	(in thousands, except per share amounts)	
Net sales	\$ 135,177	\$ 149,726
Cost of sales	123,248	138,137
<b>Gross profit on sales</b>	<b>11,929</b>	<b>11,589</b>
Operating expenses:		
Research, development and engineering	2,030	2,126
Selling	1,587	1,578
General and administrative	4,865	5,240
Total operating expenses	8,482	8,944
Operating income	3,447	2,645
Interest expense	810	903
Other income		(13)
Income before income tax provision	2,637	1,755
Income tax provision		147
Net income	\$ 2,637	\$ 1,608
Earnings per share basic:	\$ 0.27	\$ 0.17
Weighted average shares outstanding - basic	9,701	9,682
Earnings per share diluted:	\$ 0.26	\$ 0.16
Weighted average shares outstanding - diluted	10,074	9,922

See accompanying notes to consolidated financial statements.

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## KEY TRONIC CORPORATION AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

	Nine Months Ended	
	April 1, 2006	April 2, 2005
	(in thousands)	
Increase (decrease) in cash and cash equivalents:		
Cash flows from operating activities:		
Net income	\$ 2,637	\$ 1,608
Adjustments to reconcile net income to cash provided by (used in) operating activities:		
Depreciation and amortization	1,351	1,745
Provision for doubtful accounts	20	140
Provision for obsolete inventory	301	215
Provision for warranty	40	233
(Gain) loss on disposal of assets	(15)	38
Stock based compensation expense	37	
Changes in operating assets and liabilities:		
Trade receivables	798	1,472
Inventories	(1,008)	(1,319)
Other assets	(462)	(979)
Accounts payable	(3,474)	(379)
Accrued compensation and vacation	(1,554)	207
Litigation settlement	(812)	(1,120)
Other liabilities	143	2,010
<b>Cash provided by (used in) operating activities</b>	<b>(1,998)</b>	<b>3,871</b>
Cash flows from investing activities:		
Purchase of property and equipment	(1,490)	(686)
Proceeds from sale of property and equipment	57	6
<b>Cash used in investing activities</b>	<b>(1,433)</b>	<b>(680)</b>
Cash flows from financing activities:		
Payment of financing costs	(50)	(60)
Repayment of other liabilities	(384)	(315)
Decrease (increase) in restricted cash	212	(3,316)
Borrowings under revolving credit agreement	155,805	156,299
Repayment of revolving credit agreement	(151,851)	(154,236)
Proceeds from exercise of stock options	27	25
<b>Cash provided by (used in) financing activities</b>	<b>3,759</b>	<b>(1,603)</b>
Net increase in cash and cash equivalents	328	1,588
Cash and cash equivalents, beginning of period	1,463	600
<b>Cash and cash equivalents, end of period</b>	<b>\$ 1,791</b>	<b>\$ 2,188</b>
Supplemental cash flow information:		
Interest payments	\$ 757	\$ 850
Income tax payments, net of refunds	\$ 165	\$ 763



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See accompanying notes to consolidated financial statements.

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KEY TRONIC CORPORATION AND SUBSIDIARIES

NOTES TO FINANCIAL STATEMENTS

(Unaudited)

1. BASIS OF PRESENTATION

The condensed consolidated financial statements included herein have been prepared by Key Tronic Corporation and subsidiaries (the Company) pursuant to the rules and regulations of the Securities and Exchange Commission (SEC). The financial statements reflect all normal and recurring adjustments which in the opinion of management are necessary for a fair presentation of the financial position, results of operations and cash flows for the interim periods presented. The preparation of financial statements in accordance with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. The results of operations for the periods presented are not necessarily indicative of the results to be expected for the full year. The accompanying unaudited condensed consolidated financial statements should be read in conjunction with the financial statements and notes included in the Company's Annual Report on Form 10-K for the fiscal year ended July 2, 2005.

The Company's reporting period is a 52/53 week fiscal year ending on the Saturday closest to June 30. The quarters and nine months ended April 1, 2006 and April 2, 2005 were 13 and 39 week periods, respectively.

2. INVENTORIES

The components of inventories consist of the following:

	April 1, 2006	July 2, 2005
	(in thousands)	
Finished goods	\$ 7,718	\$ 10,932
Work-in-process	2,646	3,414
Raw materials and supplies	22,771	18,531
Reserve for obsolescence	(2,716)	(3,165)
	\$ 30,419	\$ 29,712

3. BORROWING FACILITIES

The Company has entered into a financing agreement with CIT Group/Business Credit, Inc. (CIT) which provides a revolving credit facility up to \$25 million. The revolving loan is secured by the assets of the Company. The interest rate provisions allow for a variable rate based on either the JP Morgan Chase prime rate or LIBOR rate. The agreement specifies four alternative levels of margin to be added to each of these base rates depending on compliance with certain financial covenants. The range of interest on outstanding balances was 7.46% to 8.00% as of April 1, 2006. The increase in rates from fiscal year end is related to increases in published prime and LIBOR rates.

The agreement and subsequent amendments contain financial covenants that relate to total equity, earnings before interest, taxes, depreciation and amortization, and a minimum fixed charge ratio. The Company is in compliance with all loan covenants. The credit facility matures August 22, 2009. As of April 1, 2006, approximately \$6.8 million was available to draw from the revolving line of credit.