

LSI INDUSTRIES INC  
Form 10-K  
September 10, 2014

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**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**WASHINGTON, D.C. 20549**

**FORM 10-K**

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

**FOR THE FISCAL YEAR ENDED JUNE 30, 2014.**

**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 No. 0-13375**

**LSI INDUSTRIES INC.**

(Exact name of Registrant as specified in its charter)

|   |   |                                     |
|---|---|-------------------------------------|
| Ohio<br>(State or other jurisdiction of<br>incorporation or organization) | 10000 Alliance Road<br>Cincinnati, Ohio 45242<br>(Address of principal executive offices) | IRS Employer I.D.<br>No. 31-0888951 |
|---|---|-------------------------------------|

(513) 793-3200  
(Telephone number of principal executive offices)

Securities Registered Pursuant to Section 12(b) of the Act:

| Title of each class         | Name of each exchange on which registered                    |
|-----------------------------|--|
| Common shares, no par value | The NASDAQ Stock Market LLC<br>(NASDAQ Global Select Market) |

Securities Registered Pursuant to Section 12(g) of the Act:  
None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.  
Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act. Yes No

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes No

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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.

Large accelerated filer   Accelerated filer   Non-accelerated filer   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 December 31, 2013, the aggregate market value of the registrant’s common stock held by non-affiliates of the registrant was approximately \$197,167,000 based upon a closing sale price of \$8.67 per share as reported on The NASDAQ Global Select Market.

At August 26, 2014 there were 24,113,030 no par value Common Shares issued and outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Registrant’s Proxy Statement filed with the Commission for its 2014 Annual Meeting of Shareholders are incorporated by reference in Part III, as specified.

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**LSI INDUSTRIES INC.  
2014 FORM 10-K ANNUAL REPORT  
TABLE OF CONTENTS**

|  | Begins<br>on<br>Page |
|--|----------------------|
| <b>PART I</b>  |                      |
| ITEM 1. BUSINESS   | 1                    |
| ITEM 1A. RISK FACTORS  | 7                    |
| ITEM 1B. UNRESOLVED STAFF COMMENTS   | 11                   |
| ITEM 2. PROPERTIES   | 11                   |
| ITEM 3. LEGAL PROCEEDINGS  | 12                   |
| ITEM 4. MINE SAFETY DISCLOSURES  | 12                   |
| <b>PART II</b>   |                      |
| ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES | 12                   |
| ITEM 6. SELECTED FINANCIAL DATA  | 14                   |
| ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS                        | 14                   |
| ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK  | 14                   |
| ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA  | 16                   |
| ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE                         | 16                   |
| ITEM 9A. CONTROLS AND PROCEDURES   | 16                   |
| ITEM 9B. OTHER INFORMATION   | 17                   |
| <b>PART III</b>  |                      |
| ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE  | 17                   |
| ITEM 11. EXECUTIVE COMPENSATION  | 17                   |

|   |    |
|---|----|
| ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS | 17 |
| ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE                      | 17 |
| ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES   | 17 |
| PART IV   |    |
| ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES   | 18 |

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***“Safe Harbor” Statement under the Private Securities Litigation Reform Act of 1995***

*This Form 10-K contains certain forward-looking statements that are subject to numerous assumptions, risks or uncertainties. The Private Securities Litigation Reform Act of 1995 provides a safe harbor for forward-looking statements. Forward-looking statements may be identified by words such as “estimates,” “anticipates,” “projects,” “plans,” “expects,” “intends,” “believes,” “seeks,” “may,” “will,” “should” or the negative versions of those words and similar expressions, and by the context in which they are used. Such statements, whether expressed or implied, are based upon current expectations of the Company and speak only as of the date made. Actual results could differ materially from those contained in or implied by such forward-looking statements as a result of a variety of risks and uncertainties over which the Company may have no control. These risks and uncertainties include, but are not limited to, the impact of competitive products and services, product demand and market acceptance risks, potential costs associated with litigation and regulatory compliance, reliance on key customers, financial difficulties experienced by customers, the cyclical and seasonal nature of our business, the adequacy of reserves and allowances for doubtful accounts, fluctuations in operating results or costs whether as a result of uncertainties inherent in tax and accounting matters or otherwise, unexpected difficulties in integrating acquired businesses, the ability to retain key employees of acquired businesses, the ability to recognize the benefits of an acquisition, including potential synergies and cost savings or the failure of an acquired company to achieve its plans and objectives generally, unfavorable economic and market conditions, the results of asset impairment assessments and the other risk factors that are identified herein. You are cautioned to not place undue reliance on these forward-looking statements. In addition to the factors described in this paragraph, the risk factors identified in our Form 10-K and other filings the Company may make with the SEC constitute risks and uncertainties that may affect the financial performance of the Company and are incorporated herein by reference. The Company does not undertake and hereby disclaims any duty to update or revise any forward-looking statements to reflect subsequent events or circumstances.*

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## **PART I**

### ITEM 1. BUSINESS

#### **Our Company**

We are a leading provider of comprehensive corporate visual image solutions through the combination of extensive digital and screen graphics capabilities, a wide variety of high quality indoor and outdoor lighting products, lighting control systems, and related professional services. We also provide graphics and lighting products and professional services on a stand-alone basis. Our company is the leading provider of corporate visual image solutions to the petroleum / convenience store industry. We use this leadership position to penetrate national retailers and multi-site retailers, including quick service and casual restaurants, retail chain stores and automobile dealerships located primarily in the United States as well as internationally. In addition, we are a provider of digital solid-state LED (light emitting diode) video screens and LED specialty lighting to such markets or industries as sports stadiums and arenas, advertising billboards, and entertainment. We design and develop all aspects of the solid-state LED video screens and lighting, from the electronic circuit board, to the software to drive and control the LEDs, to the structure of the LED product.

We seek to expand our market share in the traditional commercial / industrial lighting market by combining our LED product innovation and lighting control solutions with a strong emphasis on high service levels, U.S. manufactured products and market focused solutions. We offer a complete line of competitively priced energy efficient exterior and interior lighting products. Our solutions are targeted to both energy retrofit and new construction markets.

We believe that national retailers and niche market companies are increasingly seeking single-source suppliers with the project management skills and service expertise necessary to execute a comprehensive visual image program. The integration of our graphics, lighting, technology and professional services capabilities allows our customers to outsource to us the development of an entire visual image program from the planning and design stage through installation. Our approach is to combine standard, high-production lighting products, custom graphics applications and professional services to create complete customer-focused visual image solutions. We also offer products and services on a stand-alone basis to service our existing image solutions customers, to establish a presence in a new market or to create a relationship with a new customer. We believe that our ability to combine graphics and lighting products and professional services into a comprehensive visual image solution differentiates us from our competitors who offer only stand-alone products for lighting or graphics and who lack professional services offerings. During the past several years, we have continued to enhance our ability to provide comprehensive corporate visual image solutions by adding additional graphics capabilities, digital signage and media content management, lighting products, lighting control systems, LED video screens, LED lighting products and professional services through acquisitions and internal development.



Our focus on product development and innovation creates products that are essential components of our customers' corporate visual image strategy. Our spending on research and development was \$8.2 million in fiscal 2014, \$6.5 million in fiscal 2013, and \$5.5 million in fiscal 2012. We develop and manufacture lighting, lighting control systems, graphics and solid-state LED video screen and lighting products and distribute them through an extensive multi-channel distribution network that allows us to effectively service our target markets. Representative customers include BP, Chevron Texaco, 7-Eleven, ExxonMobil, Shell, Burger King, Dairy Queen, Taco Bell, Wendy's, Best Buy, CVS Caremark, JC Penney, Target Stores, Wal-Mart Stores, Chrysler, Ford, General Motors, Nissan, and Toyota. We service our customers at the corporate, franchise and local levels.

Our business is organized as follows: the Lighting Segment, which represented 76% of our fiscal 2014 net sales; the Graphics Segment, which represented 15% of our fiscal 2014 net sales; the Electronic Components Segment, which represented 7% of our fiscal 2014 net sales; and an All Other Category, which represented 2% of our fiscal 2014 net sales. See Note 2 of Notes to Consolidated Financial Statements beginning on page F-28 of this Form 10-K for additional information on business segments. Net sales by segment are as follows (in thousands):

|                               | 2014      | 2013      | 2012      |
|-------------------------------|-----------|-----------|-----------|
| Lighting Segment              | \$227,628 | \$206,363 | \$199,610 |
| Graphics Segment              | 46,166    | 46,770    | 42,131    |
| Electronic Components Segment | 19,491    | 20,333    | 18,515    |
| All Other Category            | 6,178     | 7,324     | 8,146     |
| Total Net Sales               | \$299,463 | \$280,790 | \$268,402 |

### **Lighting Segment**

Our Lighting Segment manufactures and markets outdoor and indoor lighting for the commercial, industrial, niche, and multi-site retail markets, including the petroleum / convenience store, quick-service, and automotive markets. Our products are designed and manufactured to provide maximum value and meet the high-quality, competitively-priced product requirements of our niche markets. We generally avoid specialty or custom-designed, low-volume products for single order opportunities. We do, however, design proprietary products used by our national account customers in large volume, and occasionally also provide custom products for large, specified projects. Our concentration is on our high-volume, standard product lines that meet our customers' needs. By focusing our product offerings, we achieve significant manufacturing and cost efficiencies.

Our lighting fixtures, poles and brackets are produced in a variety of designs, styles and finishes. Important functional variations include types of mounting, such as pole, bracket and surface, and the nature of the light requirement, such as down-lighting, wall-wash lighting, canopy lighting, flood-lighting, area lighting and security lighting. Our engineering staff performs photometric analyses and wind load safety studies for all light fixtures and also designs our fixtures and lighting systems. Our lighting products utilize a wide variety of different light sources, including solid-state LED, high-intensity discharge metal-halide, and fluorescent. The major products and services offered within our lighting segment include: exterior area lighting, interior lighting, canopy lighting, landscape lighting, LED lighting, lighting controls, light poles, lighting analysis, photometric layouts and solid state LED video screens for the sports and advertising markets. All of our products are designed for performance, reliability, ease of installation and service, as well as attractive appearance. The Company also has a focus on designing lighting system solutions and implementing strategies related to energy savings in substantially all markets served.

We offer our customers expertise in developing and utilizing high-performance LED white lightsource solutions for our Lighting and Graphics applications, which, when combined with the Company's lighting fixture expertise and

technology has the potential to result in a broad spectrum of white light LED fixtures that offer equivalent or improved lighting performance with significant energy and maintenance savings as compared to the present metal halide and fluorescent lighting fixtures.

Lighting Segment net sales of \$227,628,000 in fiscal 2014 increased 10.3% from fiscal 2013 net sales of \$206,363,000. The Lighting Segment's net sales of light fixtures having solid-state LED technology totaled \$99.9 million in fiscal 2014, representing a \$28.5 million or 40.0% increase from fiscal 2013 net sales of solid-state LED light fixtures of \$71.4 million. There was a reduction in the Company's traditional lighting sales (metal halide and fluorescent light sources) from fiscal 2013 to fiscal 2014 as customers converted from traditional lighting to light fixtures having solid-state LED technology. The Lighting Segment's net sales related to LED video screens totaled \$5.0 million in fiscal 2014, representing a \$1.0 million or 16.6% decrease from fiscal 2013 net sales of \$6.0 million.

Lighting Segment net sales of \$206,363,000 in fiscal 2013 increased 3.4% from fiscal 2012 net sales of \$199,610,000. The Lighting Segment's net sales of light fixtures having solid-state LED technology totaled \$71.4 million in fiscal 2013, representing a \$2.6 million or 3.7% increase from fiscal 2012 net sales of solid-state LED light fixtures of \$68.9 million. The Lighting Segment's net sales related to LED video screens totaled \$6.0 million in fiscal 2013, representing a \$4.1 million or 220% increase from fiscal 2012 net sales of \$1.9 million.

### **Graphics Segment**

The Graphics Segment manufactures and sells exterior and interior visual image elements related to graphics. These products are used in graphics displays and visual image programs in several markets, including the petroleum / convenience store market and multi-site retail operations. Our extensive lighting and graphics expertise, product offering, visual image solution implementation capabilities and other professional services represent significant competitive advantages. We work with corporations and design firms to establish and implement cost effective corporate visual image programs. Increasingly, we have become the primary supplier of exterior and interior graphics for our customers. We also offer installation management services for those customers who require the installation of interior or exterior products (utilizing pre-qualified independent subcontractors throughout the United States).

Our business can be significantly impacted by participation in a customer's "image conversion program," especially if it were to involve a "roll out" of that new image to a significant number of that customer's and its franchisees' retail sites. The impact to our business can be very positive with growth in net sales and profitability when we are engaged in an image conversion program. This can be followed in subsequent periods by lesser amounts of business or negative comparisons following completion of an image conversion program, unless we are successful in replacing that completed business with participation in new image conversion programs of similar size with one or more customers. An image conversion program can potentially involve any or all of the following improvements, changes or refurbishments at a customer's retail site: interior or exterior lighting (see discussion above about our lighting segment), interior or exterior store signage and graphics, and installation of these products in both the prototype and roll out phases of their program. We believe many of our retail customers, over the past several years, have delayed their normal cycle of image refresh or conversions, and therefore will choose to implement changes in the near future to maintain a safe, fresh or new image on their site in order to maintain or grow their market share.

The major products and services offered within our Graphics Segment include the following: signage and canopy graphics, pump dispenser graphics, building fascia graphics, decals, interior signage and marketing graphics, aisle markers, wall mural graphics, fleet graphics, prototype program graphics, digital signage and media content management, and installation services for graphics products.

Graphics Segment net sales of \$46,166,000 in fiscal 2014 decreased 1.3% from fiscal 2013 net sales of \$46,770,000. The \$0.6 million decrease in Graphics Segment net sales is primarily the net result of image conversion programs and sales to several petroleum / convenience store customers (\$9.7 million net increase), two grocery retailers (\$10.2 million decrease), two national drug store retailers (\$2.4 million increase), two quick-service restaurant chains (\$1.6 million increase), several retail chains (\$1.9 million decrease), one banking customer (\$0.8 million increase), and changes in volume or completion of several other smaller graphics programs in various markets (\$3.0 million decrease). The Graphics Segment net sales of graphic identification products that contain solid-state LED light sources and LED lighting for signage totaled \$2.4 million in fiscal 2014, representing a \$1.1 million increase from fiscal 2013 net sales of \$1.3 million.

Graphics Segment net sales of \$46,770,000 in fiscal 2013 increased 11.0% from fiscal 2012 net sales of \$42,131,000. The \$4.6 million increase in Graphics Segment net sales is primarily the net result of image conversion programs and sales to several petroleum / convenience store customers (\$0.9 million net decrease), two grocery retailers (\$6.7 million increase), two national drug store retailers (\$2.5 million decrease), two quick-service restaurant chains (\$1.5 million decrease), several retail chains (\$1.7 million increases) and changes in volume or completion of several other smaller graphics programs (\$1.1 million increase). The Graphics Segment net sales of graphic identification products that contain solid-state LED light sources and LED lighting for signage totaled \$1.3 million in fiscal 2013 compared to \$1.0 million in fiscal 2012.



### **Electronic Components Segment**

The Electronic Components Segment includes the results of LSI ADL Technology and LSI Controls (formerly LSI Virticus). ADL Technology operates in Columbus, Ohio and designs, engineers and manufactures custom designed electronic circuit boards, assemblies and sub-assemblies used in various applications including the control of solid-state LED lighting. The Company acquired AdL Technology in fiscal 2010 as a vertical integration of circuit boards for LED lighting as well as the Company's other LED product lines such as digital scoreboards, advertising ribbons and billboards. LSI ADL Technology allows the Company to stay on the leading edge of product development, while at the same time providing opportunities to drive down manufacturing costs and control delivery of key components. In addition to its intercompany support, LSI ADL Technology serves a variety of external customers in various markets outside the Company's traditional lighting markets. LSI Controls, acquired by the Company in March 2012, operates in Beaverton, Oregon and designs, engineers and assembles wireless, internet-based lighting control systems in addition to basic lighting controls.

Electronic Components Segment net sales of \$19,491,000 in fiscal 2014 decreased 4.1% from fiscal 2013 net sales of \$20,333,000. The \$0.8 million decrease in Electronic Components Segment net sales is primarily the net result of a \$0.3 million decrease in sales to the telecommunications market, a \$0.4 million increase in sales to the transportation market, a \$0.2 million decrease in sales to original equipment manufacturers, a \$0.2 million increase in sales to the medical markets, and a \$0.7 million increase in sales to various other markets. In addition to the Segment's decrease in customer sales, its inter-segment sales increased 29.0% due to increased intercompany demand of LED circuit board assemblies used in light fixtures having solid-state LED technology.

Electronic Components Segment net sales of \$20,333,000 in fiscal 2013 increased 9.8% from fiscal 2012 net sales of \$18,515,000. The \$1.8 million increase in Electronic Components Segment net sales is primarily the net result of a \$0.5 million decrease in sales to the telecommunications market, a \$1.5 million increase in sales to the transportation market, a \$0.1 million decrease in sales to original equipment manufacturers, a \$0.3 million decrease in sales to the medical markets, and a \$1.3 million increase in sales to various other markets. In addition to the Segment's increase in customer sales, its inter-segment sales increased 20.5% due to increased intercompany demand of LED circuit board assemblies used in light fixtures having solid-state LED technology.

### **All Other Category**

The All Other Category includes the results of all LSI operations that are not able to be aggregated into one of the three reportable business segments. Operating results of LSI Saco Technologies, LSI Images, and LSI Adapt are included in the All Other Category. The major products and services offered by operations included in the All Other Category include: design, production, and support of large format video screens using LED technology; exterior and interior menu board systems primarily for the quick service restaurant market; and surveying, permitting and project management services related to products of the Lighting and Graphics Segment. LSI Saco Technologies primarily

provides research and development support to the Lighting and Graphics Segments. LSI Saco Technologies also offers its customers expertise in developing and utilizing high-performance LED color and white light source solutions for both lighting and graphics applications. This technology developed by LSI Saco has been applied in the Company's Lighting Segment in a broad spectrum of white light LED fixtures that offer equivalent or improved lighting performance with significant energy and maintenance savings as compared to the traditional metal halide and fluorescent lighting fixtures. Additionally, this LED technology is used in the Company's Graphics Segment to light, accent and provide color lighting to graphics display and visual image programs of the Company's retail, quick service restaurant and sports market customers.

All Other Category net sales of \$6,178,000 in fiscal 2014 decreased \$1.1 million or 15.7% from fiscal 2013 net sales of \$7,324,000. The \$1.1 million decrease in the All Other Category net sales is primarily the net result of net decreased sales of menu board systems (\$1.8 million), increased project management net sales (\$0.2 million), and increased net sales of LED video screen and specialty LED lighting sales to the Entertainment and other markets (\$0.4 million). Inter-segment sales increased 3.4% mostly due to LSI Adapt providing increased intercompany project management support.

All Other Category net sales of \$7,324,000 in fiscal 2013 decreased \$0.8 million or 10.1% from fiscal 2012 net sales of \$8,146,000. The \$0.8 million decrease in the All Other Category net sales is primarily the net result of net increased sales of menu board systems (\$0.2 million), decreased project management net sales (\$0.2 million), and decreased net sales of LED video screen and specialty LED lighting sales to the Entertainment and other markets (\$0.8 million). Inter-segment sales increased 15.6% primarily as a result of LSI Adapt providing increased intercompany project management support.

### **Goodwill and Intangible Asset Impairment**

In fiscal 2014, there was no impairment of the Company's goodwill and indefinite-lived intangible assets. We recorded a non-cash \$805,000 full impairment of two definite-lived intangible assets in one of the reporting units in the Electronic Components Segment due to a decline in estimated discounted cash flows.

In fiscal 2013, we recorded a \$2,413,000, non-cash full goodwill impairment charge in one of the reporting units in the Electronic Components Segment due to a decline in estimated discounted cash flows. There was no impairment of the Company's definite or indefinite-lived intangible assets.

### **Our Competitive Strengths**

*Single Source Comprehensive Visual Image Solution Provider.* We believe that we are the only company serving our target markets that combines significant graphics capabilities, lighting products and installation implementation capabilities to create comprehensive image solutions. We believe that our position as a single-source provider creates a competitive advantage over competitors who can only address either the lighting or the graphics component of a customer's corporate visual image program. Using our broad visual image solutions capabilities, our customers can maintain complete control over the creation of their visual image programs while avoiding the added complexity of coordinating separate lighting and graphics suppliers and service providers. We can use high technology software to produce computer-generated virtual prototypes of a customer's new or improved retail site image. We believe that these capabilities are unique to our target markets and they allow our customers to make educated, cost-effective decisions quickly.

*Proven Ability to Penetrate Target Markets.* We have grown our business by establishing a leadership position in the majority of our target markets as defined by our revenues, including petroleum / convenience stores, automobile dealerships and specialty retailers. Although our relationship with our customers may begin with the need for a single product or service, we leverage our broad product and service offering to identify additional products and solutions. We combine existing graphics, lighting and image element offerings, develop products and add services to create comprehensive solutions for our customers.

*Product Development Focus.* We believe that our ability to successfully identify, patent and develop new products has allowed us to expand our market opportunity and enhance our market position. Our product development initiatives are designed to increase the value of our product offering by addressing the needs of our customers and target markets through innovative retrofit enhancements to existing products or the development of new products. In addition, we believe our product development process creates value for our customers by producing products that offer energy efficiency, low maintenance requirements and long-term operating performance at competitive prices based upon the



latest technologies available.

*Development of Innovative and Patentable Solid State Lighting Technology.* We have developed an expanding portfolio of technology patents related to the design of LED based products which are used to establish performance based product leadership in the markets we serve.

*Strong Relationships with our Customers.* We have used our innovative products and high-quality services to develop close, long-standing relationships with a large number of our customers. Many of our customers are recognized among the leaders in their respective markets, including customers such as BP, 7-Eleven, Chevron, CVS Caremark and Burger King. Their use of our products and services raises the visibility of our capabilities and facilitates the acceptance of our products and services in their markets. Within each of these markets, our ability to be a single source provider of image solutions often creates repeat business opportunities through corporate reimaging programs. We have served some of our customers since our inception in 1976.

*Well-capitalized Balance Sheet.* As part of our long-term operating strategy, we believe the Company maintains a conservative capital structure. With a strong equity base, we are able to preserve operating flexibility in times of industry expansion and contraction. In the current business environment, a strong balance sheet demonstrates financial viability to our existing and targeted customers. In addition, a strong balance sheet enables us to continue important R&D and capital spending.

*Aggressive Use of Our Lighting Product Education Center Capabilities.* Our Lighting Product Education Center and i-Zone marketing center capabilities provide us with a distinct competitive advantage to demonstrate the effectiveness of integrating graphics and lighting into a complete corporate visual image program. Our technologically advanced Lighting Product Education Center, which demonstrate the depth and breadth of our product and service offerings, have become an effective component of our sales process.

*Maintain our Vertically Integrated Business Model.* We consider our company to be a vertically integrated manufacturer rather than a product assembler. We focus on developing unique customer-oriented products, solutions and technology, and outsource certain non-core processes and product components as necessary.

### **Sales, Marketing and Customers**

Our lighting products (including lighting controls and excluding LED video screens) are sold primarily throughout the United States, but also in Canada, Australia, Latin America, Europe and the Middle East (about 6.5% of total net sales are outside the United States) using a combination of regional sales managers and independent sales representatives exclusively serving either the commercial/industrial or niche markets. Although in some cases we sell directly to national firms, more frequently we are designated as a preferred vendor for product sales to customer-owned as well as franchised, licensed and dealer operations. Our graphics products, which are program-driven, LED video screens, electronic components, and other products and services sold by operations in the All Other Category are sold primarily through our own sales force. Our marketing approach and means of distribution vary by product line and by type of market.

Sales are developed by contacts with national retail marketers, branded product companies, franchise and dealer operations. In addition, sales are also achieved through recommendations from local architects, engineers, petroleum and electrical distributors and contractors. Our sales are partially seasonal as installation of outdoor lighting and graphic systems in the northern states decreases during the winter months.

Our Lighting Product Education Center and i-Zone marketing center capabilities are important parts of our sales process. The Lighting Product Education Center, unique within the lighting and graphics industry, is a facility that can produce a computer-generated virtual prototype of a customer's facility on a large screen through the combination of high technology software and audio/visual presentation. The i-Zone marketing center is a digitally controlled facility containing a large solid-state LED video screen and several displays that showcase our LED technology and LED products. With these capabilities, our customers can instantly explore a wide variety of lighting and graphics alternatives to develop consistent day and nighttime images. These centers give our customers more options, greater control, and more effective time utilization in the development of lighting, graphics and visual image solutions, all with much less expense than traditional prototyping. In addition to being cost and time effective for our customers, we believe that our Lighting Product Education Center and i-Zone marketing center capabilities result in the best solution for our customers' needs.

The Image and i-Zone marketing centers also contain comprehensive indoor and outdoor product display areas that allow our customers to see many of our products and services in one setting. This aids our customers in making quick and effective lighting and graphic design decisions through hands-on product demonstrations and side-by-side comparisons. More importantly, these capabilities allow us to expand our customer's interest from just a single product into other products and solutions. We believe that our Lighting Product Education Center and i-Zone marketing center

capabilities have further enhanced our position as a highly qualified outsourcing partner capable of guiding a customer through image alternatives utilizing our lighting and graphics products and services. We believe this capability distinguishes us from our competitors and will become increasingly beneficial in attracting additional customers.

### **Manufacturing and Operations**

We design, engineer and manufacture substantially all of our lighting and graphics products, in the United States, through a vertically integrated business model. By emphasizing high-volume production of standard product lines, we achieve significant manufacturing efficiencies. When appropriate, we utilize alliances with vendors to outsource certain products and assemblies. LED products and related software are engineered, designed and final-assembled by the Company, while a portion of the manufacturing has been performed by select qualified vendors. We are not dependent on any one supplier for any of our component parts.

The principal raw materials and purchased components used in the manufacturing of our products are steel, aluminum, wire harnesses, sockets, lamps, certain fixture housings, acrylic and glass lenses, lighting ballasts, inks, various graphics substrates such as decal material and vinyls, LEDs and electronic components. We source these materials and components from a variety of suppliers. Although an interruption of these supplies and components could disrupt our operations, we believe generally that alternative sources of supply exist and could be readily arranged. We strive to reduce price volatility in our purchases of raw materials and components through quarterly or annual contracts with certain of our suppliers. Our Lighting operations generally carry a certain level of sub-assemblies in inventory and relatively small amounts of finished goods inventory, except for certain products that are stocked to meet quick delivery requirements. Most often, lighting products are made to order and shipped shortly after they are manufactured. Our Graphics operations manufacture custom graphics products for customers who frequently require us to stock certain amounts of finished goods in exchange for their commitment to that inventory. In some Graphics programs, customers also give us a cash advance for the inventory that we stock for them. The Company's operations dealing with LED products generally carry LED and LED component inventory due to longer lead times, or the possibility of worldwide shortages of electronic components. LED products are generally made to order and shipped shortly after assembly is complete. Customers purchasing LED video screens routinely give us cash advances for large projects prior to shipment. Our Electronic Components operations purchase electronic components from multiple suppliers and manufacture custom electronic circuit boards and lighting control systems. Most products are made to order and, as a result, these operations do not carry very many finished goods.

We believe we are a low-cost producer for our types of products, and as such, are in a position to promote our product lines with substantial marketing and sales activities.

We currently operate out of eleven manufacturing facilities and two sales facilities in eight U.S. states and Canada.

Our manufacturing operations are subject to various federal, state and local regulatory requirements relating to environmental protection and occupational health and safety. We do not expect to incur material capital expenditures with regard to these matters and believe our facilities are in compliance with such regulations.

### **Competition**

We experience strong competition in all segments of our business, and in all markets served by our product lines. Although we have many competitors, some of which have greater financial and other resources, we do not compete with the same companies across our entire product and service offerings. We believe product quality and performance, price, customer service, prompt delivery, and reputation to be important competitive factors. We also have several product and process patents which have been obtained in the normal course of business which provide a competitive advantage in the marketplace.

### **Additional Information**

Our sales are partially seasonal as installation of outdoor lighting and graphic systems in the northern states lessens during the harshest winter months. We had a backlog of orders, which we believe to be firm, of \$34.0 million and \$42.4 million at June 30, 2014 and 2013, respectively. All orders are believed to be shippable or installed within twelve months. The higher amount as of June 30, 2013 relates primarily to an increase of orders in our Lighting and Graphics Segments and to improved on-time delivery as of June 30, 2014.

We have approximately 1,277 full-time employees and 340 agency employees as of June 30, 2014. We offer a comprehensive compensation and benefit program to most employees, including competitive wages, a discretionary bonus plan, a profit-sharing plan and retirement plan, and a 401(k) savings plan (for U.S. employees), a non-qualified deferred compensation plan (for certain employees), an equity compensation plan, and medical and dental insurance.

We file reports with the Securities and Exchange Commission (“SEC”) on Forms 10-K, 10-Q and 8-K. You may read and copy any materials filed with the SEC at its public reference room at 100 F. Street, N.E., Room 1580, Washington, D.C. 20549. You may also obtain that information by calling the SEC at 1-800-SEC-0330. The SEC maintains an internet website that contains reports, proxy and information statements and other information regarding us. The address of that site is <http://www.sec.gov>. Our internet address is <http://www.lsi-industries.com>. We make available free of charge through our internet website our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and any amendments to those reports filed or furnished pursuant to Section 13(a) of the Securities Exchange Act of 1934 as soon as reasonably practical after we electronically file them with the SEC. LSI is not including the other information contained on its website as part of or incorporating it by reference into this Annual Report on Form 10-K.

LSI Industries Inc. is an Ohio corporation, incorporated in 1976.

#### ITEM 1A. RISK FACTORS

In addition to the other information set forth in this report, you should carefully consider the following factors which could materially affect our business, financial condition, cash flows or future results. Any one of these factors could cause the Company’s actual results to vary materially from recent results or from anticipated future results. The risks described below are not the only risks facing our Company. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition and/or operating results.

**The markets in which we operate are subject to competitive pressures that could affect selling prices, and therefore could adversely affect our operating results.**

Our businesses operate in markets that are highly competitive, and we compete on the basis of price, quality, service and/or brand name across the industries and markets served. Some of our competitors for certain products, primarily in the Lighting Segment, have greater sales, assets and financial resources than we have. Some of our competitors are based in foreign countries and have cost structures and prices in foreign currencies. Accordingly, currency fluctuations could cause our U.S. dollar-priced products to be less competitive than our competitors' products which are priced in other currencies. Competitive pressures could affect prices we charge our customers or demand for our products, which could adversely affect our operating results. Additionally, customers for our products are attempting to reduce the number of vendors from which they purchase in order to reduce the size and diversity of their inventories and their transaction costs. To remain competitive, we will need to invest continuously in research and development, manufacturing, marketing, customer service and support, and our distribution networks. We may not have sufficient resources to continue to make such investments and we may be unable to maintain our competitive position.

**Lower levels of economic activity in our end markets could adversely affect our operating results.**

Our businesses operate in several market segments including commercial, industrial, retail, petroleum / convenience store and entertainment. Operating results can be negatively impacted by volatility in these markets. Future downturns in any of the markets we serve could adversely affect our overall sales and profitability.

**Our operating results may be adversely affected by unfavorable economic, political and market conditions.**

Economic and political conditions worldwide have from time to time contributed to slowdowns in our industry at large, as well as to the specific segments and markets in which we operate. When combined with ongoing customer consolidation activity and periodic manufacturing and inventory initiatives, an uncertain macro-economic and political climate, including but not limited to the effects of possible weakness in domestic and foreign financial and credit markets, could lead to reduced demand from our customers and increased price competition for our products, increased risk of excess and obsolete inventories and uncollectible receivables, and higher overhead costs as a percentage of revenue. If the markets in which we participate experience further economic downturns, as well as a slow recovery period, this could negatively impact our sales and revenue generation, margins and operating expenses, and consequently have a material adverse effect on our business, financial condition and results of operations.

**Price increases or significant shortages of raw materials and components could adversely affect our operating margin.**

The Company purchases large quantities of raw materials and components — mainly steel, aluminum, light bulbs and fluorescent tubes, lighting ballasts, sockets, wire harnesses, plastic lenses, glass lenses, vinyls, inks, LEDs, electronic components and corrugated cartons. Materials comprise the largest component of costs, representing approximately

61% and 60% of the cost of sales in 2014 and 2013, respectively. While we have multiple sources of supply for each of our major requirements, significant shortages could disrupt the supply of raw materials. Further increases in the price of these raw materials and components could further increase the Company's operating costs and materially adversely affect margins. Although the Company attempts to pass along increased costs in the form of price increases to customers, the Company may be unsuccessful in doing so for competitive reasons. Even when price increases are successful, the timing of such price increases may lag significantly behind the incurrence of higher costs. On occasion, there are selected electronic component parts and certain other parts shortages in the market place, some of which have affected the Company's manufacturing operations and shipment schedules even though multiple suppliers may be available. The lead times of these suppliers can increase and the prices of some of these parts have increased during periods of shortages. Fluorescent tubes and other light bulbs contain rare earth minerals, which have become more expensive and in short supply throughout the world, thereby affecting the Company's supply and cost of these light sources.

**We have a concentration of net sales to the petroleum / convenience store market, and any substantial change in this market could have an adverse affect on our business.**

Approximately 30% of our net sales in fiscal year 2014 are concentrated in the petroleum / convenience store market. Sales to this market segment are dependent upon the general conditions prevailing in and the profitability of the petroleum and convenience store industries and general market conditions. Our petroleum market business is subject to reactions by the petroleum industry to world political events, particularly those in the Middle East, and to the price and supply of oil. Major disruptions in the petroleum industry generally result in a curtailment of retail marketing efforts, including expansion and refurbishing of retail outlets, by the petroleum industry and adversely affect our business. Any substantial change in purchasing decisions by one or more of our largest customers, whether due to actions by our competitors, customer financial constraints, industry factors or otherwise, could have an adverse effect on our business.

**Difficulties with integrating acquisitions could adversely affect operating costs and expected benefits from those acquisitions.**

We have pursued and may continue to seek potential acquisitions to complement and expand our existing businesses, increase our revenues and profitability, and expand our markets. We cannot be certain that we will be able to identify, acquire or profitably manage additional companies or successfully integrate such additional companies without substantial costs, delays or other problems. Also, companies acquired recently and in the future may not achieve revenues, profitability or cash flows that justify our investment in them. We expect to spend significant time and effort in expanding our existing businesses and identifying, completing and integrating acquisitions. We expect to face competition for acquisition candidates which may limit the number of acquisition opportunities available to us, possibly leading to a decrease in the rate of growth of our revenues and profitability, and may result in higher acquisition prices. The success of these acquisitions we do make will depend on our ability to integrate these businesses into our operations. We may encounter difficulties in integrating acquisitions into our operations, retaining key employees of acquired companies and in managing strategic investments. Therefore, we may not realize the degree or timing of the benefits anticipated when we first enter into a transaction.

**If acquisitions are made in the future and goodwill and intangible assets are recorded on the balance sheet, circumstances could arise in which the goodwill and intangible assets could become impaired and therefore would be written off.**

We have pursued and will continue to seek potential acquisitions to complement and expand our existing businesses, increase our revenues and profitability, and expand our markets through acquisitions. As a result of acquisitions, we have significant goodwill and intangible assets recorded on our balance sheet. We will continue to evaluate the recoverability of the carrying amount of our goodwill and intangible assets on an ongoing basis, and we may incur substantial non-cash impairment charges, which would adversely affect our financial results. There can be no assurance that the outcome of such reviews in the future will not result in substantial impairment charges. Impairment assessment inherently involves judgment as to assumptions about expected future cash flows and the impact of market conditions on those assumptions. Future events and changing market conditions may impact our assumptions as to prices, costs, holding periods or other factors that may result in changes in our estimates of future cash flows. Although we believe the assumptions we used in testing for impairment are reasonable, significant changes in any one of our assumptions could produce a significantly different result. If there were to be a decline in our market capitalization and a decline in estimated forecasted discounted cash flows, there could be an impairment of the goodwill and intangible assets. A non-cash impairment charge could be material to the earnings of the reporting period in which it is recorded.

**If we do not develop the appropriate new products or if customers do not accept new products, we could experience a loss of competitive position which could adversely affect future revenues.**



The Company is committed to product innovation on a timely basis to meet customer demands. Development of new products for targeted markets requires the Company to develop or otherwise leverage leading technologies in a cost-effective and timely manner. Failure to meet these changing demands could result in a loss of competitive position and seriously impact future revenues. Products or technologies developed by others may render the Company's products or technologies obsolete or noncompetitive. A fundamental shift in technologies in key product markets could have a material adverse effect on the Company's operating results and competitive position within the industry. More specifically, the development of new or enhanced products is a complex and uncertain process requiring the anticipation of technological and market trends. Rapidly changing product technologies could adversely impact operating results due to potential technological obsolescence of certain inventories or increased warranty expense related to newly developed LED lighting products. We may experience design, manufacturing, marketing or other difficulties, such as an inability to attract a sufficient number of experienced engineers that could delay or prevent our development, introduction or marketing of new products or enhancements and result in unexpected expenses. Such difficulties could cause us to lose business from our customers and could adversely affect our competitive position. In addition, added expenses could decrease the profitability associated with those products that do not gain market acceptance.

**Our business is cyclical and seasonal, and in downward economic cycles our operating profits and cash flows could be adversely affected.**

Historically, sales of our products have been subject to cyclical variations caused by changes in general economic conditions. Our revenues in our third quarter ending March 31 are also affected by the impact of weather on construction and installation programs and the annual budget cycles of major customers. The demand for our products reflects the capital investment decisions of our customers, which depend upon the general economic conditions of the markets that our customers serve, including, particularly, the petroleum and convenience store industries. During periods of expansion in construction and industrial activity, we generally have benefited from increased demand for our products. Conversely, downward economic cycles in these industries result in reductions in sales and pricing of our products, which may reduce our profits and cash flow. During economic downturns, customers also tend to delay purchases of new products. The cyclical and seasonal nature of our business could at times adversely affect our liquidity and financial results.

**A loss of key personnel or inability to attract qualified personnel could have an adverse affect on our operating results.**

The Company's future success depends on the ability to attract and retain highly skilled technical, managerial, marketing and finance personnel, and, to a significant extent, upon the efforts and abilities of senior management. The Company's management philosophy of cost-control results in a very lean workforce. Future success of the Company will depend on, among other factors, the ability to attract and retain other qualified personnel, particularly management, research and development engineers and technical sales professionals. The loss of the services of any key employees or the failure to attract or retain other qualified personnel could have a material adverse effect on the Company's results of operations.

**The costs of litigation and compliance with environmental regulations, if significantly increased, could have an adverse affect on our operating profits.**

We are, and may in the future be, a party to any number of legal proceedings and claims, including those involving patent litigation, product liability, employment matters, and environmental matters, which could be significant. Given the inherent uncertainty of litigation, we can offer no assurance that existing litigation or a future adverse development will not have a material adverse impact. We are also subject to various laws and regulations relating to environmental protection and the discharge of materials into the environment, and it could potentially be possible we could incur substantial costs as a result of the noncompliance with or liability for clean up or other costs or damages under environmental laws.

**New regulations related to conflict minerals could adversely impact our business.**

The Dodd-Frank Wall Street Reform and Consumer Protection Act contains provisions to improve transparency and accountability concerning the supply of certain minerals, known as conflict minerals, originating from the Democratic Republic of Congo (DRC) and adjoining countries. As a result, in August 2012 the SEC adopted annual disclosure and reporting requirements for those companies who use conflict minerals mined from the DRC and adjoining countries in their products. These new requirements required due diligence efforts in calendar 2013, and initial disclosure requirements in May 2014. We incurred certain costs associated with complying with these disclosure requirements, including for diligence to determine the sources of conflict minerals used in our products. Ongoing compliance with these rules could adversely affect the sourcing, supply and pricing of materials used in our products. As there may be only a limited number of suppliers offering “conflict free” conflict minerals, we cannot be sure that we will be able to obtain necessary conflict minerals from such suppliers in sufficient quantities or at competitive prices. Also, we may face reputational challenges if we determine that certain of our products contain minerals are not conflict free or if we are unable to sufficiently verify the origins for all conflict minerals used in our products through the procedures we have already implemented or may implement.

**The turnover of commissioned sales representatives could cause a significant disruption in sales volume.**

Commissioned sales representatives are critical to generating business in the Lighting Segment. From time to time, commissioned sales representatives representing a particular region are terminated and replaced with new commissioned sales representatives. During this period of transition from the previous agency to the new one, sales in the particular region will likely fall as business is disrupted. It may take several months for the new sales representative to generate sales that will equal or exceed the previous sales representative. There is also the risk that the new sales agency will not attain the sales volume of the previous agency. These sales representative changes may occur individually as one agency is replaced due to lack of performance. On the other hand, these sales representative changes can be widespread as a result of the competitive nature of the lighting industry as LSI and its competition vie for the strongest sales agency in a particular region.

**Changes in a customer's demands and commitment to proprietary inventory could result in significant inventory write-offs.**

Upgrading or replacing a customer's current image requires the manufacture of inventory that is specific to the particular customer. This is particularly true in the Graphics Segment. In as many instances as possible, we require a commitment from the customer before the inventory is produced. Our request for a commitment can range from a single site or store to a large roll-out program involving many sites or stores. The risk does exist that a customer cannot or will not honor its commitment to us. The reasons a customer cannot or will not honor its commitment can range from the bankruptcy of the customer, to the change in the image during the roll-out program, to canceling the program before its completion and before the inventory is sold to the customer. In each of these instances, we could be left with significant amounts of inventory required to support the customer's re-imaging. While all efforts are made to hold the customer accountable for its commitment, there is the risk that a significant amount of inventory could be deemed obsolete and no longer usable which could result in significant inventory write-offs.

**If we are unable to adequately protect our intellectual property, we may lose some of our competitive advantage.**

Our success is determined in part by our ability to obtain United States and foreign patent protection for our technology and to preserve our trade secrets. Our ability to compete and the ability of our business to grow could suffer if our intellectual property rights are not adequately protected. There can be no assurance that our patent applications will result in patents being issued or that current or additional patents will afford protection against competitors. We rely on a combination of patents, copyrights, trademarks and trade secret protection and contractual rights to establish and protect our intellectual property. Failure of our patents, copyrights, trademarks and trade secret protection, non-disclosure agreements and other measures to provide protection of our technology and our intellectual property rights could enable our competitors to more effectively compete with us and have an adverse effect on our business, financial condition and results of operations. In addition, our trade secrets and proprietary know-how may otherwise become known or be independently discovered by others. No guarantee can be given that others will not independently develop substantially equivalent proprietary information or techniques, or otherwise gain access to our proprietary technology.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

The Company has fourteen facilities:

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| Description  | Size  | Location                          | Status               |
|--|---|-----------------------------------|----------------------|
| 1) LSI Industries Corporate Headquarters and lighting fixture manufacturing                                | 243,000 sq. ft. (includes 66,000 sq. ft. of office space) | Cincinnati, OH                    | Owned                |
| 2) LSI Industries pole manufacturing and dry powder-coat painting  | 122,000 sq. ft.   | Cincinnati, OH                    | Owned                |
| 3) LSI Metal Fabrication and LSI Images manufacturing and dry powder-coat painting                         | 98,000 sq. ft. (includes 5,000 sq. ft. of office space)   | Independence, KY                  | Owned                |
| 4) LSI Integrated Graphics office; screen printing manufacturing; and architectural graphics manufacturing | 141,000 sq. ft. (includes 34,000 sq. ft. of office space) | Houston, TX                       | Leased               |
| 5) LSI Industries sales and engineering office   | 9,000 sq. ft. (includes 3,000 sq. ft. of office space)    | Dallas, TX                        | Leased               |
| 6) Grady McCauley office and manufacturing   | 210,000 sq. ft. (includes 20,000 sq. ft. of office space) | North Canton, OH                  | Owned                |
| 7) LSI MidWest Lighting office and manufacturing   | 137,000 sq. ft. (includes 6,000 sq. ft. of office space)  | Kansas City, KS                   | Owned                |
| 8) LSI Retail Graphics office and manufacturing  | 33,000 sq. ft. (includes 5,000 sq. ft. of office space)   | Woonsocket, RI                    | Owned                |
| 9) LSI Lightron office and manufacturing   | 170,000 sq. ft. (includes 10,000 sq. ft. of office space) | New Windsor, NY                   | Owned and Leased (a) |
| 10) LSI Adapt offices  | 2,000 sq. ft.   | North Canton, OH<br>Pineville, NC | Owned<br>Leased      |
| 11) LSI Saco Technologies office and manufacturing   | 13,000 sq. ft. (includes 4,000 sq. ft. of office space)   | Montreal, Canada                  | Leased               |
| 12) LSI ADL Technology office and manufacturing  | 57,000 sq. ft. (includes 5,000 sq. ft. of office space)   | Columbus, OH                      | Owned                |

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|  |   |               |        |
|--|---|---------------|--------|
| 13) LSI Controls office and manufacturing/assembly | 11,000 sq. ft. (includes<br>5,000 sq.<br>ft. of office space) | Beaverton, OR | Leased |
|--|---|---------------|--------|

(a) The land at this facility is leased and the building is owned.

*The Company considers these facilities (total of 1,246,600 square feet) adequate for its current level of operations.*

ITEM 3. LEGAL PROCEEDINGS

Nothing to report.

ITEM 4. MINE SAFETY DISCLOSURES

None.

**PART II**

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Common share information appears in Note 15 — SUMMARY OF QUARTERLY RESULTS (UNAUDITED) under (a) “Range of share prices” beginning on page F-43 of this Form 10-K. Information related to “Earnings (loss) per share” and “Cash dividends paid per share” appears in SELECTED FINANCIAL DATA on page F-44 of this Form 10-K. LSI's shares of common stock are traded on the NASDAQ Global Select Market under the symbol “LYTS.”

The Company's policy with respect to dividends is to pay a quarterly cash dividend representing a payout ratio of between 50% and 70% of the then current fiscal year net income forecast. Accordingly, the Board of Directors established an annual cash dividend rate of \$0.24 per share beginning with the first quarter of fiscal 2014 consistent with the above dividend policy. The Company has paid annual cash dividends beginning in fiscal 1987 through fiscal 1994, and quarterly cash dividends since fiscal 1995. The Company's indicated annual rate for payment of a cash dividend for fiscal 2015 has yet to be determined and is currently under evaluation.

At August 26, 2014, there were 522 shareholders of record. The Company believes this represents approximately 3,000 beneficial shareholders.

The Company does not purchase into treasury its own common shares for general purposes. However, the Company does purchase its own common shares, through a Rabbi Trust, as investments of employees/participants of the LSI Industries Inc. Non-Qualified Deferred Compensation Plan. Purchases of Company common shares for this Plan in the fourth quarter of fiscal 2014 were as follows:

ISSUER PURCHASES OF EQUITY SECURITIES

| Period            | (a) Total<br>Number<br>of<br>Shares<br>Purchased | (b) Average<br>Price<br>Paid<br>per<br>Share | (c) Total<br>Number of<br>Shares<br>Purchased<br>as<br>Part of<br>Publicly<br>Announced<br>Plans or<br>Programs | (d) Maximum<br>Number<br>(or<br>Approximate<br>Dollar<br>Value) of<br>Shares that<br>May Yet Be<br>Purchased<br>Under the<br>Plans or<br>Programs |
|-------------------|--|--|---|---|
| 4/1/14 to 4/30/14 | 611  | \$ 8.16                                      | 611   | (1 )  |
| 5/1/14 to 5/31/14 | 946  | \$ 7.93                                      | 946   | (1 )  |
| 6/1/14 to 6/30/14 | 647  | \$ 7.80                                      | 647   | (1 )  |
| Total             | 2,204  | \$ 8.00                                      | 2,204   | (1 )  |

(1) All acquisitions of shares reflected above have been made in connection with the Company's Non-Qualified Deferred Compensation Plan, which does not contemplate a limit on shares to be acquired.



The following graph compares the cumulative total shareholder return on the Company's common shares during the five fiscal years ended June 30, 2014 with a cumulative total return on the NASDAQ Stock Market Index (U.S. companies) and the Dow Jones Electrical Equipment Index. The comparison assumes \$100 was invested June 30, 2009 in the Company's Common Shares and in each of the indexes presented; it also assumes reinvestment of dividends.

*The stock price performance included in this graph is not necessarily indicative of future stock price performance.*

#### ITEM 6. SELECTED FINANCIAL DATA

“Selected Financial Data” begins on page F-44 of this Form 10-K.

#### ITEM 7. MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

“Management’s Discussion and Analysis of Financial Condition and Results of Operations” appears on pages F-1 through F-15 of this Form 10-K.

#### ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company is exposed to market risk from changes in variable interest rates, changes in prices of raw materials and component parts, and changes in foreign currency translation rates. Each of these risks is discussed below.

##### **Interest Rate Risk**

The Company earns interest income on its cash, cash equivalents, and short-term investments (if any) and pays interest expense on its debt (if any). Because of variable interest rates, the Company is exposed to the risk of interest rate fluctuations, which impact interest income, interest expense, and cash flows. With the current balance in the Company’s short-term cash investments and absence of any outstanding variable rate debt, the adverse exposure to interest rate fluctuations has decreased considerably.

All of the Company's \$35,000,000 available lines of credit are subject to interest rate fluctuations, should the Company borrow certain amounts on these lines of credit. Additionally, the Company expects to generate cash from its operations that will subsequently be used to pay down as much of the debt (if any is outstanding) as possible or invest cash in short-term investments (if no debt is outstanding), while still funding the growth of the Company.

### **Raw Material Price Risk**

The Company purchases large quantities of raw materials and components, mainly steel, aluminum, light bulbs, fluorescent tubes, lighting ballasts, sockets, wire harnesses, plastic lenses, glass lenses, vinyls, inks, LEDs, electronic components, and corrugated cartons. The Company's operating results could be affected by the availability and price fluctuations of these materials. The Company uses multiple suppliers, has alternate suppliers for most materials, and has no significant dependence on any single supplier. Other than the possibility of industry-wide electronic component supply shortages and the potential shortage in rare earth minerals used in fluorescent lamps, the Company has not experienced any significant supply problems in recent years. Supply shortages of certain electronic components and certain other parts in fiscal 2012 and fiscal 2013 along with shortages in die cast light housings in the fiscal 2014 have caused some production and shipment delays. The Company has dealt with these issues and is currently not experiencing such delays. Price risk for these materials is related to increases in commodity items that affect all users of the materials, including the Company's competitors. For the fiscal year ended June 30, 2014, the raw material component of cost of goods sold subject to price risk was approximately \$143 million. The Company does not actively hedge or use derivative instruments to manage its risk in this area. The Company does, however, seek new vendors, negotiate with existing vendors, and at times commit to minimum volume levels to mitigate price increases. The Company negotiates supply agreements with certain vendors to lock in prices over a negotiated period of time. On occasion, the Company's Lighting Segment has announced price increases with customers in order to offset raw material price increases. In fiscal 2014, the company did initiate a 3% to 5% price increase, effective in February 2014. While competitors of the Company's lighting business have announced similar price increases, the lighting market remains very price competitive. The Company's Graphics Segment generally establishes new sales prices, reflective of the then current raw material prices, for each custom graphics program as it begins.

### **Foreign Currency Translation Risk**

As a result of the operation of a subsidiary in Montreal, Canada, the Company is exposed to fluctuations in foreign currency exchange rates in the operation of its Canadian business. However, a substantial amount of this business is conducted in U.S. Dollars, therefore, any potential risk is deemed immaterial. Additionally, the financial transactions and financial statements of this subsidiary are recorded in U.S. Dollars.



ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

Index to Financial Statements

|   | Begins<br>on<br>Page |
|---|----------------------|
| Financial Statements:   |                      |
| Management’s Report on Internal Control Over Financial Reporting                                  | F-16                 |
| Report of Independent Registered Public Accounting Firm   | F-17                 |
| Report of Independent Registered Public Accounting Firm   | F-18                 |
| Consolidated Statements of Operations for the years ended June 30, 2014, 2013, and 2012           | F-19                 |
| Consolidated Balance Sheets at June 30, 2014 and 2013   | F-20                 |
| Consolidated Statements of Shareholders’ Equity for the years ended June 30, 2014, 2013, and 2012 | F-22                 |
| Consolidated Statements of Cash Flows for the years ended June 30, 2014, 2013, and 2012           | F-23                 |
| Notes to Consolidated Financial Statements  | F-24                 |
| Financial Statement Schedules:  |                      |
| II — Valuation and Qualifying Accounts for the years ended June 30, 2014, 2013, and 2012          | F-45                 |

Schedules other than those listed above are omitted for the reason(s) that they are either not applicable or not required or because the information required is contained in the financial statements or notes thereto. Selected quarterly financial data is found in Note 15 of the accompanying consolidated financial statements.

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

ITEM 9A. CONTROLS AND PROCEDURES

Disclosure Controls and Procedures

The Company maintains disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934 as amended (the "Exchange Act")) that are designed to ensure that information required to be disclosed in the Company's reports under the Exchange Act, is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to management, including the Company's Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. The Company periodically reviews the design and effectiveness of its disclosure controls and internal control over financial reporting. The Company makes modifications to improve the design and effectiveness of its disclosure controls and internal control structure, and may take other corrective action, if its reviews identify a need for such modifications or actions. The Company's disclosure controls and procedures are designed to provide reasonable assurance of achieving their objectives.

As of the end of the period covered by this Form 10-K, an evaluation was completed under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, regarding the design and effectiveness of our disclosure controls and procedures. Based on this evaluation, our management, including our principal executive officer and principal financial officer, has concluded that our disclosure controls and procedures were effective as of June 30, 2014.

Changes in Internal Control

There were no changes in the Company's internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the fiscal quarter ended June 30, 2014, that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting. See Management's Report on Internal Control Over Financial Reporting on page F-16.

ITEM 9B. OTHER INFORMATION

None.

**PART III**

ITEMS 10, 11, 12, 13 and 14 of Part III are incorporated by reference to the LSI Industries Inc. Proxy Statement for its Annual Meeting of Shareholders to be held November 20, 2014, as filed with the Commission pursuant to Regulation 14A.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED SHAREHOLDER MATTERS

The description of equity compensation plans required by Regulation S-K, Item 201(d) is incorporated by reference to the LSI Industries Inc. Proxy Statement for its Annual Meeting of Shareholders to be held November 20, 2014, as filed with the Commission pursuant to Regulation 14A.

The following table presents information about the Company's equity compensation plans (LSI Industries Inc. 2003 Equity Compensation Plan and the 2012 Stock Incentive Plan) as of June 30, 2014.

|     |   |
|-----|---|
| (a) | (c)<br>Number of securities remaining available |
|-----|---|

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| Plan category  | Number of securities to be issued upon exercise of outstanding options, warrants and rights | (b) Weighted average exercise price of outstanding options, warrants and rights | for future issuance under equity compensation plans (excluding securities reflected in column (a)) |
|--|---|---|--|
| Equity compensation plans approved by security holders     | 2,677,464   | \$ 9.57   | 686,831  |
| Equity compensation plans not approved by security holders | —   | —   | —  |
| Total  | 2,677,464   | \$ 9.57   | 686,831  |

- 17 -

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**PART IV**

ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

(a) The following documents are filed as part of this report:

(1) Consolidated Financial Statements

Appear as part of Item 8 of this Form 10-K.

(2) Exhibits — Exhibits set forth below are either on file with the Securities and Exchange Commission and are incorporated by reference as exhibits hereto, or are filed with this Form 10-K.

| Exhibit<br>No. | Exhibit Description  |
|----------------|--|
| 3.1            | Articles of Incorporation of LSI (incorporated by reference to Exhibit 3.1 to LSI's Form S-3 Registration Statement File No. 33-65043).  |
| 3.2            | Amended Article Fourth of LSI's Amended and Restated Articles of Incorporation (incorporated by reference to Exhibit 3.1 to LSI's Form 8-K filed November 19, 2009).                           |
| 3.3            | Amended and Restated Code of Regulations of LSI (incorporated by reference to Exhibit 3 to LSI's Form 8-K filed January 22, 2009).   |
| 4.1            | Form of Senior Indenture (incorporated by reference to Exhibit 4.3 to LSI's Form S-3 Registration Statement File No. 333-169266 filed on September 8, 2010).                                   |
| 4.2            | Form of Subordinated Indenture (incorporated by reference to Exhibit 4.4 to LSI's Form S-3 Registration Statement File No. 333-169266 filed on September 8, 2010).                             |
| 10.1           | Amended and Restated Loan Agreement between LSI Industries Inc. and PNC Bank, National Association (\$30 million; June 19, 2014)   |
| 10.2           | Loan Agreement between LSI Saco Technologies Inc. and PNC Bank Canada Branch (\$5 million; June 19, 2014)  |
| 10.9 *         | LSI Industries Inc. Retirement Plan (Amended and Restated as of July 1, 2012) (incorporated by reference to Exhibit 10.9 to LSI's Form 10-K filed September 6, 2012).                          |
| 10.10*         | LSI Industries Inc. 1995 Directors' Stock Option Plan (Amended as of December 6, 2001) (incorporated by reference to Exhibit 10 to LSI's Form S-8 Registration Statement File No. 333-100038). |

- 10.11\* LSI Industries Inc. 1995 Stock Option Plan (Amended as of December 6, 2001) (incorporated by reference to Exhibit 10 to LSI's Form S-8 Registration Statement File No. 333-100039).
- 10.12\* LSI Industries Inc. 2003 Equity Compensation Plan (Amended and Restated through November 19, 2009) (incorporated by reference to Exhibit 10.1 to LSI's Form 8-K filed November 19, 2009).
- 10.13\* Amended and Restated 2012 Stock Incentive Plan as of August 21, 2013 (incorporated by reference to Exhibit 10.1 to LSI's Form 8-K filed August 26, 2013).
- 10.14\* Trust Agreement Establishing the Rabbi Trust Agreement by and between LSI Industries Inc. and Prudential Bank & Trust, FSB (incorporated by reference to Exhibit 10.1 to LSI's Form 8-K filed January 5, 2006).
- 10.15\* LSI Industries Inc. Nonqualified Deferred Compensation Plan (Amended and Restated as of November 18, 2010) (incorporated by reference to Exhibit 10.1 to LSI's Form 8-K filed November 24, 2010).
- 10.16\* Amended Agreement dated January 25, 2005 with Robert J. Ready (incorporated by reference to Exhibit 10.1 to LSI's Form 8-K filed January 27, 2005).

- 10.17\* Amended Agreement dated January 25, 2005 with James P. Sferra (incorporated by reference to Exhibit 10.2 to LSI's Form 8-K filed January 27, 2005).
- 10.18\* Corporate Officer 2014 Incentive Plan (incorporated by reference to Exhibit 10.1 to LSI's Form 8-K filed August 26, 2013).
- 10.19\* Change of Control Policy (incorporated by reference to Exhibit 10.1 to LSI's Form 8-K filed October 3, 2011).
- 14 Code of Ethics (incorporated by reference to Exhibit 14 to LSI's Form 10-K for the fiscal year ended June 30, 2004).
- 21 Subsidiaries of the Registrant
- 23.1 Consent of Independent Registered Public Accounting Firm (Grant Thornton LLP)
- 24 Power of Attorney (included as part of signature page)
- 31.1 Certification of Principal Executive Officer required by Rule 13a-14(a)
- 31.2 Certification of Principal Financial Officer required by Rule 13a-14(a)
- 32.1 18 U.S.C. Section 1350 Certification of Principal Executive Officer
- 32.2 18 U.S.C. Section 1350 Certification of Principal Financial Officer
  
- 101.INS XBRL Instance Document
- 101.SCH XBRL Taxonomy Extension Schema
- 101.CAL XBRL Taxonomy Extension Calculation Linkbase
- 101.LAB XBRL Taxonomy Extension Label Linkbase
- 101.PRE XBRL Taxonomy Extension Presentation Linkbase
- 101.DEF XBRL Taxonomy Extension Definition Document

\* Management Compensatory Agreements

LSI will provide shareholders with any exhibit upon the payment of a specified reasonable fee, which fee shall be limited to LSI's reasonable expenses in furnishing such exhibit. The exhibits identified herein as being filed with the SEC have been so filed with the SEC but may not be included in this version of the Annual Report to Shareholders.



**SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

LSI INDUSTRIES INC.

September 10, 2014 BY: /s/ Robert J. Ready

Date Robert J. Ready  
Chairman of the Board and Chief Executive Officer

We, the undersigned directors and officers of LSI Industries Inc. hereby severally constitute Robert J. Ready and Ronald S. Stowell, and each of them singly, our true and lawful attorneys with full power to them and each of them to sign for us, in our names in the capacities indicated below, any and all amendments to this Annual Report on Form 10-K filed with the Securities and Exchange Commission.

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

| Signature  | Title  |
|--|--|
| /s/ Robert J. Ready  | Chairman of the Board and Chief Executive Officer      |
| Robert J. Ready<br>Date: September 10, 2014                        | (Principal Executive Officer)                          |
| /s/ Ronald S. Stowell  | Vice President, Chief Financial Officer, and Treasurer |
| Ronald S. Stowell<br>Date: September 10, 2014                      | (Principal Financial and Accounting Officer)           |
| /s/ Robert P. Beech<br>Robert P. Beech<br>Date: September 10, 2014 | Director   |

/s/ Gary P. Kreider

Director

Gary P. Kreider

Date: September 10, 2014

Director

Dennis B. Meyer

Date: September 10, 2014

/s/ Wilfred T. O’Gara

Director

Wilfred T. O’Gara

Date: September 10, 2014

/s/ Mark A. Serriane

Director

Mark A. Serriane

Date: September 10, 2014

/s/ James P. Sferra

Executive Vice President

James P. Sferra

— Manufacturing, Secretary, and Director

Date: September 10, 2014

## MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The Company's "forward looking statements" and disclosures as presented earlier in this Form 10-K in the "Safe Harbor" Statement, as well as the Company's consolidated financial statements and accompanying notes presented later in this Form 10-K should be referred to when reading Management's Discussion and Analysis of Financial Condition and Results of Operations.

### Net Sales by Business Segment

| <i>(In thousands)</i>         | <b>2014</b>      | 2013      | 2012      |
|-------------------------------|------------------|-----------|-----------|
| Lighting Segment              | <b>\$227,628</b> | \$206,363 | \$199,610 |
| Graphics Segment              | <b>46,166</b>    | 46,770    | 42,131    |
| Electronic Components Segment | <b>19,491</b>    | 20,333    | 18,515    |
| All Other Category            | <b>6,178</b>     | 7,324     | 8,146     |
| Total Net Sales               | <b>\$299,463</b> | \$280,790 | \$268,402 |

### Operating Income (Loss) by Business Segment

| <i>(In thousands)</i>         | <b>2014</b>    | 2013     | 2012     |
|-------------------------------|----------------|----------|----------|
| Lighting Segment              | <b>\$9,788</b> | \$10,092 | \$11,828 |
| Graphics Segment              | <b>(2,802)</b> | (1,253 ) | (1,938 ) |
| Electronic Components Segment | <b>2,369</b>   | (916 )   | 3,634    |
| All Other Category            | <b>(138 )</b>  | (1,451 ) | (1,114 ) |
| Corporate and Eliminations    | <b>(6,899)</b> | (5,842 ) | (6,079 ) |
| Total Operating Income        | <b>\$2,318</b> | \$630    | \$6,331  |

### Summary Comments

Fiscal 2014 net sales of \$299,463,000 increased \$18.7 million or 6.7% as compared to fiscal 2013. Net sales were favorably influenced by increased net sales of the Lighting Segment (up \$21.3 million or 10.3%). Net sales were unfavorably influenced by net sales of the Graphics Segment (down \$0.6 million or 1.3%), the Electronic Components Segment (down \$0.8 million or 4.1%) and the All Other Category (down \$1.1 million or 15.6%).

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Fiscal 2014 operating income of \$2,318,000 increased 268% from operating income of \$630,000 in fiscal 2013. The \$1.7 million increase in operating income was the net result of increased net sales, an increase in gross profit as a percentage of net sales from 21.5% in fiscal 2013 to 21.8% in fiscal 2014, a \$1.2 million provision for a reserve against inventory deemed technologically obsolete and no longer useable at our Canadian operation in fiscal 2013 with no comparable expense in fiscal 2014, an increase in selling and administrative expenses primarily due to an increase in sales commissions and an increase in research and development expenses, an increase in warranty expense, a reduction of the contingent earn-out liability related to the Virticus acquisition (\$0.9 million as further discussed in Note 13) in fiscal 2013 with no comparable reduction of expense in fiscal 2014, and a goodwill impairment expense of \$2.4 million in fiscal 2013 with no comparable expense in fiscal 2014 partially offset by an intangible asset impairment expense of \$0.8 million in fiscal 2014 with no comparable expense in fiscal 2013.

The Company recorded intangible asset impairment expense in the Electronic Components Segment in fiscal 2014 totaling \$805,000. The Company recorded goodwill impairment expense in fiscal 2013 totaling \$2,413,000 in the Electronic Components Segment and in fiscal 2012 totaling \$258,000 in the Graphics Segment. There was no goodwill impairment expense in fiscal 2014 and there was no intangible asset impairment expense in fiscal 2013 or 2012.

The Company recorded acquisition-related and other professional fees expenses in fiscal 2012, totaling \$610,000 (\$25,000 of inventory adjustments related to acquisition fair value accounting on the opening balance sheet of LSI Controls (formerly LSI Virticus) and \$585,000 of acquisition transaction costs and related expenses for the acquisition of LSI Controls). There were no such similar significant expenses in fiscal 2014 and 2013. See also the section below on Non-GAAP Financial Measures.



The Company's total net sales related to solid-state LED technology in light fixtures and video screens for sports, advertising and entertainment markets have been recorded as indicated in the table below. In addition, the Company sells certain elements of graphic identification programs that contain solid-state LED light sources.

| LED Net Sales         |           |          |                  |          |                  |    |
|-----------------------|-----------|----------|------------------|----------|------------------|----|
| <i>(In thousands)</i> | FY 2014   | FY 2013  | % change         |          | % change         |    |
|                       |           |          | (FY 14 vs FY 13) | FY 2012  | (FY 13 vs FY 12) |    |
| First Quarter         | \$25,293  | \$23,809 | 6.2              | % 15,842 | 50.3             | %  |
| Second Quarter        | 27,466    | 18,724   | 46.7             | % 20,471 | (8.5)            | )% |
| First Half            | 52,759    | 42,533   | 24.0             | % 36,313 | 17.1             | %  |
| Third Quarter         | 25,452    | 18,794   | 35.4             | % 17,285 | 8.7              | %  |
| Nine Months           | 78,211    | 61,327   | 27.5             | % 53,598 | 14.4             | %  |
| Fourth Quarter        | 30,210    | 18,305   | 65.0             | % 19,802 | (7.6)            | )% |
| Full Year             | \$108,421 | \$79,632 | 36.2             | % 73,400 | 8.5              | %  |

LED net sales include sales of LED lighting products, certain graphics products containing LEDs, and LED video and sports screens. Fiscal 2014 LED net sales of \$108,421,000 were up \$28.8 million or 36.2% from the same period of the prior year. The \$108,421,000 total LED net sales and the \$28.8 million increase are primarily the result of Lighting Segment LED net sales of \$104.9 million (up \$27.5 million or 35.5%), which is comprised of \$99.9 million of light fixtures having solid-state LED technology and \$5.0 million related to video screens, Graphics Segment LED net sales of \$2.4 million (up \$1.1 million or 89.5%), and All Other Category LED net sales of \$1.1 million (up \$0.2 million or 19.3%).

Fiscal 2013 net sales of \$280,790,000 increased \$12.4 million or 4.6% as compared to fiscal 2012. Net sales were favorably influenced by increased net sales of the Lighting Segment (up \$6.8 million or 3.4%), the Graphics Segment (up \$4.6 million or 11.0%), and the Electronic Components Segment (up \$1.8 million or 9.8%). Net sales were unfavorably influenced by the All Other Category (down \$0.8 million or 10.1%).

Fiscal 2013 operating income of \$630,000 decreased 90% from operating income of \$6,331,000 in fiscal 2012. The \$5.7 million decrease in operating income was the net result of increased net sales, a decrease in gross profit as a percentage of net sales from 22.5% in fiscal 2012 to 21.5% in fiscal 2013, a \$1.2 million provision for a reserve against inventory deemed technologically obsolete and no longer useable at our Canadian operation in fiscal 2013 with no comparable expense in fiscal 2012, an increase in selling and administrative expenses primarily due to the net effect of increase in sales commissions, an increase in benefit and compensation expense, a reduction of the contingent earn-out liability related to the Virticus acquisition (\$0.9 million as further discussed in Note 13) in fiscal

2013 with no comparable reduction of expense in fiscal 2012, and an increase in goodwill impairment expense of \$2.2 million.

### **Non-GAAP Financial Measures**

The Company believes it is appropriate to evaluate its performance after making adjustments to net income (loss) for the 2014, 2013 and 2012 fiscal years reported in conformity with accounting principals generally accepted in the United States of America (U.S. GAAP). Adjusted net income and earnings per share, which exclude the impact of the LSI Virticus acquisition transaction costs and related expenses, goodwill and intangible asset impairments, the reversal of the contingent Earn-Out liability, and the adjustment of the New York State tax code change are non-GAAP financial measures. We believe that these adjusted supplemental measures are useful in assessing the operating performance of our business. These supplemental measures are used by our management, including our chief operating decision maker, to evaluate business results. We exclude these items because they are not representative of the ongoing results of operations of our business. Below is a reconciliation of this non-GAAP measure to net income for the periods indicated.

| <i>(In thousands, except per share data; unaudited)</i>  | FY 2014            |                | FY 2013               |                | FY 2012            |                |
|--|--------------------|----------------|-----------------------|----------------|--------------------|----------------|
|  | Amount             | Diluted<br>EPS | Amount                | Diluted<br>EPS | Amount             | Diluted<br>EPS |
| Reconciliation of net income (loss) to adjusted net income:  |                    |                |                       |                |                    |                |
| Net income (loss) as reported  | \$930              | \$ 0.04        | \$(123 )              | \$(0.01 )      | \$3,224            | \$ 0.13        |
| Adjustment for the New York State tax code change  | 362 <sup>(1)</sup> | 0.01           |                       |                |                    |                |
| Adjustment for the reversal of a contingent Earn-Out liability, inclusive of income tax effect   | —                  | —              | (897 ) <sup>(3)</sup> | (0.04 )        | —                  | —              |
| Adjustment for the acquisition transaction costs, related expenses, and acquisition-related fair value inventory adjustments, inclusive of the income tax effect | —                  | —              | —                     | —              | 373 <sup>(4)</sup> | 0.02           |
| Adjustment for goodwill and intangible assets impairments, inclusive of the income tax effect  | 514 <sup>(2)</sup> | 0.02           | 2,413 <sup>(5)</sup>  | 0.10           | 258 <sup>(6)</sup> | 0.01           |
| Adjusted net income and earnings per share   | \$1,806            | \$ 0.07        | \$1,393               | \$ 0.06        | \$3,855            | \$ 0.16        |

The income tax effects of the adjustments in the tables above were calculated using the estimated U.S. effective income tax rates for the periods indicated. The income tax effects were as follows (in thousands):

(1) n/a

(2) \$291

(3) \$0

(4) \$237

(5) \$0

(6) \$0



**Results of Operations****2014 Compared to 2013****Lighting Segment***(In thousands)*

|                  | 2014      | 2013      |
|------------------|-----------|-----------|
| Net Sales        | \$227,628 | \$206,363 |
| Gross Profit     | \$50,380  | \$47,381  |
| Operating Income | \$9,788   | \$10,092  |

Lighting Segment net sales of \$227,628,000 in fiscal 2014 increased 10.3% from fiscal 2013 net sales of \$206,363,000. The Lighting Segment's net sales of light fixtures having solid-state LED technology totaled \$99.9 million in fiscal 2014, representing a \$28.5 or 40.0% increase from fiscal 2013 net sales of solid-state LED light fixtures of \$71.4 million. There was a reduction in the Company's traditional lighting sales (metal halide and fluorescent light sources) from fiscal 2013 to fiscal 2014 as customers converted from traditional lighting to light fixtures having solid-state LED technology. The Lighting Segment's net sales related to LED video screens totaled \$5.0 million in fiscal 2014, representing a \$1.0 million or 16.6% decrease from fiscal 2013 net sales of \$6.0 million.

Gross profit of \$50,380,000 in fiscal 2014 increased \$3.0 million or 6.3% from fiscal 2013, and decreased from 22.7% to 21.8% as a percentage of Lighting Segment net sales (customer plus inter-segment net sales). The increase in amount of gross profit is due to the net effect of increased net sales, competitive pricing pressures, a shift in product mix to a greater percentage of light fixtures containing LED solid-state technology, manufacturing inefficiencies due to strong demand of newly introduced LED lighting fixtures, an increase in inventory reserves against inventory deemed obsolete and no longer useable (\$0.2 million), increased freight expense, increased employee compensation and benefits expense (\$1.0 million), decreased customer relations expense (\$1.1 million), increased warranty expense (\$2.4 million), increased supplies expense (\$0.5 million), increased repairs and maintenance expense (\$0.2 million), increased outside service expense (\$0.5 million), and increased utilities expense (\$0.2 million).

Selling and administrative expenses of \$40,592,000 in fiscal 2014 increased \$3.3 million or 8.9% from fiscal 2013 primarily as the net result of decreased employee compensation and benefits expense (\$0.2 million), increased outside service expense (\$0.4 million), decreased bad debt expense (\$0.2 million), increased research and development

expense (\$1.6 million), increased sales commission (\$2.7 million), and decreased amortization expense (\$1.7 million).

The Lighting Segment fiscal 2014 operating income of \$9,788,000 decreased \$0.3 million or 3.0% from operating income of \$10,092,000 in fiscal 2013. This decrease of \$0.3 million was primarily the net result of increased net sales, a lower gross margin as a percentage of sales, and increased selling and administrative expenses.

## Graphics Segment

*(In thousands)*

|                  | 2014      | 2013      |
|------------------|-----------|-----------|
| Net Sales        | \$46,166  | \$46,770  |
| Gross Profit     | \$6,568   | \$7,597   |
| Operating (Loss) | \$(2,802) | \$(1,253) |

Graphics Segment net sales of \$46,166,000 in fiscal 2014 decreased 1.3% from fiscal 2013 net sales of \$46,770,000. The \$0.6 million decrease in Graphics Segment net sales is primarily the net result of image conversion programs and sales to several petroleum / convenience store customers (\$9.7 million net increase), two grocery retailers (\$10.2 million decrease), two national drug store retailers (\$2.4 million increase), two quick-service restaurant chains (\$1.6 million increase), several retail chains (\$1.9 million decrease), one banking customer (\$0.8 million increase), and changes in volume or completion of several other smaller graphics programs in various markets (\$3.0 million decrease). The Graphics Segment net sales of graphic identification products that contain solid-state LED light sources and LED lighting for signage totaled \$2.4 million in fiscal 2014, representing a \$1.1 million increase from fiscal 2013 net sales of \$1.3 million. Customer spending continued to remain soft and contributed to the operating losses in the Graphics Segment.

Gross profit of \$6,568,000 in fiscal 2014 decreased \$1.0 million or 13.5% from fiscal 2013, and decreased from 15.6% to 14.0% as a percentage of Graphics Segment net sales (customer plus inter-segment net sales). The change in the amount of gross profit is due to the net effect of decreased net sales, lower gross profit margins on product sales, and the write-down of certain inventory to lower of cost or market (\$0.1 million), partially offset by improved gross margin as a percentage of sales on installation sales, decreased freight costs as a percentage of sales, decreased benefits and compensation (\$0.2 million), decreased warranty costs (\$0.3 million), decreased customer relations expense (\$0.2 million), decreased supplies expense (\$0.2 million), and decreased outside service expense (\$0.1 million).

Selling and administrative expenses of \$9,370,000 in fiscal 2014 increased \$0.5 million or 5.9% from fiscal 2013 primarily as a result of increased benefits and compensation expense (\$0.5 million).

The Graphics Segment fiscal 2014 operating loss of \$(2,802,000) increased \$1.5 million from the operating loss of \$(1,253,000) in 2013 and is the net result of decreased net sales, decreased gross margin, and increased selling and administrative expenses.

### Electronic Components Segment

*(In thousands)*

|                         | 2014     | 2013     |
|-------------------------|----------|----------|
| Net Sales               | \$19,491 | \$20,333 |
| Gross Profit            | \$7,220  | \$5,318  |
| Operating Income (Loss) | \$2,369  | \$(916 ) |

Electronic Components Segment net sales of \$19,491,000 in fiscal 2014 decreased 4.1% from fiscal 2013 net sales of \$20,333,000. The \$0.8 million decrease in Electronic Components Segment net sales is primarily the net result of a \$0.3 million decrease in sales to the telecommunications market, a \$0.4 million increase in sales to the transportation market, a \$0.2 million decrease in sales to original equipment manufacturers, a \$0.2 million increase in sales to the medical markets, and a \$0.7 million decrease in sales to various other markets. In addition to the Segment's decrease in customer sales, its inter-segment sales increased 29.0% due to increased intercompany demand of LED circuit board assemblies used in light fixtures having solid-state LED technology.

Gross profit of \$7,220,000 in fiscal 2014 increased \$1.9 million or 35.8% from fiscal 2013, and increased from 11.3% to 13.4% as a percentage of Electronic Components Segment net sales (customer plus inter-segment net sales). The \$1.9 million increase in amount of gross profit is due to the net effect of decreased customer net sales, increased inter-segment sales, increased employee compensation and benefit expense (\$0.9 million), decreased outside service expense (\$0.3 million), decreased warranty expense (\$0.4 million), and decreased customer relations expense (\$0.1 million).

Selling and administrative expenses of \$4,046,000 in fiscal 2014 increased \$0.2 million or 5.9% from fiscal 2013 as the result of increased research and development expense related to lighting controls (\$0.4 million), and decreased outside service expense (\$0.1 million). In fiscal 2014, the Electronic Components Segment recorded an intangible asset impairment expense of \$0.8 million with no comparable intangible asset impairment expense in fiscal 2013. In fiscal 2013, the Electronic Components Segment recorded a goodwill impairment expense of \$2.4 million with no comparable goodwill impairment expense in fiscal 2014.

The Electronic Components Segment fiscal 2014 operating income of \$2,369,000 is an improvement from the \$(916,000) operating loss in fiscal 2013. The \$3.3 million increase from an operating loss in fiscal 2013 to operating income in fiscal 2014 was the net result of decreased net customer sales, increased intersegment sales, increased gross profit, increased selling and administrative expenses and a goodwill impairment charge of \$2.4 million in fiscal 2013 with no comparable goodwill impairment expense in fiscal 2013 partially offset with a \$0.8 million intangible asset impairment expense in fiscal 2014 with no comparable intangible asset impairment expense in fiscal 2013.



**All Other Category***(In thousands)*

|                  | 2014     | 2013      |
|------------------|----------|-----------|
| Net Sales        | \$6,178  | \$7,324   |
| Gross Profit     | \$1,701  | \$613     |
| Operating (Loss) | \$(138 ) | \$(1,451) |

All Other Category net sales of \$6,178,000 in fiscal 2014 decreased \$1.1 million or 15.6% from fiscal 2013 net sales of \$7,324,000. The \$1.1 million decrease in the All Other Category net sales is primarily the net result of net decreased sales of menu board systems (\$1.8 million), increased project management net sales (\$0.2 million), and increased net sales of LED video screen and specialty LED lighting sales to the Entertainment and other markets (\$0.4 million). Inter-segment sales increased 3.7% mostly due to LSI Adapt providing intercompany project management support.

Gross profit of \$1,701,000 in fiscal 2014 increased \$1.1 million or 177% from fiscal 2013. The \$1.1 million increase in gross profit is the net result of decreased net customer sales, a change in the mix of product and services sold to a more profitable mix, increased inter-segment sales, and an inventory reserve of \$1.2 million against inventory deemed technologically obsolete and no longer useable at our Canadian operation in fiscal 2013 with no comparable expense in fiscal 2014.

Selling and administrative expenses of \$1,839,000 in fiscal 2014 decreased \$0.2 million or 10.9% as compared to the same period of the prior year. The decrease in selling and administrative expense is primarily the result of decreased research and development expense (\$0.1 million).

The All Other Category fiscal 2014 operating loss of \$(138,000) compares to an operating loss of \$(1,451,000) in fiscal 2013. This \$1.3 million decrease in operating loss was the net result of decreased net sales, an increase in gross profit most notably impacted by a decrease in obsolete inventory reserves, and decreased selling and administrative expenses.

**Corporate and Eliminations**

*(In thousands)*

|                  | 2014      | 2013      |
|------------------|-----------|-----------|
| Gross Profit     | \$(571 )  | \$(499 )  |
| Operating (Loss) | \$(6,899) | \$(5,842) |

The negative gross profit relates to the intercompany profit in inventory elimination.

Selling and administrative expenses of \$6,328,000 in fiscal 2014 increased \$1.0 million or 18.4% from fiscal 2013. The increase in expense is the net result of decreased employee compensation and benefit expense (\$0.2 million), increased depreciation expense (\$0.5 million), increased repairs and maintenance expense (\$0.1 million), increased outside service expense (\$0.5 million), and a reduction of the contingent Earn-Out liability related to the Virticus acquisition in fiscal 2013 with no comparable reduction of expense in fiscal 2014 (\$0.9 million).

### **Consolidated Results**

The Company reported net interest expense of \$51,000 in fiscal 2014 as compared to net interest expense of \$15,000 in fiscal 2013. Commitment fees related to the unused portions of the Company's lines of credit and interest income on invested cash are included in the net interest expense amounts in both fiscal 2014 and 2013. The major factor that contributed to the increase in net interest expense from fiscal 2013 to fiscal 2014 was related to the fiscal 2013 reduction of the accrued interest expense related to the reduction of the contingent earn-out liability associated with the Virticus acquisition, with no comparable reduction of accrued interest expense in fiscal 2014.

The \$1,337,000 income tax expense in fiscal 2014 represents a consolidated effective tax rate of 59.0%. This is the net result of an income tax rate of 44.5% for the Company's U.S. operations, influenced by certain permanent book-tax differences that were significant relative to the amount of taxable income, an increase in the valuation reserve against New York State tax credits of \$362,000 resulting from changes to the New York tax code, by certain U.S. federal and Canadian income tax credits, by a benefit related to uncertain income tax positions, and by a full valuation reserve on the Company's Canadian tax position. The \$738,000 income tax expense in fiscal 2013 represents consolidated tax expense related to a pre-tax profit of \$630,000. The relationship between tax expense which is greater than pre-tax profit is the net result of an income tax rate of 33.6% for the Company's U.S. operations, influenced by certain permanent book-tax differences that were significant relative to the amount of taxable income (most notably the \$2.4 million goodwill impairment), by certain U.S. federal and Canadian income tax credits, by a benefit related to uncertain income tax positions, and most notably by a full valuation reserve on the Company's Canadian tax position.

The Company reported net income of \$930,000 in fiscal 2014 as compared to a net loss of \$(123,000) in fiscal 2013. The increase from a net loss in fiscal 2013 to net income in fiscal 2014 is primarily the net result of increased net sales, increased gross profit, increased operating expenses, the net effect of decreased goodwill impairment partially offset by increased intangible asset impairment expense, and increased income tax expense. Diluted income per share was \$0.04 in fiscal 2014 as compared to a diluted loss per share of \$(0.01) in fiscal 2013. The weighted average common shares outstanding for purposes of computing the diluted loss per share in fiscal 2014 were 24,546,000 shares as compared to 24,313,000 shares when computing earnings per share in fiscal 2013.

## 2013 Compared to 2012

### Lighting Segment

*(In thousands)*

|                  | 2013      | 2012      |
|------------------|-----------|-----------|
| Net Sales        | \$206,363 | \$199,610 |
| Gross Profit     | \$47,381  | \$46,463  |
| Operating Income | \$10,092  | \$11,828  |

Lighting Segment net sales of \$206,363,000 in fiscal 2013 increased 3.4% from fiscal 2012 net sales of \$199,610,000. The \$6.8 million increase in Lighting Segment net sales is primarily the net result of a \$1.2 million or 1.3% net increase in lighting sales to our niche and national accounts markets (petroleum / convenience store sales were up 5%, retail national net sales were down 46%, quick-service restaurant market sales were up 87%, and automotive market net sales were up 52%), a \$1.2 million or 7.5% increase in lighting sales to the international

markets, a \$4.1 million or 220% increase in LED video screens, and a \$0.2 million or 0.2% increase in commissioned net sales to the commercial / industrial lighting market. The Company replaced certain commissioned sales representatives during fiscal 2013, which has the short-term effect of disrupting sales with a view towards strategic sales growth in the long-term. Sales of lighting to the petroleum / convenience store market represented 28% of Lighting Segment net sales in both fiscal years 2013 and 2012. Lighting Segment net sales of lighting to this, the Company's largest niche market, were up 5.0% from last year to \$58,326,000. The petroleum / convenience store market has been, and will continue to be, a very important niche market for the Company. The Lighting Segment's net sales of light fixtures having solid-state LED technology totaled \$71.4 million in fiscal 2013, representing a 3.7% increase from fiscal 2012 net sales of solid-state LED light fixtures of \$68.9 million. The Lighting Segment's net sales related to LED video screens totaled \$6.0 million in fiscal 2013, representing a \$4.1 million or 220% increase from fiscal 2012 net sales of \$1.9 million.

Gross profit of \$47,381,000 in fiscal 2013 increased \$0.9 million or 2.0% from fiscal 2012, and decreased from 23.0% to 22.7% as a percentage of Lighting Segment net sales (customer plus inter-segment net sales). The increase in amount of gross profit is due to the net effect of increased net sales, competitive pricing pressures, efficiencies gained in direct labor, increased overhead absorption, an increase in inventory reserves against inventory deemed obsolete and no longer useable (\$0.8 million), increased employee compensation and benefits expense (\$2.2 million), increased customer relations expense (\$0.7 million), decreased warranty expense (\$1.0 million), increased supplies expense (\$0.4 million), decreased outside service expense (\$0.3 million), and decreased depreciation expense (\$0.3 million).

Selling and administrative expenses of \$37,289,000 in fiscal 2013 increased \$2.7 million or 7.7% from fiscal 2012 primarily as the net result of increased employee compensation and benefits expense (\$1.2 million), decreased customer relations expense (\$0.2 million), increased research and development expense (\$0.7 million), increased sales commission (\$1.5 million), and decreased amortization expense (\$0.3 million).

The Lighting Segment fiscal 2013 operating income of \$10,092,000 decreased \$1.7 million or 14.7% from operating income of \$11,828,000 in fiscal 2012. This decrease of \$1.7 million was primarily the net result of increased net sales, competitive pricing pressures, increased overhead absorption, increased commission expense, increased research and development expense, and increased employee compensation and benefit expense.

## Graphics Segment

*(In thousands)*

|                  | 2013      | 2012      |
|------------------|-----------|-----------|
| Net Sales        | \$46,770  | \$42,131  |
| Gross Profit     | \$7,597   | \$6,765   |
| Operating (Loss) | \$(1,253) | \$(1,938) |

Graphics Segment net sales of \$46,770,000 in fiscal 2013 increased 11.0% from fiscal 2012 net sales of \$42,131,000. The \$4.6 million increase in Graphics Segment net sales is primarily the net result of image conversion programs and sales to several petroleum / convenience store customers (\$0.9 million net decrease), two grocery retailers (\$6.7 million increase), two national drug store retailers (\$2.5 million decrease), two quick-service restaurant chains (\$1.5 million decrease), several retail chains (\$1.7 million increases) and changes in volume or completion of several other smaller graphics programs (\$1.1 million increase). Sales of graphics products and services to the petroleum / convenience store market represented 39% and 37% of Graphics Segment net sales in fiscal years 2013 and 2012, respectively. Graphics Segment net sales of graphics to this, the Company's largest niche market, were up 15.3% from fiscal 2012 to \$18,063,000. The petroleum / convenience store market has been, and will continue to be, a very important niche market for the Company. The Graphics Segment net sales of graphic identification products that contain solid-state LED light sources and LED lighting for signage totaled \$1.3 million in fiscal 2013 compared to \$1.0 million in fiscal 2012.

Gross profit of \$7,597,000 in fiscal 2013 increased \$0.8 million or 12.3% from fiscal 2012, and increased from 15.5% to 15.6% as a percentage of Graphics Segment net sales (customer plus inter-segment net sales). The increase in amount of gross profit is due to the net effect of increased net sales, increased overhead absorption, increased freight costs as a percentage of sales, increased benefits and compensation (\$0.7 million), increased warranty costs (\$0.3 million), increased customer relations expense (\$0.1 million); decreased repairs and maintenance expense (\$0.2 million); and increased outside service expense (\$0.1 million).

Selling and administrative expenses of \$8,850,000 in fiscal 2013 increased \$0.4 million or 4.8% from fiscal 2012 primarily as a result of increased benefits and compensation expense (\$0.4 million) and increased outside services

(\$0.1 million). In fiscal 2012, the Graphics Segment recorded a goodwill impairment expense of \$0.3 million with no comparable expense in fiscal 2013.

The Graphics Segment fiscal 2013 operating loss of \$(1,253,000) improved \$0.7 million from the operating loss of \$(1,938,000) in fiscal 2012 and is the net result of increased sales, increased gross margin, increased selling and administrative expenses, and a goodwill impairment charge in fiscal 2012 with no comparable expense in fiscal 2013.

### Electronic Components Segment

*(In thousands)*

|                         | 2013     | 2012     |
|-------------------------|----------|----------|
| Net Sales               | \$20,333 | \$18,515 |
| Gross Profit            | \$5,318  | \$5,815  |
| Operating Income (Loss) | \$(916 ) | \$3,634  |

Electronic Components Segment net sales of \$20,333,000 in fiscal 2013 increased 9.8% from fiscal 2012 net sales of \$18,515,000. The \$1.8 million increase in Electronic Components Segment net sales is primarily the net result of a \$0.5 million decrease in sales to the telecommunications market, a \$1.5 million increase in sales to the transportation market, a \$0.1 million decrease in sales to original equipment manufacturers, a \$0.3 million decrease in sales to the medical markets, and a \$1.3 million increase in sales to various other markets. In addition to the Segment's increase in customer sales, its inter-segment sales increased 20.5% due to increased intercompany demand of LED circuit board assemblies used in light fixtures having solid-state LED technology.

Gross profit of \$5,318,000 in fiscal 2013 decreased \$0.5 million or 8.5% from fiscal 2012, and decreased from 14.3% to 11.3% as a percentage of Electronic Components Segment net sales (customer plus inter-segment net sales). The \$0.5 million decrease in amount of gross profit is due to the net effect of increased customer net sales, the effect of increased inter-segment sales on the gross profit margin percentage, competitive pricing pressures, increased material costs, increased employee compensation and benefit expense (\$0.6 million), increased supplies (\$0.2 million), increased outside service expense (\$0.4 million), increased rent expense (\$0.1 million), and a net increase in warranty expense (\$0.2 million). The largest impact affecting the drop in gross profit is LSI Controls (formerly LSI Virticus). Current sales of lighting controls have not been enough to cover fixed overhead expenses. Besides traditional manufacturing expenses, the company also incurred warranty charges of \$0.3 million related to the first generation control systems.

Selling and administrative expenses of \$3,821,000 in fiscal 2013 increased \$1.6 million or 75.2% from fiscal 2012 primarily as the result of increased employee compensation and benefits expense (\$0.3 million), increased research and development expense related to lighting controls (\$0.7 million), increased amortization expense (\$0.1 million), and increased outside service expense (\$0.2 million). The Company's lighting controls business is contributing to most of the increase in selling and administrative expenses with a full fiscal year of expenses in fiscal 2013 compared to approximately three months of expense recorded in fiscal 2012. In fiscal 2013, the Electronic Components Segment recorded a goodwill impairment expense of \$2.4 million with no comparable expense in fiscal 2012.

The Electronic Components Segment fiscal 2013 operating loss of \$(916,000) decreased \$4.6 million from operating income of \$3,634,000 in fiscal 2012. The \$4.6 million decrease from operating income in fiscal 2012 to an operating loss in fiscal 2013 was the net result of increased net sales, decreased gross profit (mostly due to the Company's lighting controls business, LSI Controls), increased selling and administrative expenses (most notably the increase in research and development costs associated with LSI Controls, as the Company invested in new product offerings), and a goodwill impairment charge of \$2.4 million in fiscal 2013 with no comparable expense in fiscal 2012.

### All Other Category

*(In thousands)*

|                  | 2013      | 2012      |
|------------------|-----------|-----------|
| Net Sales        | \$7,324   | \$8,146   |
| Gross Profit     | \$613     | \$1,554   |
| Operating (Loss) | \$(1,451) | \$(1,114) |

All Other Category net sales of \$7,324,000 in fiscal 2013 decreased \$0.8 million or 10.1% from fiscal 2012 net sales of \$8,146,000. The \$0.8 million decrease in the All Other Category net sales is primarily the net result of net increased sales of menu board systems (\$0.2 million), decreased project management net sales (\$0.2 million), and decreased net sales of LED video screen and specialty LED lighting sales to the Entertainment and other markets (\$0.8 million). Inter-segment sales increased 15.6% primarily as a result of LSI Adapt providing increased intercompany project management support.

Gross profit of \$613,000 in fiscal 2013 decreased \$0.9 million or 60.6% from fiscal 2012. The \$0.9 million decrease in gross profit is the net result of decreased net customer sales, increased inter-segment sales at a lower gross margin as a percentage of sales, and an inventory reserve of \$1.2 million against inventory deemed technologically obsolete and no longer useable at our Canadian operation.

Selling and administrative expenses of \$2,064,000 in fiscal 2013 decreased \$0.6 million or 22.6% as compared to the same period of the prior year. The decrease in selling and administrative expense is the net result of increased benefit and compensation expense (\$0.1 million) offset by lower research and development expense (\$0.6 million).

The All Other Category fiscal 2013 operating loss of \$(1,451,000) compares to an operating loss of \$(1,114,000) in fiscal 2012. This \$0.3 million increase in operating loss was the net result of decreased net sales, an increase in obsolete inventory reserves, and decreased selling and administrative expenses.



**Corporate and Eliminations***(In thousands)*

|                  | 2013      | 2012      |
|------------------|-----------|-----------|
| Gross Profit     | \$(499 )  | \$(284 )  |
| Operating (Loss) | \$(5,842) | \$(6,079) |

The negative gross profit relates to the intercompany profit in inventory elimination.

Selling and administrative expenses of \$5,343,000 in fiscal 2013 decreased \$0.5 million or 7.8% from the prior year. The decrease in expenses is the net result of increased employee compensation and benefit expense (\$0.9 million), decreased depreciation expense (\$0.3 million), increased repairs and maintenance expense (\$0.1 million), acquisition deal costs of \$0.4 million in fiscal 2012 with no comparable expense in fiscal 2013, and a reduction of the contingent Earn-Out liability related to the Virticus acquisition (\$0.9 million as further discussed in Note 13).

**Consolidated Results**

The Company reported net interest expense of \$15,000 in fiscal 2013 as compared to net interest expense of \$140,000 in fiscal 2012. Commitment fees related to the unused portions of the Company's lines of credit and interest income on invested cash are included in the net interest expense amounts in both fiscal 2013 and 2012. The primary reasons for the drop in net interest expense from fiscal 2012 to fiscal 2013 can be attributed to the payoff of a mortgage in fiscal 2012 for which there was no corresponding mortgage interest expense in fiscal 2013 and the reversal in fiscal 2013 of the accrued interest expenses associated with the Earn-Out liability.

The \$738,000 income tax expense in fiscal 2013 represents consolidated tax expense related to a pre-tax profit of \$630,000. The relationship between tax expense which is greater than pre-tax profit is the net result of an income tax rate of 33.6% for the Company's U.S. operations, influenced by certain permanent book-tax differences that were significant relative to the amount of taxable income (most notably the \$2.4 million goodwill impairment), by certain U.S. federal and Canadian income tax credits, by a benefit related to uncertain income tax positions, and most notably

by a full valuation reserve on the Company's Canadian tax position. The \$2,967,000 income tax expense in fiscal 2012 represents a consolidated effective tax rate of 47.9%. This is the net result of an income tax rate of 38.9% for the Company's U.S. operations influenced by certain temporary and permanent book-tax differences that were significant relative to the amount of taxable income, by the goodwill impairment of \$258,000 for which there was no tax effect, by an increase in a valuation reserve on a state income tax net operating loss carryover, by certain U.S. federal and Canadian income tax credits, by a benefit related to uncertain income tax positions, and by a full valuation reserve on the Company's Canadian tax position.

The Company reported a net loss of \$(123,000) in fiscal 2013 as compared to net income of \$3,224,000 in fiscal 2012. The decrease from net income in fiscal 2012 to a net loss in fiscal 2013 is primarily the net result of increased net sales, decreased gross profit, increased operating expenses, increased goodwill impairment and decreased income tax expense. Diluted loss per share was \$(0.01) in fiscal 2013 as compared to diluted earnings per share of \$0.13 in fiscal 2012. The weighted average common shares outstanding for purposes of computing the diluted loss per share in fiscal 2013 were 24,385,000 shares as compared to 24,352,000 shares when computing earnings per share in fiscal 2012.

### **Liquidity and Capital Resources**

The Company considers its level of cash on hand, borrowing capacity, current ratio and working capital levels to be its most important measures of short-term liquidity. For long-term liquidity indicators, the Company believes its ratio of long-term debt to equity and its historical levels of net cash flows from operating activities to be the most important measures.

At June 30, 2014, the Company had working capital of \$76.8 million, compared to \$76.7 million at June 30, 2013. The ratio of current assets to current liabilities was 3.62 to 1 as compared to a ratio of 3.93 to 1 at June 30, 2013. The \$0.1 million increase in working capital from June 30, 2013 to June 30, 2014 was primarily related to the net effect of increased cash and cash equivalents (\$1.1 million), increased accounts payable (\$1.2 million), increased accrued expenses (\$1.9 million), decreased net accounts receivable (\$3.2 million), increased net inventory (\$3.3 million), increased other current assets (\$1.5 million), and increased refundable income tax (\$0.5 million). The Company has a strategy of aggressively managing working capital, including the reduction of the accounts receivable days sales outstanding (DSO) and reduction of inventory levels, without reducing service to our customers.

The Company generated \$11.6 million of cash from operating activities in fiscal 2014 as compared to cash from operating activities of \$8.9 million in fiscal 2013. This \$2.7 million increase in net cash flows from operating activities is primarily the net result of a decrease rather than an increase in accounts receivable (favorable change of \$5.1 million), a greater increase in inventories (unfavorable change of \$1.0 million), a smaller increase in refundable income tax (favorable change of \$0.7 million), a net profit in fiscal 2014 compared to a net loss in fiscal 2013 (favorable change of \$1.1 million), a decrease in goodwill and intangible asset impairment expense (unfavorable change of \$1.6 million), less of an increase in accrued expenses and other (unfavorable change of \$1.4 million), a decrease in obsolete inventory expense (unfavorable change of \$1.5 million), a decrease in the Earn-Out liability adjustment in fiscal 2013 with no adjustment in fiscal 2014 (favorable change of \$0.9 million), and a reduction in depreciation and amortization expense (unfavorable change of \$1.0 million).

Net accounts receivable were \$42.8 million and \$46.0 million at June 30, 2014 and 2013, respectively. The decrease of \$3.2 million in net receivables is primarily due to the net effect of a higher amount of net sales in the fourth quarter of fiscal 2014 as compared to the fourth quarter of fiscal 2013, more than offset by a lower days sales outstanding (DSO). The DSO decreased to 50 days at June 30, 2014 from 60 days at June 30, 2013. In particular, a \$4.7 million payment was received from a single customer in early July 2013, beyond agreed to payment terms. Had this payment been received prior to the end of fiscal 2013, DSO would have been 53 days as of June 2013 and the accounts receivable balance as of June 30, 2013 would have been lower than the June 30, 2014 account receivable balance. The Company believes that its receivables are ultimately collectible or recoverable, net of certain reserves, and that aggregate allowances for doubtful accounts are adequate.

Net inventories at June 30, 2014 increased \$3.3 million from June 30, 2013 levels. The increase of \$3.3 million is the result of an increase in gross inventory of \$2.5 million and by a decrease in inventory obsolescence reserves of \$0.8 million. Based on a strategy of balancing inventory reductions with customer service and the timing of shipments, net inventory increases occurred in fiscal 2014 in the Lighting Segment of approximately \$3.0 million, in the Graphics Segment of approximately \$0.2 million, and in the Electronic Segment of approximately \$0.4 million. Inventory decreased in the All Other Category approximately \$0.3 million.

Cash provided from operations and borrowing capacity under two lines of credit are the Company's primary source of liquidity. The Company has an unsecured \$30 million revolving line of credit for its U.S. operations and an unsecured \$5 million revolving line of credit for its Canadian operation. As of August 22, 2014, there were no borrowings against either line of credit. Both lines of credit expire in the third quarter of fiscal 2017. The Company believes that \$35 million total lines of credit plus cash flows from operating activities are adequate for the Company's fiscal 2015 operational and capital expenditure needs. The Company is in compliance with all of its loan covenants.

The Company used \$5.0 million of cash related to investing activities in fiscal 2014 as compared to a use of \$7.5 million in the prior year, resulting in a favorable change of \$2.5 million. Capital expenditures for fiscal 2014 decreased \$2.3 million to \$5.2 million from fiscal 2013. The primary change in capital expenditures between years relates to an upgrade of the Company's ERP software in fiscal 2013 with no comparable capital expenditure in fiscal 2014. Other than the upgrade to the Company's ERP software, capital spending in both periods is primarily for tooling

and equipment. There was also a favorable change in the proceeds from the sale of equipment of \$0.2 million.

The Company used \$5.5 million of cash related to financing activities in fiscal 2014 as compared to a use of cash of \$8.6 million in fiscal 2013, resulting in a favorable change of \$3.1 million. The change between years is primarily attributed to decreased dividend payments (favorable change of \$2.9 million), mostly due to an additional cash dividend payment of \$0.12 per share paid in December 2012 with no similar additional dividend payment in fiscal 2014. There was also an increase in the exercise of stock options (favorable change of \$0.2 million).

The Company has, or could have, on its balance sheet financial instruments consisting primarily of cash and cash equivalents, short-term investments, revolving lines of credit, and long-term debt. The fair value of these financial instruments approximates carrying value because of their short-term maturity and/or variable, market-driven interest rates.

## Off-Balance Sheet Arrangements

The Company has no financial instruments with off-balance sheet risk and has no off-balance sheet arrangements.

| Contractual Obligations as<br>of June 30, 2014 (a) | Payments Due by Period |                        |              |              |                            |
|--|------------------------|------------------------|--------------|--------------|----------------------------|
|  | Total                  | Less<br>than<br>1 year | 1-3<br>years | 3-5<br>years | More<br>than<br>5<br>years |
| Acquisition Contingent Earn-Out Obligations (b)    | \$--                   | \$--                   | \$--         | \$--         | \$ --                      |
| Operating Lease Obligations                        | 4,784                  | 1,406                  | 2,293        | 1,085        | --                         |
| Purchase Obligations                               | 31,089                 | 30,797                 | 193          | 82           | 17                         |
| Total Contractual Obligations                      | \$35,873               | \$32,203               | \$2,486      | \$1,167      | \$ 17                      |

(a) The liability for uncertain tax positions of \$1.0 million is not included due to the uncertainty of timing of payments.

(b) Refer to Note 13 — Commitments and Contingencies, for an explanation as to the elimination of the Earn-Out liability.

## Cash Dividends

On August 20, 2014, the Board of Directors declared a regular quarterly cash dividend of \$0.06 per share (approximately \$1,442,000) payable September 9, 2014 to shareholders of record on September 2, 2014. The Company's cash dividend policy is that the indicated annual dividend rate will be set between 50% and 70% of the expected net income for the current fiscal year. Consideration will also be given by the Board to declare a special cash or stock dividend. The declaration and amount of any cash and stock dividends will be determined by the Company's Board of Directors, in its discretion, based upon its evaluation of earnings, cash flow, capital requirements and future business developments and opportunities, including acquisitions. The Company's indicated annual rate for payment of a cash dividend for fiscal 2015 has yet to be determined and is currently under evaluation.

## Critical Accounting Policies and Estimates

The Company is required to make estimates and judgments in the preparation of its financial statements that affect the reported amounts of assets, liabilities, revenues and expenses, and related footnote disclosures. The Company bases

its estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities. The Company continually reviews these estimates and their underlying assumptions to ensure they remain appropriate. The Company believes the items discussed below are among its most significant accounting policies because they utilize estimates about the effect of matters that are inherently uncertain and therefore are based on management's judgment. Significant changes in the estimates or assumptions related to any of the following critical accounting policies could possibly have a material impact on the financial statements.

### ***Revenue Recognition***

Revenue is recognized when title to goods and risk of loss have passed to the customer, there is persuasive evidence of a purchase arrangement, delivery has occurred or services have been rendered, and collectability is reasonably assured. Revenue is typically recognized at time of shipment. In certain arrangements with customers, as is the case with the sale of some of our solid-state LED video screens, revenue is recognized upon customer acceptance of the video screen at the job site. Sales are recorded net of estimated returns, rebates and discounts. Amounts received from customers prior to the recognition of revenue are accounted for as customer pre-payments and are included in accrued expenses.

The Company has four sources of revenue: revenue from product sales; revenue from installation of products; service revenue generated from providing integrated design, project and construction management, site engineering and site permitting; and revenue from shipping and handling.

Product revenue is recognized on product-only orders upon passing of title and risk of loss, generally at time of shipment. However, product revenue related to orders where the customer requires the Company to install the product is recognized when the product is installed. Other than normal product warranties or the possibility of installation or post-shipment service, support and maintenance of certain solid state LED video screens, billboards, or active digital signage, the Company has no post-shipment responsibilities.

Installation revenue is recognized when the products have been fully installed. The Company is not always responsible for installation of products it sells and has no post-installation responsibilities, other than normal warranties.

Service revenue from integrated design, project and construction management, and site permitting is recognized when all products have been installed at each retail site of the customer.

Shipping and handling revenue coincides with the recognition of revenue from sale of the product.

The Company evaluates the appropriateness of revenue recognition in accordance with Accounting Standards Codification (“ASC”) Subtopic 605-25, Revenue Recognition: Multiple-Element Arrangements. In situations where the Company is responsible for re-imaging programs with multiple sites, each site is viewed as a separate unit of accounting and has stand-alone value to the customer. Revenue is recognized upon the Company’s complete performance at the location, which may include a site survey, graphics products, lighting products, and installation of products. The selling price assigned to each site is based upon an agreed upon price between the Company and its customer and reflects the estimated selling price for that site relative to the selling price for sites with similar image requirements.

The Company also evaluates the appropriateness of revenue recognition in accordance with ASC Subtopic 985-605, “Software: Revenue Recognition.” Our solid-state LED video screens, billboards and active digital signage contain software elements which the Company has determined are incidental and therefore excluded from the scope of ASC Subtopic 985-605.

### ***Income Taxes***

The Company accounts for income taxes in accordance with ASC Topic 740, “Income Taxes.” Accordingly, deferred income taxes are provided on items that are reported as either income or expense in different time periods for financial reporting purposes than they are for income tax purposes. Deferred income tax assets and liabilities are reported on the Company’s balance sheet. Significant management judgment is required in developing the Company’s income tax provision, including the estimation of taxable income and the effective income tax rates in the multiple taxing jurisdictions in which the Company operates, the estimation of the liability for uncertain income tax positions, the determination of deferred tax assets and liabilities, and any valuation allowances that might be required against deferred tax assets.

The Company operates in multiple taxing jurisdictions and is subject to audit in these jurisdictions. The Internal Revenue Service and other tax authorities routinely review the Company's tax returns. These audits can involve complex issues which may require an extended period of time to resolve. In management's opinion, an adequate provision has been made for potential adjustments arising from these examinations.

In September 2013, the Internal Revenue Service issued Treasury Decision 9636, which enacted final tax regulations regarding the capitalization and expensing of amounts paid to acquire, produce, or improve tangible property. The regulations also include guidance regarding the retirement of depreciable property. The regulations are required to be effective in taxable years beginning on or after January 1, 2014, although taxpayers may choose to apply them in taxable years beginning on or after January 1, 2012. The Company has reviewed the impact of the final regulations and the anticipated impact to the financial statements is immaterial.

The Company is recording estimated interest and penalties related to potential underpayment of income taxes as a component of tax expense in the Consolidated Statements of Operations. The reserve for uncertain tax positions is not expected to change significantly in the next twelve months.

### ***Asset Impairment***

Carrying values of goodwill and other intangible assets with indefinite lives are reviewed at least annually for possible impairment in accordance with ASC Topic 350, "Intangibles – Goodwill and Other." The Company may first assess qualitative factors in order to determine if goodwill is impaired in accordance with ASU 2011 – 08, "Intangible – Goodwill and Other (Topic 350)." If through the qualitative assessment it is determined that it is more likely than not that goodwill is not impaired, no further testing is required. If it is determined that it is more likely than not that goodwill is impaired, or if the Company elects not to first assess qualitative factors, the Company's impairment testing continues with the estimation of the fair value of goodwill and indefinite-lived intangible assets using a combination of a market approach and an income (discounted cash flow) approach, at the reporting unit level, that requires significant management judgment with respect to revenue and expense growth rates, changes in working capital and the selection and use of an appropriate discount rate. The estimates of fair value of reporting units are based on the best information available as of the date of the assessment. The use of different assumptions would increase or decrease estimated discounted future operating cash flows and could increase or decrease an impairment charge. Company management uses its judgment in assessing whether assets may have become impaired between annual impairment tests. Indicators such as adverse business conditions, economic factors and technological change or competitive activities may signal that an asset has become impaired.



Carrying values for long-lived tangible assets and definite-lived intangible assets, excluding goodwill and indefinite-lived intangible assets, are reviewed for possible impairment as circumstances warrant as required by ASC Topic 360, "Property, Plant, and Equipment." Impairment reviews are conducted at the judgment of Company management when it believes that a change in circumstances in the business or external factors warrants a review. Circumstances such as the discontinuation of a product or product line, a sudden or consistent decline in the forecast for a product, changes in technology or in the way an asset is being used, a history of negative operating cash flow, or an adverse change in legal factors or in the business climate, among others, may trigger an impairment review. The Company's initial impairment review to determine if a potential impairment charge is required is based on an undiscounted cash flow analysis at the lowest level for which identifiable cash flows exist. The analysis requires judgment with respect to changes in technology, the continued success of product lines and future volume, revenue and expense growth rates, and discount rates.

### ***Credit and Collections***

The Company maintains allowances for doubtful accounts receivable for probable estimated losses resulting from either customer disputes or the inability of its customers to make required payments. If the financial condition of the Company's customers were to deteriorate, resulting in their inability to make the required payments, the Company may be required to record additional allowances or charges against income. The Company determines its allowance for doubtful accounts by first considering all known collectability problems of customers' accounts, and then applying certain percentages against the various aging categories based on the due date of the remaining receivables. The resulting allowance for doubtful accounts receivable is an estimate based upon the Company's knowledge of its business and customer base, and historical trends. The amount ultimately not collected may differ from the reserve established, particularly in the case where percentages are applied against aging categories. In all cases, it is management's goal to carry a reserve against the Company's accounts receivable which is adequate based upon the information available at that time so that net accounts receivable is properly stated. The Company also establishes allowances, at the time revenue is recognized, for returns and allowances, discounts, pricing and other possible customer deductions. These allowances are based upon historical trends.

### ***Warranty Reserves***

The Company maintains a warranty reserve which is reflective of its limited warranty policy. The warranty reserve covers the estimated future costs to repair or replace defective product or installation services, whether the product is returned or it is repaired in the field. The warranty reserve is first determined based upon known claims or issues, and then by the application of a specific percentage of sales to cover general claims. The percentage applied to sales to calculate general claims is based upon historical claims as a percentage of sales. Management addresses the adequacy of its warranty reserves on a quarterly basis to ensure the reserve is accurate based upon the most current information.

### ***Inventory Reserves***

The Company maintains an inventory reserve for probable obsolescence of its inventory. The Company first determines its obsolete inventory reserve by considering specific known obsolete items, and then by applying certain percentages to specific inventory categories based upon inventory turns. The Company uses various tools, in addition to inventory turns, to identify which inventory items have the potential to become obsolete. Significant judgment is used to establish obsolescence reserves and management adjusts these reserves as more information becomes available about the ultimate disposition of the inventory item. Management values inventory at lower of cost or market.

### **New Accounting Pronouncements**

In July 2013, the Financial Accounting Standards Board issued ASU 2013-11, "Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists." This amended guidance is intended to eliminate the diversity that is in practice with regard to the financial statement presentation of unrecognized tax benefits when a net operating loss carryforward, a similar tax loss, or a tax credit carryforward exists. The amended guidance is effective for fiscal years and interim periods within those years, beginning after December 15, 2013, or the Company's fiscal year 2015, with early adoption permissible. The adoption of this guidance is not expected to have a material impact on the financial statements.

In June 2014, the Financial Accounting Standards Board issued ASU 2014-09, "Revenue from Contracts with Customers." This amended guidance supersedes and replaces all existing U.S. GAAP revenue recognition guidance. The guidance established a new revenue recognition model, changes the basis for deciding when revenue is recognized over a point in time, provides new and more detailed guidance on specific revenue topics, and expands and improves disclosures about revenue. The amended guidance is effective for fiscal years and interim periods within those years, beginning after December 15, 2016, or the Company's fiscal year 2018. The Company has not yet determined the impact the amended guidance will have on its financial statements.

## **MANAGEMENT'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING**

The Management of LSI Industries Inc. and subsidiaries (the "Company" or "LSI") is responsible for the preparation and accuracy of the financial statements and other information included in this report. LSI's Management is also responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Securities Exchange Act Rules 13a-15(f). Under the supervision and with the participation of Management, including LSI's principal executive officer and principal financial officer, the Company conducted an evaluation of the effectiveness of internal control over financial reporting as of June 30, 2014, based on the criteria set forth in "the 1992 Internal Control – Integrated Framework" issued by the Committee of Sponsoring Organizations of the Treadway Commission.

A control system, no matter how well conceived and operated, can provide only reasonable assurance that the objectives of the control system are met. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, have been detected. These inherent limitations include the reality that judgments in decision making can be faulty, the possibility of human error, and the circumvention or overriding of the controls and procedures.

In meeting its responsibility for the reliability of the financial statements, the Company depends upon its system of internal accounting controls. The system is designed to provide reasonable assurance that assets are safeguarded and that transactions are properly authorized and recorded. The system is supported by policies and guidelines, and by careful selection and training of financial management personnel. The Company also has a Disclosure Controls Committee, whose responsibility is to help ensure appropriate disclosures and presentation of the financial statements and notes thereto. Additionally, the Company has an Internal Audit Department to assist in monitoring compliance with financial policies and procedures.

The Board of Directors meets its responsibility for overview of the Company's financial statements through its Audit Committee which is composed entirely of independent Directors who are not employees of the Company. The Audit Committee meets periodically with Management and Internal Audit to review and assess the activities of each in meeting their respective responsibilities. Grant Thornton LLP has full access to the Audit Committee to discuss the results of their audit work, the adequacy of internal accounting controls, and the quality of financial reporting.

Based upon LSI's evaluation, the Company's principal executive officer and principal financial officer concluded that internal control over financial reporting was effective as of June 30, 2014. We reviewed the results of Management's assessment with the Audit Committee of our Board of Directors. Additionally, our independent registered public accounting firm audited and independently assessed the effectiveness of the Company's internal control over financial reporting. Grant Thornton LLP, an independent registered public accounting firm, has issued an attestation report on the effectiveness of the Company's internal control over financial reporting, which is presented in the financial statements.

**Robert J. Ready**

President and Chief Executive Officer  
(Principal Executive Officer)

**Ronald S. Stowell**

Vice President, Chief Financial Officer, and Treasurer  
(Principal Financial Officer)

F - 16

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## REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors and Shareholders

LSI Industries Inc.

We have audited the internal control over financial reporting of LSI Industries Inc. (an Ohio corporation) and subsidiaries (the “Company”) as of June 30, 2014, based on criteria established in the 1992 *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company’s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management’s Report On Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the Company’s internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company’s internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company’s internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company’s assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of June 30, 2014, based on criteria established in the 1992 *Internal Control—Integrated Framework* issued by COSO.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated financial statements of the Company as of and for the year ended June 30, 2014, and our report dated September 10, 2014 expressed an unqualified opinion on those financial statements.

/s/ GRANT THORNTON LLP

Cincinnati, Ohio

September 10, 2014

**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

Board of Directors and Shareholders

LSI Industries Inc.

We have audited the accompanying consolidated balance sheets of LSI Industries Inc. (an Ohio corporation) and subsidiaries (the “Company”) as of June 30, 2014 and 2013, and the related consolidated statements of operations, shareholders’ equity, and cash flows for each of the three years in the period ended June 30, 2014. Our audits of the basic consolidated financial statements included the financial statement schedule listed in the index appearing under Item 15. These financial statements and financial statement schedule are the responsibility of the Company’s management. Our responsibility is to express an opinion on these financial statements and financial statement schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of LSI Industries Inc. and subsidiaries as of June 30, 2014 and 2013, and the results of their operations and their cash flows for each of the three years in the period ended June 30, 2014 in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, the related financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Company’s internal control over financial reporting as of June 30, 2014, based on criteria established in the 1992 *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated September 10, 2014 expressed an unqualified opinion.

/s/ GRANT THORNTON LLP



Cincinnati, Ohio

September 10, 2014

F - 18

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**LSI INDUSTRIES INC.****CONSOLIDATED STATEMENTS OF OPERATIONS****For the years ended June 30, 2014, 2013, and 2012***(In thousands, except per share data)*

|   | <b>2014</b>      | 2013      | 2012      |
|---|------------------|-----------|-----------|
| Net sales                                     | <b>\$299,463</b> | \$280,790 | \$268,402 |
| Cost of products and services sold            | <b>234,165</b>   | 220,380   | 208,089   |
| Gross profit                                  | <b>65,298</b>    | 60,410    | 60,313    |
| Selling and administrative expenses           | <b>62,175</b>    | 57,367    | 53,724    |
| Goodwill and intangible asset impairments     | <b>805</b>       | 2,413     | 258       |
| Operating income                              | <b>2,318</b>     | 630       | 6,331     |
| Interest (income)                             | <b>(17 )</b>     | (47 )     | (25 )     |
| Interest expense                              | <b>68</b>        | 62        | 165       |
| Income before income taxes                    | <b>2,267</b>     | 615       | 6,191     |
| Income tax expense                            | <b>1,337</b>     | 738       | 2,967     |
| Net income (loss)                             | <b>\$930</b>     | \$(123 )  | \$3,224   |
| Earnings (loss) per common share (see Note 3) |                  |           |           |
| Basic   | <b>\$0.04</b>    | \$(0.01 ) | \$0.13    |
| Diluted                                       | <b>\$0.04</b>    | \$(0.01 ) | \$0.13    |
| Weighted average common shares outstanding    |                  |           |           |
| Basic   | <b>24,388</b>    | 24,313    | 24,298    |
| Diluted                                       | <b>24,546</b>    | 24,313    | 24,352    |

*The accompanying notes are an  
integral part of these financial statements.*

F - 19

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**LSI INDUSTRIES INC.****CONSOLIDATED BALANCE SHEETS****June 30, 2014 and 2013***(In thousands, except shares)*

|  | <b>2014</b>      | 2013      |
|--|------------------|-----------|
| <b>ASSETS</b>  |                  |           |
| Current Assets   |                  |           |
| Cash and cash equivalents  | <b>\$9,013</b>   | \$7,949   |
| Accounts and notes receivable, less allowance for doubtful accounts of \$294 and \$346, respectively | <b>42,753</b>    | 45,991    |
| Inventories  | <b>45,408</b>    | 42,093    |
| Refundable income taxes  | <b>1,973</b>     | 1,435     |
| Asset held for sale  | <b>611</b>       | --        |
| Prepaid and other current assets   | <b>6,319</b>     | 5,445     |
| Total current assets   | <b>106,077</b>   | 102,913   |
| Property, Plant and Equipment, at cost   |                  |           |
| Land   | <b>6,918</b>     | 7,015     |
| Buildings  | <b>37,027</b>    | 37,889    |
| Machinery and equipment  | <b>75,533</b>    | 71,535    |
| Construction in progress   | <b>221</b>       | 3,464     |
|  | <b>119,699</b>   | 119,903   |
| Less accumulated depreciation  | <b>(75,417 )</b> | (74,553 ) |
| Net property, plant and equipment  | <b>44,282</b>    | 45,350    |
| Goodwill   | <b>10,508</b>    | 10,508    |
| Other Intangible Assets, net   | <b>7,227</b>     | 8,579     |
| Other Long-Term Assets, net  | <b>1,794</b>     | 1,829     |
| Total assets   | <b>\$169,888</b> | \$169,179 |

*The accompanying notes are an  
integral part of these financial statements.*

F - 20

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|  | 2014             | 2013      |
|--|------------------|-----------|
| <b>LIABILITIES &amp; SHAREHOLDERS' EQUITY</b>  |                  |           |
| Current Liabilities  |                  |           |
| Accounts payable   | <b>\$13,658</b>  | \$12,429  |
| Accrued expenses   | <b>15,631</b>    | 13,781    |
| Total current liabilities  | <b>29,289</b>    | 26,210    |
| Other Long-Term Liabilities  | <b>2,187</b>     | 1,279     |
| Commitments and contingencies (Note 13)  |                  |           |
| Shareholders' Equity   |                  |           |
| Preferred shares, without par value; Authorized 1,000,000 shares, none issued  | —                | —         |
| Common shares, without par value; Authorized 40,000,000 shares; Outstanding 24,122,284 and 24,057,266 shares, respectively | <b>104,064</b>   | 102,492   |
| Retained earnings  | <b>34,348</b>    | 39,198    |
| Total shareholders' equity   | <b>138,412</b>   | 141,690   |
| Total liabilities & shareholders' equity   | <b>\$169,888</b> | \$169,179 |

*The accompanying notes are an integral part of these financial statements.*

**LSI INDUSTRIES INC.****CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY****For the years ended June 30, 2014, 2013, and 2012***(In thousands, except per share data)*

|   | Common Shares          |                   | Retained         |                   |
|---|------------------------|-------------------|------------------|-------------------|
|   | Number<br>of<br>Shares | Amount            | Earnings         | Total             |
| Balance at June 30, 2011                | 24,047                 | \$ 100,944        | \$ 50,274        | \$ 151,218        |
| Net income                              | —                      | —                 | 3,224            | 3,224             |
| Stock compensation awards               | 7                      | 48                | —                | 48                |
| Purchase of treasury shares, net        | (21 )                  | (141 )            | —                | (141 )            |
| Deferred stock compensation             | —                      | 124               | —                | 124               |
| Stock option expense                    | —                      | 410               | —                | 410               |
| Stock options exercised, net            | 3                      | 14                | —                | 14                |
| Dividends — \$0.23 per share            | —                      | —                 | (5,529 )         | (5,529 )          |
| Balance at June 30, 2012                | 24,036                 | 101,399           | 47,969           | 149,368           |
| Net (loss)                              | —                      | —                 | (123 )           | (123 )            |
| Stock compensation awards               | 8                      | 57                | —                | 57                |
| Purchase of treasury shares, net        | (22 )                  | (150 )            | —                | (150 )            |
| Deferred stock compensation             | —                      | 169               | —                | 169               |
| Stock option expense                    | —                      | 842               | —                | 842               |
| Stock options exercised, net            | 35                     | 175               | —                | 175               |
| Dividends — \$0.36 per share            | —                      | —                 | (8,648 )         | (8,648 )          |
| Balance at June 30, 2013                | 24,057                 | 102,492           | 39,198           | 141,690           |
| <b>Net income</b>                       | —                      | —                 | <b>930</b>       | <b>930</b>        |
| <b>Stock compensation awards</b>        | <b>23</b>              | <b>193</b>        | —                | <b>193</b>        |
| <b>Purchase of treasury shares, net</b> | <b>(19 )</b>           | <b>(124 )</b>     | —                | <b>(124 )</b>     |
| <b>Deferred stock compensation</b>      | —                      | <b>99</b>         | —                | <b>99</b>         |
| <b>Stock option expense</b>             | —                      | <b>1,005</b>      | —                | <b>1,005</b>      |
| <b>Stock options exercised, net</b>     | <b>61</b>              | <b>399</b>        | —                | <b>399</b>        |
| <b>Dividends — \$0.24 per share</b>     | —                      | —                 | <b>(5,780 )</b>  | <b>(5,780 )</b>   |
| <b>Balance at June 30, 2014</b>         | <b>24,122</b>          | <b>\$ 104,064</b> | <b>\$ 34,348</b> | <b>\$ 138,412</b> |

*The accompanying notes are an  
integral part of these financial statements.*

F - 22

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**LSI INDUSTRIES INC.****CONSOLIDATED STATEMENTS OF CASH FLOWS****For the years ended June 30, 2014, 2013, and 2012***(In thousands)*

|   | <b>2014</b>     | 2013     | 2012     |
|---|-----------------|----------|----------|
| <b>Cash Flows From Operating Activities</b>                   |                 |          |          |
| Net income (loss)   | <b>\$930</b>    | \$(123 ) | \$3,224  |
| Non-cash items included in net income (loss)                  |                 |          |          |
| Depreciation and amortization                                 | <b>6,226</b>    | 7,197    | 7,805    |
| Goodwill and intangible asset impairment                      | <b>805</b>      | 2,413    | 258      |
| Earn-out liability adjustment                                 | —               | (897 )   | —        |
| Deferred income taxes   | <b>856</b>      | 263      | 309      |
| Deferred compensation plan                                    | <b>99</b>       | 169      | 124      |
| Stock option expense  | <b>1,005</b>    | 842      | 410      |
| Issuance of common shares as compensation                     | <b>193</b>      | 57       | 48       |
| Loss on disposition of fixed assets                           | <b>36</b>       | 7        | 18       |
| Allowance for doubtful accounts                               | <b>6</b>        | 269      | 360      |
| Inventory obsolescence reserve                                | <b>1,464</b>    | 2,957    | 1,453    |
| Change in certain assets and liabilities, net of acquisitions |                 |          |          |
| Accounts and notes receivable                                 | <b>3,232</b>    | (1,848 ) | 205      |
| Inventories   | <b>(4,779 )</b> | (3,774 ) | 7,784    |
| Refundable income taxes                                       | <b>(538 )</b>   | (1,208 ) | 1,568    |
| Accounts payable  | <b>1,229</b>    | 917      | 1,722    |
| Accrued expenses and other                                    | <b>269</b>      | 1,644    | (1,299 ) |
| Customer prepayments  | <b>526</b>      | (35 )    | 371      |
| Net cash flows provided by operating activities               | <b>11,559</b>   | 8,850    | 24,360   |
| <b>Cash Flows From Investing Activities</b>                   |                 |          |          |
| Purchases of property, plant, and equipment                   | <b>(5,245 )</b> | (7,571 ) | (3,436 ) |
| Proceeds from sale of fixed assets                            | <b>255</b>      | 38       | 3        |
| Acquisition of businesses, net of cash received               | —               | —        | (2,973 ) |
| Net cash flows (used in) investing activities                 | <b>(4,990 )</b> | (7,533 ) | (6,406 ) |
| <b>Cash Flows From Financing Activities</b>                   |                 |          |          |
| Payment of long-term debt                                     | —               | —        | (1,099 ) |
| Cash dividends paid   | <b>(5,780 )</b> | (8,648 ) | (5,529 ) |
| Purchase of treasury shares                                   | <b>(188 )</b>   | (175 )   | (154 )   |
| Issuance of treasury shares                                   | <b>64</b>       | 25       | 13       |
| Exercise of stock options                                     | <b>399</b>      | 175      | 14       |

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|  |                 |          |          |
|--|-----------------|----------|----------|
| Net cash flows (used in) financing activities    | <b>(5,505 )</b> | (8,623 ) | (6,755 ) |
| Increase (decrease) in cash and cash equivalents | <b>1,064</b>    | (7,306 ) | 11,199   |
| Cash and cash equivalents at beginning of year   | <b>7,949</b>    | 15,255   | 4,056    |
| Cash and cash equivalents at end of year         | <b>\$9,013</b>  | \$7,949  | \$15,255 |

*The accompanying notes are an integral part of these financial statements.*

F - 23

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**NOTE 1 — SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

**Consolidation:**

The consolidated financial statements include the accounts of LSI Industries Inc. (an Ohio corporation) and its subsidiaries (collectively, the “Company”), all of which are wholly owned. All intercompany transactions and balances have been eliminated in consolidation.

**Revenue Recognition:**

Revenue is recognized when title to goods and risk of loss have passed to the customer, there is persuasive evidence of a purchase arrangement, delivery has occurred or services have been rendered, and collectability is reasonably assured. Revenue from product sales is typically recognized at time of shipment. In certain arrangements with customers, as is the case with the sale of some of our solid-state LED (light emitting diode) video screens, revenue is recognized upon customer acceptance of the video screen at the job site. Sales are recorded net of estimated returns, rebates and discounts. Amounts received from customers prior to the recognition of revenue are accounted for as customer pre-payments and are included in accrued expenses.

The Company has four sources of revenue: revenue from product sales; revenue from installation of products; service revenue generated from providing integrated design, project and construction management, site engineering and site permitting; and revenue from shipping and handling.

Product revenue is recognized on product-only orders upon passing of title and risk of loss, generally at time of shipment. However, product revenue related to orders where the customer requires the Company to install the product is recognized when the product is installed. Other than normal product warranties or the possibility of installation or post-shipment service, support and maintenance of certain solid state LED video screens, billboards, or active digital signage, the Company has no post-shipment responsibilities.

Installation revenue is recognized when the products have been fully installed. The Company is not always responsible for installation of products it sells and has no post-installation responsibilities, other than normal warranties.

Service revenue from integrated design, project and construction management, and site permitting is recognized when all products at each customer site have been installed.

Shipping and handling revenue coincides with the recognition of revenue from sale of the product.

The Company evaluates the appropriateness of revenue recognition in accordance with Accounting Standards Codification (“ASC”) Subtopic 605-25, Revenue Recognition: Multiple-Element Arrangements. In situations where the Company is responsible for re-imaging programs with multiple sites, each site is viewed as a separate unit of accounting and has stand-alone value to the customer. Revenue is recognized upon the Company’s complete performance at the location, which may include a site survey, graphics products, lighting products, and installation of products. The selling price assigned to each site is based upon an agreed upon price between the Company and its customer and reflects the estimated selling price for that site relative to the selling price for sites with similar image requirements.

The Company also evaluates the appropriateness of revenue recognition in accordance with ASC Subtopic 985-605, “Software: Revenue Recognition.” Our solid-state LED video screens, billboards and active digital signage contain software elements which the Company has determined are incidental and therefore excluded from the scope of ASC Subtopic 985-605.

#### **Credit and Collections:**

The Company maintains allowances for doubtful accounts receivable for probable estimated losses resulting from either customer disputes or the inability of its customers to make required payments. If the financial condition of the Company’s customers were to deteriorate, resulting in their inability to make the required payments, the Company may be required to record additional allowances or charges against income. The Company determines its allowance for doubtful accounts by first considering all known collectability problems of customers’ accounts, and then applying certain percentages against the various aging categories based on the due date of the remaining receivables. The resulting allowance for doubtful accounts receivable is an estimate based upon the Company’s knowledge of its business and customer base, and historical trends. The Company also establishes allowances, at the time revenue is recognized, for returns, discounts, pricing and other possible customer deductions. These allowances are based upon historical trends.



The following table presents the Company's net accounts receivable at the dates indicated.

| <i>(In thousands)</i>                | June 30,<br>2014 | June 30,<br>2013 |
|--------------------------------------|------------------|------------------|
| Accounts receivable                  | \$43,047         | \$46,337         |
| less Allowance for doubtful accounts | (294 )           | (346 )           |
| Accounts receivable, net             | \$42,753         | \$45,991         |

### **Cash and Cash Equivalents:**

The cash balance includes cash and cash equivalents which have original maturities of less than three months. The Company maintains balances at financial institutions in the United States and Canada. The balances at financial institutions in Canada are not covered by insurance. In the United States, the FDIC limit for insurance coverage on non-interest bearing accounts is \$250,000. As of June 30, 2014 and June 30, 2013, the Company had bank balances of \$12,367,000 and \$11,145,000, respectively, without insurance coverage. Of these amounts, \$741,000 and \$613,000 were held in foreign bank accounts as of June 30, 2014 and June 30, 2013, respectively.

### **Inventories:**

Inventories are stated at the lower of cost or market. Cost of inventories includes the cost of purchased raw materials and components, direct labor, as well as manufacturing overhead which is generally applied to inventory based on direct labor and on material content. Cost is determined on the first-in, first-out basis.

### **Property, Plant and Equipment and Related Depreciation:**

Property, plant and equipment are stated at cost. Major additions and betterments are capitalized while maintenance and repairs are expensed. For financial reporting purposes, depreciation is computed on the straight-line method over the estimated useful lives of the assets as follows:

|                                    |         |
|------------------------------------|---------|
| Buildings (in years)               | 28 - 40 |
| Machinery and equipment (in years) | 3 - 10  |
| Computer software (in years)       | 3 - 8   |

Costs related to the purchase, internal development, and implementation of the Company's fully integrated enterprise resource planning/business operating software system are either capitalized or expensed in accordance with ASC Subtopic 350-40, "Intangibles – Goodwill and Other: Internal-Use Software." Leasehold improvements are depreciated over the shorter of fifteen years or the remaining term of the lease.

The company is in the process of selling one of two buildings at its Woonsocket, Rhode Island operation, which is included in the Graphics Segment. The sale of this property is the result of the consolidation of the operations into the remaining facility in order to eliminate redundancies and improve manufacturing efficiencies. The sale of the building is expected to be complete in the first quarter of fiscal 2015. The selling price of the building is in excess of its carrying value. The asset held for sale is separately disclosed on the balance sheet.

The Company recorded \$5,411,000, \$4,702,000 and \$5,174,000 of depreciation expense in the years ended June 30, 2014, 2013 and 2012, respectively.

#### **Intangible Assets:**

Intangible assets consisting of customer relationships, trade names and trademarks, patents, technology and software, and non-compete agreements are recorded on the Company's balance sheet. The definite-lived intangible assets are being amortized to expense over periods ranging between five and twenty years. The Company evaluates definite-lived intangible assets for permanent impairment when triggering events are identified. Neither indefinite-lived intangible assets nor the excess of cost over fair value of assets acquired ("goodwill") are amortized, however they are subject to review for impairment. See additional information about goodwill and intangibles in Note 6.

**Fair Value:**

The Company has financial instruments consisting primarily of cash and cash equivalents, revolving lines of credit, and on occasion long-term debt. The fair value of these financial instruments approximates carrying value because of their short-term maturity and/or variable, market-driven interest rates. The Company has no financial instruments with off-balance sheet risk.

Fair value measurements of nonfinancial assets and nonfinancial liabilities are primarily used in goodwill and other intangible asset impairment analyses, in the purchase price of acquired companies (if any), and in the valuation of the contingent earn-out. The fair value measurement of these nonfinancial assets and nonfinancial liabilities is based on significant inputs not observable in the market and thus represent Level 3 measurements as defined in ASC 820, "Fair Value Measurement."

**Product Warranties:**

The Company offers a limited warranty that its products are free of defects in workmanship and materials. The specific terms and conditions vary somewhat by product line, but generally cover defective products returned within one to five years from the date of shipment. The Company records warranty liabilities to cover the estimated future costs for repair or replacement of defective returned products as well as products that need to be repaired or replaced in the field after installation. The Company calculates its liability for warranty claims by applying estimates to cover unknown claims, as well as estimating the total amount to be incurred for known warranty issues. The Company periodically assesses the adequacy of its recorded warranty liabilities and adjusts the amounts as necessary.

Changes in the Company's warranty liabilities, which are included in accrued expenses in the accompanying consolidated balance sheets, during the periods indicated below were as follows:

| <i>(In thousands)</i>                   | June<br>30,<br>2014 | June<br>30,<br>2013 |
|---|---------------------|---------------------|
| Balance at beginning of the period      | \$1,424             | \$1,121             |
| Additions charged to expense            | 3,816               | 2,134               |
| Deductions for repairs and replacements | (2,578)             | (1,831)             |
| Balance at end of the period            | \$2,662             | \$1,424             |

**Employee Benefit Plans:**



The Company has a defined contribution retirement plan and a discretionary profit sharing plan covering substantially all of its non-union employees in the United States, and a non-qualified deferred compensation plan covering certain employees. The costs of employee benefit plans are charged to expense and funded annually. Total costs were \$1,961,000 in 2014, \$1,932,000 in 2013, and \$960,000 in 2012. Effective July 1, 2012, the Company increased the employer contribution percentage from 2% to 4%.

#### **Research and Development Costs:**

Research and development expenses are costs directly attributable to new product development, including the development of new technology for both existing and new products, and consist of salaries, payroll taxes, employee benefits, materials, supplies, depreciation and other administrative costs. The Company follows the requirements of ASC Subtopic 985-20, "Software: Costs of Software to be Sold, Leased, or Marketed," and expenses as research and development all costs associated with development of software used in solid-state LED products. All costs are expensed as incurred and are included in selling and administrative expenses. Research and development costs related to both product and software development totaled \$8,226,000, \$6,480,000 and \$5,511,000 for the fiscal years ended June 30, 2014, 2013 and 2012, respectively.

#### **Advertising Expense:**

The Company recorded \$322,000, \$280,000, and \$328,000 of advertising expense in 2014, 2013 and 2012, respectively. Advertising costs are expensed the first time the advertising occurs. Expense related to printed product or capabilities literature, brochures, etc. is recorded on a ratable basis over the useful life of that printed media.

### **Earnings Per Common Share:**

The computation of basic earnings per common share is based on the weighted average common shares outstanding for the period net of treasury shares held in the Company's non-qualified deferred compensation plan. The computation of diluted earnings per share is based on the weighted average common shares outstanding for the period and includes common share equivalents. Common share equivalents include the dilutive effect of stock options, contingently issuable shares and common shares to be issued under a deferred compensation plan, all of which totaled 462,000 shares in fiscal 2014, 356,000 shares in fiscal 2013, and 316,000 shares in fiscal 2012. See further discussion in Note 3.

### **New Accounting Pronouncements:**

In July 2012, the Financial Accounting Standards Board issued ASU 2012-02, "Intangibles – Goodwill and Other (Topic 350): Testing Long-Lived Intangible Assets for Impairment." This amended guidance is intended to simplify the test of indefinite-lived intangible assets for impairment by allowing companies to first assess qualitative factors to determine whether or not it is more likely than not that the fair value of an indefinite-lived intangible asset is less than its carrying value as the basis for determining whether it is necessary to perform the two-step impairment test. Previous guidance required companies to perform an annual indefinite-lived intangible asset impairment test. The amended guidance is effective for annual and interim tests performed for fiscal years beginning after September 15, 2012, or the Company's fiscal year 2014, with early adoption permissible. The adoption of this standard in fiscal 2014 did not have an impact on the financial statements.

In September 2013, the Internal Revenue Service issued Treasury Decision 9636, which enacted final tax regulations regarding the capitalization and expensing of amounts paid to acquire, produce, or improve tangible property. The regulations also include guidance regarding the retirement of depreciable property. The regulations are required to be effective in taxable years beginning on or after January 1, 2014, although taxpayers may choose to apply them in taxable years beginning on or after January 1, 2012. The Company has reviewed the impact of the final regulations and the anticipated impact to the financial statements is immaterial.

In June 2014, the Financial Accounting Standards Board issued ASU 2014-09, "Revenue from Contracts with Customers." This amended guidance supersedes and replaces all existing U.S. GAAP revenue recognition guidance. The guidance established a new revenue recognition model, changes the basis for deciding when revenue is recognized over a point in time, provides new and more detailed guidance on specific revenue topics, and expands and improves disclosures about revenue. The amended guidance is effective for fiscal years and interim periods within those years, beginning after December 15, 2016, or the Company's fiscal year 2018. The Company has not yet determined the impact the amended guidance will have on its financial statements.

**Comprehensive Income:**

The Company does not have any comprehensive income items other than net income (loss). The functional currency of the Company's Canadian operation is the U.S. dollar.

**Subsequent Events:**

On August 22, 2014, the Company signed a non-binding letter of intent to sell the stock of its wholly-owned subsidiary LSI Saco Technologies, located in Montreal, Canada. It is likely a loss will be recognized on the sale, but the actual amount of the loss will not be known until the sale is complete. The loss on the sale is expected to be between \$500,000 and \$1,000,000. The \$5 million unsecured revolving line of credit for this Canadian operation (See Note 7) will be terminated once the sale is complete. The Company anticipates the sale to be completed in the first or second quarter of fiscal 2015.

The assets and liabilities of LSI Saco are comprised of the following at June 30, 2014 and 2013:

| <i>Amounts in thousands</i>           | <b>June<br/>30,<br/>2014</b> | <b>June<br/>30,<br/>2013</b> |
|---------------------------------------|------------------------------|------------------------------|
| Cash                                  | \$741                        | \$613                        |
| Accounts Receivable (net)             | 860                          | 996                          |
| Inventory (net)                       | 342                          | 697                          |
| Other Current Assets                  | 105                          | 468                          |
| PP&E (net)                            | 187                          | 329                          |
| Intangible Assets                     | 622                          | 674                          |
| Other Long-Term Asset                 | 3                            | 7                            |
| <b>Total Assets</b>                   | <b>\$2,860</b>               | <b>\$3,784</b>               |
| Accounts Payable and Accrued Expenses | \$195                        | \$319                        |
| <b>Total Liabilities</b>              | <b>\$195</b>                 | <b>\$319</b>                 |

The Company has evaluated subsequent events for potential recognition and disclosure through the date the consolidated financial statements were filed. No other items were identified during this evaluation that required adjustment to or disclosure in the accompanying financial statements.

#### **Reclassifications:**

Certain prior year amounts have been reclassified to conform to the current year presentation within the cash flows from operating activities section of the statement of cash flows. These reclassifications have no impact on net income, earnings per share, or total operating cash flows.

#### **Use of Estimates:**

The preparation of the financial statements in conformity with accounting principles generally accepted in the United States of America requires the Company to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

**NOTE 2 — BUSINESS SEGMENT INFORMATION**

ASC Topic 280, “Segment Reporting,” establishes standards for reporting information regarding operating segments in annual financial statements and requires selected information of those segments to be presented in financial statements. Operating segments are identified as components of an enterprise for which separate discrete financial information is available for evaluation by the chief operating decision maker (the Company’s Chief Executive Officer) in making decisions on how to allocate resources and assess performance. While the Company has twelve operating segments, it has only three reportable operating business segments (Lighting, Graphics, and Electronic Components), an All Other Category, and Corporate and Eliminations.

The Lighting Segment includes outdoor, indoor, and landscape lighting utilizing both traditional and LED light sources, that has been fabricated and assembled for the commercial, industrial and multi-site retail lighting markets, the Company’s primary niche markets (petroleum / convenience store market, automotive dealership market, and quick service restaurant market), and LED solid state digital sports video screens. LED video screens are designed and manufactured by the Company’s Lighting Segment and by LSI Saco in the All Other Category. The Lighting Segment includes the operations of LSI Ohio Operations, LSI Metal Fabrication, LSI MidWest Lighting and LSI Lightron. These operations have been integrated, have similar economic characteristics and meet the other requirements for aggregation in segment reporting.

The Graphics Segment designs, manufactures and installs exterior and interior visual image elements related to traditional graphics along with digital signage. These products are used in visual image programs in several markets, including the petroleum / convenience store market and multi-site retail operations. The Graphics Segment includes the operations of Grady McCauley, LSI Retail Graphics and LSI Integrated Graphic Systems, which have been aggregated as such facilities manufacture two-dimensional graphics with the use of screen and digital printing, fabricate three-dimensional structural graphics sold in the multi-site retail and petroleum / convenience store markets, and each exhibit similar economic characteristics and meet the other requirements for aggregation in segment reporting.

The Electronic Components Segment designs, engineers and manufactures custom designed electronic circuit boards, assemblies and sub-assemblies, and various products used in various applications including the control of solid-state LED lighting and metal halide lighting. The Electronic Components Segment includes the operations of LSI ADL Technology as well as LSI Controls (formerly LSI Virticus). LSI ADL Technology sells electronic circuit boards, assemblies and sub-assemblies directly to customers and also has significant inter-segment sales to the Lighting Segment. LSI Controls sells lighting control systems directly to customers and to the Lighting Segment. Products produced by this segment may have applications in the Company's other LED product lines such as digital scoreboards, advertising ribbon boards and billboards.

The All Other Category includes the Company's operating segments that neither meet the aggregation criteria, nor the criteria to be a separate reportable segment. The Operations of LSI Images (menu board systems), LSI Adapt (implementation, installation and program management services related to products of the Graphics and Lighting Segments) and LSI Saco Technologies (designs and produces high-performance light engines, large format video screens using solid-state LED technology, and certain specialty LED lighting) are combined in the All Other Category.

The Company's corporate administration activities are reported in a line item titled Corporate and Eliminations. This primarily includes intercompany profit in inventory eliminations, expense related to certain corporate officers and support staff, the Company's internal audit staff, expense related to the Company's Board of Directors, stock option expense for options granted to corporate administration employees, certain consulting expenses, investor relations activities, and a portion of the Company's legal, auditing and professional fee expenses. In fiscal 2013 and fiscal 2012, all stock option expense was reported in Corporate and Eliminations. In fiscal 2014, stock option expense was reported in each segment to match with compensation and benefit expense. Corporate identifiable assets primarily consist of cash, invested cash (if any), refundable income taxes, and deferred income tax assets.

There were no customers or customer programs representing a concentration of 10% or more of the Company's net sales in the fiscal year ended June 30, 2014, 2013 and 2012. The Company had a concentration of receivables with Ahold USA totaling \$5.3 million or 11.6% of total net accounts receivable as of June 30, 2013. There was no concentration of accounts receivable at June 30, 2014 or 2012.

Summarized financial information for the Company's reportable business segments is provided for the indicated periods and as of June 30, 2014, June 30, 2013, June 30, 2012:

| <i>(In thousands)</i>         | <b>2014</b>      | 2013      | 2012      |
|-------------------------------|------------------|-----------|-----------|
| <b>Net Sales:</b>             |                  |           |           |
| Lighting Segment              | <b>\$227,628</b> | \$206,363 | \$199,610 |
| Graphics Segment              | <b>46,166</b>    | 46,770    | 42,131    |
| Electronic Components Segment | <b>19,491</b>    | 20,333    | 18,515    |

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|                    |                  |           |           |
|--------------------|------------------|-----------|-----------|
| All Other Category | <b>6,178</b>     | 7,324     | 8,146     |
| Total Net Sales    | <b>\$299,463</b> | \$280,790 | \$268,402 |

**Operating Income (Loss):**

|                               |                |          |          |
|-------------------------------|----------------|----------|----------|
| Lighting Segment              | <b>\$9,788</b> | \$10,092 | \$11,828 |
| Graphics Segment              | <b>(2,802)</b> | (1,253)  | (1,938)  |
| Electronic Components Segment | <b>2,369</b>   | (916)    | 3,634    |
| All Other Category            | <b>(138)</b>   | (1,451)  | (1,114)  |
| Corporate and Eliminations    | <b>(6,899)</b> | (5,842)  | (6,079)  |
| Total Operating Income        | <b>\$2,318</b> | \$630    | \$6,331  |

**Capital Expenditures:**

|                               |                |         |         |
|-------------------------------|----------------|---------|---------|
| Lighting Segment              | <b>\$3,294</b> | \$2,081 | \$1,606 |
| Graphics Segment              | <b>461</b>     | 350     | 576     |
| Electronic Components Segment | <b>726</b>     | 1,528   | 558     |
| All Other Category            | <b>20</b>      | 115     | 182     |
| Corporate and Eliminations    | <b>744</b>     | 3,497   | 514     |
| Total Capital Expenditures    | <b>\$5,245</b> | \$7,571 | \$3,436 |

**Depreciation and Amortization:**

|                                     |                |         |         |
|-------------------------------------|----------------|---------|---------|
| Lighting Segment                    | <b>\$2,845</b> | \$4,434 | \$4,953 |
| Graphics Segment                    | <b>940</b>     | 896     | 884     |
| Electronic Components Segment       | <b>1,497</b>   | 1,357   | 1,130   |
| All Other Category                  | <b>171</b>     | 191     | 223     |
| Corporate and Eliminations          | <b>773</b>     | 319     | 615     |
| Total Depreciation and Amortization | <b>\$6,226</b> | \$7,197 | \$7,805 |

|                               | <b>June 30,<br/>2014</b> | June 30,<br>2013 |
|-------------------------------|--------------------------|------------------|
| <b>Identifiable Assets:</b>   |                          |                  |
| Lighting Segment              | <b>\$96,499</b>          | \$90,536         |
| Graphics Segment              | <b>22,312</b>            | 28,792           |
| Electronic Components Segment | <b>30,788</b>            | 30,926           |
| All Other Category            | <b>4,987</b>             | 6,361            |
| Corporate and Eliminations    | <b>15,302</b>            | 12,564           |
| Total Identifiable Assets     | <b>\$169,888</b>         | \$169,179        |

The segment net sales reported above represent sales to external customers. Segment operating income, which is used in management's evaluation of segment performance, represents net sales less all operating expenses including impairment of goodwill, but excluding interest expense and interest income. Identifiable assets are those assets used by each segment in its operations. Corporate identifiable assets primarily consist of cash, invested cash (if any), refundable income taxes, and deferred income tax assets.

The Company records a 10% mark-up on intersegment revenues. Any intersegment profit in inventory is eliminated in consolidation. Intersegment revenues were eliminated in consolidation as follows:

| <i>(In thousands)</i>                        | <b>2014</b>     | 2013     | 2012     |
|--|-----------------|----------|----------|
| Lighting Segment intersegment net sales      | <b>\$3,534</b>  | \$2,746  | \$2,457  |
| Graphics Segment intersegment net sales      | <b>\$843</b>    | \$1,854  | \$1,581  |
| Electronic Components intersegment net sales | <b>\$34,238</b> | \$26,522 | \$22,019 |
| All Other Category intersegment net sales    | <b>\$6,957</b>  | \$6,710  | \$5,805  |

The Company considers its geographic areas to be: 1) the United States; and 2) Canada. The majority of the Company's operations are in the United States, with one operation in Canada. The geographic distribution of the Company's net sales and long-lived assets are as follows:

| <i>(In thousands)</i> | <b>2014</b>      | 2013      | 2012      |
|-----------------------|------------------|-----------|-----------|
| <b>Net Sales (a):</b> |                  |           |           |
| United States         | <b>\$298,089</b> | \$279,818 | \$266,590 |
| Canada                | <b>1,374</b>     | 972       | 1,812     |
| Total Net Sales       | <b>\$299,463</b> | \$280,790 | \$268,402 |



|                               | <b>June<br/>30,<br/>2014</b> | June 30,<br>2013 | June 30,<br>2012 |
|-------------------------------|------------------------------|------------------|------------------|
| <b>Long-Lived Assets (b):</b> |                              |                  |                  |
| United States                 | <b>\$45,886</b>              | \$46,843         | \$44,286         |
| Canada                        | <b>190</b>                   | 336              | 322              |
| Total Long-Lived Assets       | <b>\$46,076</b>              | \$47,179         | \$44,608         |

- a. Net sales are attributed to geographic areas based upon the location of the operation making the sale.
- b. Long-lived assets include property, plant and equipment, and other long term assets. Goodwill and intangible assets are not included in long-lived assets.

**NOTE 3 — EARNINGS PER COMMON SHARE**

The following table presents the amounts used to compute basic and diluted earnings per common share, as well as the effect of dilutive potential common shares on weighted average shares outstanding (in thousands, except per share data):

| <i>(In thousands, except per share data)</i>  | <b>2014</b>   | 2013      | 2012    |
|---|---------------|-----------|---------|
| <b>BASIC EARNINGS PER SHARE</b>   |               |           |         |
| Net income (loss)   | <b>\$930</b>  | \$(123 )  | \$3,224 |
| Weighted average shares outstanding during the period, net of treasury shares (a)                       | <b>24,084</b> | 24,029    | 24,036  |
| Weighted average shares outstanding in the Deferred Compensation Plan during the period                 | <b>304</b>    | 284       | 262     |
|   | <b>24,388</b> | 24,313    | 24,298  |
| Weighted average shares outstanding   |               |           |         |
| Basic earnings (loss) per share   | <b>\$0.04</b> | \$(0.01 ) | \$0.13  |
| <b>DILUTED EARNINGS PER SHARE</b>   |               |           |         |
| Net income (loss)   | <b>\$930</b>  | \$(123 )  | \$3,224 |
| Weighted average shares outstanding   |               |           |         |
| Basic   | <b>24,388</b> | 24,313    | 24,298  |
| Effect of dilutive securities (b):  |               |           |         |
| Impact of common shares to be issued under stock option plans, and contingently issuable shares, if any | <b>158</b>    | —         | 54      |
| Weighted average shares outstanding (c)   | <b>24,546</b> | 24,313    | 24,352  |
| Diluted earnings (loss) per share   | <b>\$0.04</b> | \$(0.01 ) | \$0.13  |

(a) Includes shares accounted for like treasury stock in accordance with Accounting Standards Codification Topic 710, Compensation — General.

(b) Calculated using the “Treasury Stock” method as if dilutive securities were exercised and the funds were used to purchase common shares at the average market price during the period.

(c) Options to purchase 1,974,775 common shares, 2,027,450 common shares, and 1,782,868 common shares at June 30, 2014, 2013, and 2012, respectively, were not included in the computation of diluted earnings per share

because the exercise price was greater than the average fair market value of the common shares.

#### NOTE 4 — INVENTORIES

The following information is provided as of the dates indicated:

|                       | <b>June<br/>30,<br/>2014</b> | June 30,<br>2013 |
|-----------------------|------------------------------|------------------|
| <i>(In thousands)</i> |                              |                  |
| Inventories:          |                              |                  |
| Raw materials         | <b>\$30,278</b>              | \$28,113         |
| Work-in-process       | <b>5,393</b>                 | 4,959            |
| Finished goods        | <b>9,737</b>                 | 9,021            |
| Total Inventories     | <b>\$45,408</b>              | \$42,093         |

**NOTE 5 — ACCRUED EXPENSES**

The following information is provided as of the dates indicated:

| <i>(In thousands)</i>     | <b>June<br/>30,<br/>2014</b> | June 30,<br>2013 |
|---------------------------|------------------------------|------------------|
| Accrued Expenses:         |                              |                  |
| Compensation and benefits | <b>\$7,134</b>               | \$8,023          |
| Customer prepayments      | <b>1,473</b>                 | 947              |
| Accrued sales commissions | <b>1,814</b>                 | 1,595            |
| Accrued warranty          | <b>2,662</b>                 | 1,424            |
| Other accrued expenses    | <b>2,548</b>                 | 1,792            |
| Total Accrued Expenses    | <b>\$15,631</b>              | \$13,781         |

**NOTE 6 — GOODWILL AND OTHER INTANGIBLE ASSETS**

Carrying values of goodwill and other intangible assets with indefinite lives are reviewed at least annually for possible impairment in accordance with ASC Topic 350, “Intangibles – Goodwill and Other.” The Company may first assess qualitative factors in order to determine if goodwill and indefinite-lived intangible assets are impaired. If through the qualitative assessment it is determined that it is more likely than not that goodwill and indefinite-lived assets are not impaired, no further testing is required. If it is determined more likely than not that goodwill and indefinite-lived assets are impaired, or if the Company elects not to first assess qualitative factors, the Company’s impairment testing continues with the estimation of the fair value of goodwill and indefinite-lived intangible assets using a combination of a market approach and an income (discounted cash flow) approach, at the reporting unit level, that requires significant management judgment with respect to revenue and expense growth rates, changes in working capital and the selection and use of an appropriate discount rate. The estimates of fair value of reporting units are based on the best information available as of the date of the assessment. The use of different assumptions would increase or decrease estimated discounted future operating cash flows and could increase or decrease an impairment charge. Company management uses its judgment in assessing whether assets may have become impaired between annual impairment tests. Indicators such as adverse business conditions, economic factors and technological change or competitive activities may signal that an asset has become impaired.

The Company identified its reporting units in conjunction with its annual goodwill impairment testing. The Company relies upon a number of factors, judgments and estimates when conducting its impairment testing. These include operating results, forecasts, anticipated future cash flows and marketplace data, to name a few. There are inherent uncertainties related to these factors and judgments in applying them to the analysis of goodwill impairment.

The Company performed an interim goodwill impairment test as of December 31, 2012 on LSI Controls (formerly LSI Virticus), one of its reporting units that contain goodwill. LSI Controls was acquired March 19, 2012 and is part of the Electronic Components Segment. The reduction of the sales forecast that was originally used to value the Earn-Out liability related to the LSI Controls acquisition and which ultimately led to an adjustment to the Earn-Out liability in the second quarter of fiscal 2013 (see Note 13), led management to conclude that an interim goodwill impairment test was required on the LSI Controls reporting unit. As a result of the test, it was determined that goodwill associated with this reporting unit was impaired. Of the original goodwill of \$2,413,000, it was determined that \$2,141,000 or 89% of the original goodwill value was impaired. (As part of the annual goodwill test performed as of March 1, 2013, the remaining \$272,000 of goodwill associated with LSI Controls was found to be fully impaired.) A similar test was not performed on the three other reporting units that contain goodwill because the triggering events that indicate the potential impairment of goodwill did not exist.

As of March 1, 2013, the Company performed its annual goodwill impairment test on the four reporting units that contain goodwill. The goodwill impairment test of one of the reporting units in the Electronic Components Segment that contains goodwill passed with an estimated business enterprise value that was \$10.5 million or 42% above the carrying value of this reporting unit. The goodwill impairment test of a reporting unit in the All Other Category passed with an estimated business enterprise value that was \$2.1 million or 182% above the carrying value of the reporting unit. The goodwill impairment test of a reporting unit in the Lighting Segment passed with a margin in excess of \$8.5 million or 10% above its carrying value. The fourth reporting unit that contains goodwill that is also in the Electronic Components Segment, LSI Controls, was found to be fully impaired. It was this same reporting unit that incurred an impairment loss of \$2,141,000, or 89% of the original goodwill value, as of December 31, 2012. The remaining \$272,000 of goodwill associated with LSI Controls was found to be fully impaired, primarily as a result of a decline in the discounted cash flows related to this reporting unit.

As of March 1, 2014, the Company performed its annual goodwill impairment test on the three reporting units that contain goodwill. The goodwill impairment test of one of the reporting units in the Electronic Components Segment that contains goodwill passed with an estimated business enterprise value that was \$18.2 million or 71% above the carrying value of this reporting unit. The goodwill impairment test of a reporting unit in the All Other Category passed with an estimated business enterprise value that was \$2.5 million or 453% above the carrying value of the reporting unit. The goodwill impairment test of a reporting unit in the Lighting Segment passed with a business enterprise value that was \$2.5 million or 3% above its carrying value.

The following table presents information about the Company's goodwill on the dates or for the periods indicated.

| Goodwill<br>(In thousands)        | Lighting<br>Segment | Graphics<br>Segment | Electronic<br>Components<br>Segment | All<br>Other<br>Category | Total    |
|-----------------------------------|---------------------|---------------------|-------------------------------------|--------------------------|----------|
| Balance as of June 30, 2013       |                     |                     |                                     |                          |          |
| Goodwill                          | \$34,913            | \$24,959            | \$ 11,621                           | \$ 6,850                 | \$78,343 |
| Accumulated impairment losses     | (34,778)            | (24,959)            | (2,413 )                            | (5,685 )                 | (67,835) |
| Goodwill, net as of June 30, 2013 | \$135               | \$--                | \$ 9,208                            | \$ 1,165                 | \$10,508 |
| Balance as of June 30, 2014       |                     |                     |                                     |                          |          |
| Goodwill                          | \$34,913            | \$24,959            | \$ 11,621                           | \$ 6,850                 | \$78,343 |
| Accumulated impairment losses     | (34,778)            | (24,959)            | (2,413 )                            | (5,685 )                 | (67,835) |
| Goodwill, net as of June 30, 2014 | \$135               | \$--                | \$ 9,208                            | \$ 1,165                 | \$10,508 |

The Company performed its annual review of indefinite-lived intangible assets as of March 1, 2013 and 2014 and determined there was no impairment. As of June 30, 2014, the Company performed an impairment test on two definite-lived intangible assets at the LSI Controls reporting unit (formerly LSI Virticus) in the Electronic Components Segment. The triggering event for this impairment analysis was the shortfall in lighting control sales relative to forecast. The income (discounted cash flow) approach was used to determine the fair market value of the intangible assets. As a result of the analysis, it was determined that two definite-lived intangible assets were fully impaired, totaling \$805,000 of impairment expense.



In the first quarter of fiscal 2014, the Company purchased intellectual property related to certain lighting control systems. The cost of this intellectual property was \$268,000 and it is being amortized over a nine year period.

The gross carrying amount and accumulated amortization by major other intangible asset class is as follows:

| Other Intangible Assets                  | June 30, 2014         |                          |            |
|--|-----------------------|--------------------------|------------|
|  | Gross Carrying Amount | Accumulated Amortization | Net Amount |
| <i>(In thousands)</i>                    |                       |                          |            |
| Amortized Intangible Assets              |                       |                          |            |
| Customer relationships                   | \$10,352              | \$ 7,412                 | \$ 2,940   |
| Patents                                  | 338                   | 84                       | 254        |
| LED technology firmware, software        | 11,228                | 10,832                   | 396        |
| Trade name                               | 460                   | 454                      | 6          |
| Non-compete agreements                   | 710                   | 501                      | 209        |
| Total Amortized Intangible Assets        | 23,088                | 19,283                   | 3,805      |
| Indefinite-lived Intangible Assets       |                       |                          |            |
| Trademarks and trade names               | 3,422                 | --                       | 3,422      |
| Total Indefinite-lived Intangible Assets | 3,422                 | --                       | 3,422      |
| Total Other Intangible Assets            | \$26,510              | \$ 19,283                | \$ 7,227   |
| <br>                                     |                       |                          |            |
| Other Intangible Assets                  | June 30, 2013         |                          |            |
|  | Gross Carrying Amount | Accumulated Amortization | Net Amount |
| <i>(In thousands)</i>                    |                       |                          |            |
| Amortized Intangible Assets              |                       |                          |            |
| Customer relationships                   | \$10,352              | \$ 7,068                 | \$ 3,284   |
| Patents                                  | 70                    | 55                       | 15         |
| LED technology firmware, software        | 12,361                | 10,958                   | 1,403      |
| Trade name                               | 460                   | 362                      | 98         |
| Non-compete agreements                   | 948                   | 591                      | 357        |
| Total Amortized Intangible Assets        | 24,191                | 19,034                   | 5,157      |
| Indefinite-lived Intangible Assets       |                       |                          |            |
| Trademarks and trade names               | 3,422                 | --                       | 3,422      |
| Total Indefinite-lived Intangible Assets | 3,422                 | --                       | 3,422      |
| Total Other Intangible Assets            | \$27,613              | \$ 19,034                | \$ 8,579   |



Amortization Expense  
of Other Intangible  
Assets

*(In thousands)*

2014 2013 2012

Amortization Expense \$815 \$2,495 \$2,631

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The Company expects to record amortization expense as follows:

*(In thousands)*

|            |         |
|------------|---------|
| 2015       | \$564   |
| 2016       | \$557   |
| 2017       | \$460   |
| 2018       | \$452   |
| 2019       | \$452   |
| After 2019 | \$1,320 |

#### **NOTE 7 — REVOLVING LINES OF CREDIT AND LONG-TERM DEBT**

In April 2014, the Company renewed its unsecured revolving credit line placing both the \$30 million unsecured revolving line of credit for its U.S. operations and the \$5 million unsecured revolving line of credit for its Canadian operations under one bank. The lines of credit expire in the third quarter of fiscal 2017. Interest on the revolving line of credit is charged based upon an increment over the LIBOR rate as periodically determined, or at the bank's base lending rate, at the Company's option. The increment over the LIBOR borrowing rate, as periodically determined, fluctuates between 150 and 190 basis points depending upon the ratio of indebtedness to earnings before interest, taxes, depreciation and amortization ("EBITDA"), as defined in the credit facility. The fee on the unused balance of both the \$30 million and \$5 million committed lines of credit is 15 basis points. Under the terms of this credit facility, the Company has agreed to a negative pledge of assets and is required to comply with financial covenants that limit the amount of debt obligations, require a minimum amount of tangible net worth, and limit the ratio of indebtedness to EBITDA. There are no borrowings against either line of credit as of June 30, 2014.

The Company is in compliance with all of its loan covenants as of June 30, 2014.

#### **NOTE 8 — CASH DIVIDENDS**

The Company paid cash dividends of \$5,780,000, \$8,648,000 and \$5,529,000 in fiscal years 2014, 2013 and 2012, respectively. In August 2014, the Board of Directors declared a regular quarterly cash dividend of \$0.06 per share payable September 9, 2014 to shareholders of record September 2, 2014.

## NOTE 9 - EQUITY COMPENSATION

### Stock Options

The Company has an equity compensation plan that was approved by shareholders in November 2012 and that covers all of its full-time employees, outside directors and certain advisors. This 2012 Stock Incentive Plan replaces all previous equity compensation plans. The options granted or stock awards made pursuant to this plan are granted at fair market value at date of grant or award. Options granted to non-employee directors become exercisable 25% each ninety days (cumulative) from date of grant and options granted to employees generally become exercisable 25% per year (cumulative) beginning one year after the date of grant. The maximum contractual term of the Company's stock options is ten years. If a stock option holder's employment with the Company terminates by reason of death, disability or retirement, as defined in the Plan, the Plan generally provides for acceleration of vesting. The number of shares reserved for issuance is 686,831 shares, all of which were available for future grant or award as of June 30, 2014. This plan allows for the grant of incentive stock options, non-qualified stock options, stock appreciation rights, restricted and unrestricted stock awards, performance stock awards, and other stock awards. As of June 30, 2014, a total of 2,677,464 options for common shares were outstanding from this plan as well as one previous stock option plan (which had also been approved by shareholders), and of these, a total of 1,874,326 options for common shares were vested and exercisable. As of June 30, 2014, the approximate unvested stock option expense that will be recorded as expense in future periods is \$614,781. The weighted average time over which this expense will be recorded is approximately 30 months.

The fair value of each option on the date of grant was estimated using the Black-Scholes option pricing model. The below listed weighted average assumptions were used for grants in the periods indicated.

|                          | 2014  | 2013  | 2012  |
|--------------------------|-------|-------|-------|
| Dividend yield           | 3.3 % | 3.6 % | 3.1 % |
| Expected volatility      | 53 %  | 51 %  | 55 %  |
| Risk-free interest rate  | 1.7 % | 0.6 % | 1.0 % |
| Expected life (in years) | 5.5   | 4.7   | 4.7   |

At June 30, 2014, the 436,000 options granted to employees during fiscal 2014 had exercise prices ranging from of \$7.20 to \$8.44 per share, fair values ranging from \$2.64 to \$3.64 per share, and remaining contractual lives of between nine years two months and nine years six months.

At June 30, 2013, the 414,750 options granted during fiscal 2013 to both employees and non-employee directors had exercise prices ranging from \$6.28 to \$6.58 per share, fair values ranging from \$2.00 to \$2.11 per share, and remaining contractual lives of between nine years two months and nine years five months.

At June 30, 2012, the 36,000 options granted during fiscal 2012 to both employees and non-employee directors had exercise prices ranging from \$6.68 to \$7.22 per share, fair values ranging from \$2.45 to \$2.60 per share, and remaining contractual lives of between nine years five months and nine years eight months.

The Company calculates stock option expense using the Black-Scholes model. Stock option expense is recorded on a straight line basis, or sooner if the grantee is retirement eligible as defined in the 2012 Stock Incentive Plan, with an estimated 2.0% forfeiture rate effective April 1, 2014. Previous estimated forfeiture rates were 2.1% effective January 1, 2014, 2.2% effective July 1, 2013, 2.3% effective January 1, 2013, 3.4% effective October 1, 2012, 4.1% effective April 1, 2012, 3.6% effective April 1, 2011, 3.0% effective July 1, 2010 and 6.55% prior to July 1, 2010. The expected volatility of the Company's stock was calculated based upon the historic monthly fluctuation in stock price for a period approximating the expected life of option grants. The risk-free interest rate is the rate of a five year Treasury security at constant, fixed maturity on the approximate date of the stock option grant. The expected life of outstanding options is determined to be less than the contractual term for a period equal to the aggregate group of option holders' estimated weighted average time within which options will be exercised. It is the Company's policy that when stock options are exercised, new common shares shall be issued. The Company recorded \$1,004,676, \$842,401 and \$410,550 of expense related to stock options in fiscal years 2014, 2013 and 2012, respectively. As of June 30, 2014, the Company had 2,667,192 stock options that were vested and that were expected to vest, with a weighted average exercise price of \$9.58 per share, an aggregate intrinsic value of \$1,664,121 and weighted average remaining contractual terms of 5.4 years.



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Information related to all stock options for the years ended June 30, 2014, 2013 and 2012 is shown in the following tables:

| Twelve Months Ended June 30, 2014 |           |  |   |                                 |
|-----------------------------------|-----------|--|---|---------------------------------|
|                                   | Shares    | Weighted<br>Average<br>Exercise<br>Price | Weighted<br>Average<br>Remaining<br>Contractual<br>Term<br>(in years) | Aggregate<br>Intrinsic<br>Value |
| Outstanding at 6/30/13            | 2,341,150 | \$ 9.95                                  | 5.6   | \$1,544,896                     |
| Granted                           | 436,000   | \$ 7.24                                  |   |                                 |
| Forfeitures                       | (39,050 ) | \$ 11.59                                 |   |                                 |
| Exercised                         | (60,636 ) | \$ 6.22                                  |   |                                 |
| Outstanding at 6/30/14            | 2,677,464 | \$ 9.57                                  | 5.4   | \$1,674,010                     |
| Exercisable at 6/30/14            | 1,874,326 | \$ 10.74                                 | 4.0   | \$750,925                       |

| Twelve Months Ended June 30, 2013 |           |  |   |                                 |
|-----------------------------------|-----------|--|---|---------------------------------|
|                                   | Shares    | Weighted<br>Average<br>Exercise<br>Price | Weighted<br>Average<br>Remaining<br>Contractual<br>Term<br>(in years) | Aggregate<br>Intrinsic<br>Value |
| Outstanding at 6/30/12            | 2,006,250 | \$ 10.64                                 | 5.8   | \$654,747                       |
| Granted                           | 414,750   | \$ 6.58                                  |   |                                 |
| Forfeitures                       | (44,350 ) | \$ 13.61                                 |   |                                 |
| Exercised                         | (35,500 ) | \$ 4.93                                  |   |                                 |
| Outstanding at 6/30/13            | 2,341,150 | \$ 9.95                                  | 5.6   | \$1,544,896                     |
| Exercisable at 6/30/13            | 1,643,050 | \$ 11.34                                 | 4.6   | \$524,522                       |

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| Twelve Months Ended June 30, 2012 |            |  |   |                                 |
|-----------------------------------|------------|--|---|---------------------------------|
|                                   | Shares     | Weighted<br>Average<br>Exercise<br>Price | Weighted<br>Average<br>Remaining<br>Contractual<br>Term<br>(in years) | Aggregate<br>Intrinsic<br>Value |
| Outstanding at 6/30/11            | 2,123,939  | \$ 10.80                                 | 6.3   | \$ 955,401                      |
| Granted                           | 36,000     | \$ 7.13                                  |   |                                 |
| Forfeitures                       | (150,939 ) | \$ 12.12                                 |   |                                 |
| Exercised                         | (2,750 )   | \$ 5.18                                  |   |                                 |
| Outstanding at 6/30/12            | 2,006,250  | \$ 10.64                                 | 5.8   | \$ 654,747                      |
| Exercisable at 6/30/12            | 1,404,400  | \$ 12.11                                 | 5.1   | \$ 234,971                      |

The following table presents information related to unvested stock options:

|                             | Shares    | Weighted-Average<br>Grant Date<br>Fair Value |
|-----------------------------|-----------|--|
| Non-vested at June 30, 2013 | 698,100   | \$ 2.20                                      |
| Granted                     | 436,000   | \$ 2.67                                      |
| Vested                      | (329,587) | \$ 2.36                                      |
| Forfeited                   | (1,375 )  | \$ 2.03                                      |
| Non-vested at June 30, 2014 | 803,138   | \$ 2.39                                      |

The weighted average grant date fair value of options granted was \$2.67, \$2.11 and \$2.58 per share in fiscal years 2014, 2013 and 2012, respectively. The aggregate intrinsic value of options exercised during the years ended June 30, 2014, 2013 and 2012 were \$142,714, \$95,223 and \$3,365, respectively. The aggregate grant date fair value of options that vested during 2014, 2013 and 2012 was \$777,825, \$756,543 and \$1,122,010, respectively. The Company received \$377,401, \$175,023 and \$14,235 of cash from employees who exercised options in fiscal years 2014, 2013 and 2012, respectively. Additionally, in fiscal 2014 the Company recorded \$48,747 as a reduction of federal income taxes payable, \$13,009 as an increase in common stock, \$27,693 as a reduction of income tax expense, and \$8,045 as a reduction of the deferred tax asset related to the exercises of stock options in which the employees sold the common shares prior to the passage of twelve months from the date of exercise.

### **Stock Compensation Awards**

The Company awarded a total of 23,205 common shares in fiscal 2014, a total of 8,092 common shares in fiscal 2013, and a total of 7,076 common shares in fiscal 2012 as stock compensation awards. These common shares were valued at their approximate \$192,100, \$56,700 and \$47,700 fair market values based on their stock price at dates of issuance multiplied by the number of common shares awarded, respectively, pursuant to the compensation programs for non-employee directors who receive a portion of their compensation as an award of Company stock and for employees who receive a nominal stock award following their twentieth employment anniversary. Stock compensation awards are made in the form of newly issued common shares of the Company.

### **Deferred Compensation Plan**



The Company has a non-qualified deferred compensation plan providing for both Company contributions and participant deferrals of compensation. This plan is fully funded in a Rabbi Trust. All plan investments are in common shares of the Company. As of June 30, 2014 there were 31 participants, all with fully vested account balances. A total of 307,328 common shares with a cost of \$2,914,700, and 288,505 common shares with a cost of \$2,791,000 were held in the plan as of June 30, 2014 and 2013, respectively, and, accordingly, have been recorded as treasury shares. The change in the number of shares held by this plan is the net result of share purchases and sales on the open stock market for compensation deferred into the plan and for distributions to terminated employees. The Company does not issue new common shares for purposes of the non-qualified deferred compensation plan. The Company accounts for assets held in the non-qualified deferred compensation plan in accordance with Accounting Standards Codification Topic 710, Compensation — General. The Company used approximately \$183,100 and \$175,100 to purchase 24,215 and 25,549 common shares of the Company in the open stock market during fiscal years 2014 and 2013, respectively, for either employee salary deferrals or Company contributions into the non-qualified deferred compensation plan. For fiscal year 2015, the Company estimates the Rabbi Trust for the Nonqualified Deferred Compensation Plan will make net repurchases in the range of 19,000 to 23,000 common shares of the Company. The Company does not currently repurchase its own common shares for any other purpose.

#### **NOTE 10 — LEASES AND PURCHASE COMMITMENTS**

Purchase commitments, including minimum annual rental commitments, of the Company totaled \$35,873,000 and \$33,273,000 as of June 30, 2014 and June 30, 2013, respectively. The Company leases certain of its facilities and equipment under operating lease arrangements. The facility leases contain the option to renew for periods ranging from one to five years. Rental expense was \$1,783,000 in 2014, \$1,794,000 in 2013, and \$1,836,000 in 2012. Minimum annual rental commitments under non-cancelable operating leases are indicated in the table below:

| 2015        | 2016        | 2017        | 2018      | 2019      | 2020 &<br>Beyond |
|-------------|-------------|-------------|-----------|-----------|------------------|
| \$1,406,000 | \$1,228,000 | \$1,065,000 | \$942,000 | \$143,000 | --               |

**NOTE 11 — INCOME TAXES**

The following information is provided for the years ended June 30:

| <i>(In thousands)</i>                            | <b>2014</b>    | 2013    | 2012    |
|--|----------------|---------|---------|
| <b>Components of income before income taxes:</b> |                |         |         |
| United States                                    | <b>\$3,121</b> | \$2,369 | \$8,131 |
| Foreign  | <b>(854 )</b>  | (1,754) | (1,940) |
| Income before income taxes                       | <b>\$2,267</b> | \$615   | \$6,191 |
| <b>Provision (benefit) for income taxes:</b>     |                |         |         |
| Current  |                |         |         |
| U.S. federal                                     | <b>\$500</b>   | \$972   | \$2,543 |
| State and local                                  | <b>35</b>      | (440 )  | 313     |
| Foreign  | <b>(54 )</b>   | (57 )   | (198 )  |
| Total current                                    | <b>481</b>     | 475     | 2,658   |
| Deferred   | <b>856</b>     | 263     | 309     |
| Total provision for income taxes                 | <b>\$1,337</b> | \$738   | \$2,967 |

| <i>(In thousands)</i>                            | <b>2014</b>   | 2013    | 2012   |
|--|---------------|---------|--------|
| <b>Reconciliation to federal statutory rate:</b> |               |         |        |
| Federal statutory tax rate                       | <b>34.0 %</b> | 34.0 %  | 34.0%  |
| State and local taxes, net of federal benefit    | <b>6.9</b>    | 17.0    | 6.6    |
| Impact of foreign operations                     | <b>1.2</b>    | (7.1 )  | (4.1 ) |
| Federal and state tax credits                    | <b>(6.3 )</b> | (34.1 ) | (1.3 ) |
| Goodwill   | <b>0.1</b>    | 133.6   | 1.3    |
| Valuation allowance                              | <b>30.8</b>   | 145.6   | 13.1   |
| Domestic production activities deduction         | <b>(2.8 )</b> | (22.2 ) | (4.0 ) |
| Uncertain tax position activity                  | <b>(11.3)</b> | (101.6) | (0.9 ) |
| Contingent liability                             | <b>--</b>     | (49.6 ) | --     |
| Other  | <b>6.4</b>    | 4.5     | 3.2    |
| Effective tax rate                               | <b>59.0 %</b> | 120.1 % | 47.9%  |

The components of deferred income tax assets and (liabilities) at June 30, 2014 and 2013 are as follows:

| <i>(In thousands)</i>           | <b>2014</b>  | 2013  |
|---------------------------------|--------------|-------|
| Reserves against current assets | <b>\$74</b>  | \$370 |
| Accrued expenses                | <b>2,366</b> | 1,686 |

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|   |                 |          |
|---|-----------------|----------|
| Goodwill, acquisition costs and intangible assets     | <b>1,171</b>    | 1,646    |
| Deferred compensation                                 | <b>1,051</b>    | 999      |
| State net operating loss carryover and credits        | <b>1,991</b>    | 1,991    |
| Foreign net operating loss carryover and credits      | <b>4,465</b>    | 4,256    |
| U.S. Federal net operating loss carryover and credits | <b>556</b>      | 606      |
| Deferred income tax asset before valuation reserve    | <b>11,674</b>   | 11,554   |
| Valuation reserve                                     | <b>(6,450 )</b> | (5,750 ) |
| Deferred income tax asset                             | <b>5,224</b>    | 5,804    |
| Depreciation  | <b>(3,985 )</b> | (3,709 ) |
| Deferred income tax liability                         | <b>(3,985 )</b> | (3,709 ) |
| Net deferred income tax asset                         | <b>\$1,239</b>  | \$2,095  |

F - 39

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Reconciliation to the balance sheets as of June 30, 2014 and 2013:

| <i>(In thousands)</i>                  | <b>2014</b>    | 2013    |
|--|----------------|---------|
| Deferred income tax asset included in: |                |         |
| Other current assets                   | <b>\$2,439</b> | \$2,056 |
| Other long-term assets (liability)     | <b>(1,200)</b> | 39      |
| Net deferred income tax asset          | <b>\$1,239</b> | \$2,095 |

As of June 30, 2014 and 2013, the Company has recorded a deferred tax asset in the amount of \$556,000 and \$606,000, respectively, related to U.S. Federal net operating loss and research and development credit carryovers acquired in the acquisition of Virticus Corporation. The net operating losses will expire over a period of 3 years, beginning in June 30, 2029. The research and development credits will expire over a period of 2 years, beginning in June 30, 2029. The annual utilization is limited by Internal Revenue Code Section 382. However, the Company has determined these assets, more likely than not, will be realized.

As of June 30, 2014 and 2013, the Company has recorded a deferred state income tax asset in the amount of \$1,727,000 and \$1,727,000, respectively, net of federal tax benefits, related to non-refundable New York state tax credits. The Company has determined that this deferred state income tax asset requires a partial valuation reserve. These credits do not expire, but pursuant to New York state legislation enacted in the Company's quarter ending March 31, 2014, and effective for the Company's tax year ending June 30, 2015, the Company has determined that this asset, more likely than not, will not be realized. The legislation enacted in the quarter ending March 31, 2014, caused the Company to change the determination as of June 30, 2013 that only a partial valuation reserve was required. As of June 30, 2014 and 2013, the Company has recorded a valuation reserve in the amount of \$1,721,000 and \$1,231,000, respectively. This activity netted to an additional state income tax expense of \$489,000 (of which \$362,000 related to the state tax code change), \$312,000, and \$95,000 in fiscal years 2014, 2013, and 2012 respectively.

As of June 30, 2014 and 2013, the Company has recorded a deferred state income tax asset in the amount of \$90,000 related to a state net operating loss carryover in Tennessee, and has determined that a full valuation reserve is required. The net loss carryover was created from a company that was previously sold. Because of the sale of this Tennessee-based company, the Company has determined this asset more likely than not, will not be realized. This activity netted to an additional state income tax expense of \$0 in fiscal 2014, 2013 and 2012. The Tennessee net operating loss carryover will expire over a period of 7 years, beginning in June 30, 2019.

As of June 30, 2014 and 2013, the Company has recorded a deferred state income tax asset in the amount of \$173,000 related to a state net operating loss carryover and a state research and development credit in Oregon acquired during the acquisition of Virticus Corporation. The Company has determined this asset more likely than not, will not be realized and that a full valuation reserve is required. The Oregon net operating loss will expire over a period of 4 years, beginning in June 30, 2027. The Oregon research and development credit will expire over a period of 2 years,

beginning in June 30, 2015.

As of June 30, 2014 and 2013, the Company has recorded deferred tax assets for its Canadian subsidiary related to net operating loss carryover and to research and development tax credits totaling \$4,466,000 and \$4,256,000, respectively. In view of the financial statements of this subsidiary and a current series of loss years, the Company has determined these assets, more likely than not, will not be realized. The Canada net operating loss carryover will expire over a period of 9 years, beginning in June 30, 2026. The Canada research and development credit will expire over a period of 8 years, beginning in June 30, 2027.

Considering all issues discussed above, the Company has recorded valuation reserves of \$6,450,000 and \$5,750,000 as of June 30, 2014 and 2013, respectively.

The Company accounts for uncertain tax positions in accordance with Accounting Standards Codification 740-10. At June 30, 2014, tax and interest, net of potential federal tax benefits, were \$485,000 and \$333,000 respectively, of the total reserve for uncertain tax positions of \$987,000. Additionally, penalties were \$169,000 of the reserve at June 30, 2014. Of the \$987,000 reserve for uncertain tax positions, \$819,000 would have an unfavorable impact on the effective tax rate if recognized. At June 30, 2013, tax and interest, net of potential federal tax benefits, were \$630,000 and \$395,000, respectively, of the total reserve for uncertain tax positions of \$1,244,000. Additionally, penalties were \$219,000 of the reserve at June 30, 2013. Of the \$1,244,000 reserve for uncertain tax positions, \$1,025,000 would have an unfavorable impact on the effective tax rate if recognized. The liability for uncertain tax positions is included in Other Long-Term Liabilities.

The Company recognized a \$147,000 tax benefit in fiscal 2014, a \$540,000 tax benefit in fiscal 2013, and a \$9,000 tax benefit in fiscal 2012 related to the change in reserves for uncertain tax positions. The Company is recording estimated interest and penalties related to potential underpayment of income taxes as a component of tax expense in the Consolidated Statements of Operations. The reserve for uncertain tax positions is not expected to change significantly in the next twelve months.

The fiscal 2014, 2013 and 2012 gross tax activity in the liability for uncertain tax positions was as follows:

| <i>(in thousands)</i>                       | <b>2014</b>  | 2013    | 2012    |
|---|--------------|---------|---------|
| Balance at beginning of the fiscal year     | <b>\$969</b> | \$1,860 | \$1,910 |
| Decreases — tax positions in prior period   | <b>(225)</b> | (234 )  | (284 )  |
| Increases — tax positions in current period | <b>2</b>     | 37      | 234     |
| Settlements and payments                    | --           | (694 )  | —       |
| Lapse of statute of limitations             | --           | —       | —       |
| Balance at end of the fiscal year           | <b>\$746</b> | \$969   | \$1,860 |

The Company files a consolidated federal income tax return in the United States, and files various combined and separate tax returns in several foreign, state, and local jurisdictions. With limited exceptions, the Company is no longer subject to U.S. Federal, state and local tax examinations by tax authorities for fiscal years ending prior to June 30, 2010.

The Company is no longer subject to Canada Federal and provincial tax examinations by tax authorities for fiscal years ending prior to June 30, 2010.

#### **NOTE 12 — SUPPLEMENTAL CASH FLOW INFORMATION**

| <i>(In thousands)</i>                     | <b>2014</b>  | 2013    | 2012    |
|---|--------------|---------|---------|
| Cash payments:                            |              |         |         |
| Interest                                  | <b>\$76</b>  | \$76    | \$132   |
| Income taxes                              | <b>\$978</b> | \$3,404 | \$1,016 |
| Issuance of common shares as compensation | <b>\$193</b> | \$57    | \$48    |

#### **NOTE 13 — COMMITMENTS AND CONTINGENCIES**

As part of the acquisition of Virticus Corporation on March 19, 2012, a contingent Earn-Out liability of \$877,000 was recorded based on the fair value of estimated Earn-Out payments. This discounted liability is to be paid over a five year period, contingent upon reaching certain sales in each year over the five year period (fiscal year 2013 through fiscal year 2017). In December 2012, as a result of modified sales forecasts for LSI Virticus, the fair value of the Earn-Out liability was adjusted to \$218,000. In June 2013, another revised forecast was provided which in turn reduced the remaining Earn-Out liability to zero. In addition to the \$877,000 reversal of the Earn-Out liability, which was recorded in selling and administrative expenses in Corporate and Eliminations, \$20,000 of accrued interest expense was also reversed. As of June 30, 2014, the maximum potential undiscounted liability related to the Earn-Out is \$3 million, which is based upon the achievement of a defined level of sales of lighting control systems in fiscal years 2015 through 2017. The likelihood of this occurring is not considered probable.

The Company is party to various negotiations, customer bankruptcies, and legal proceedings arising in the normal course of business. The Company provides reserves for these matters when a loss is probable and reasonably estimable. The Company does not disclose a range of potential loss because the likelihood of such a loss is remote. In the opinion of management, the ultimate disposition of these matters will not have a material adverse effect on the Company's financial position, results of operations, cash flows or liquidity.

The Company may occasionally issue a standby letter of credit in favor of third parties. As of June 30, 2014, there were no such standby letters of credit.

**NOTE 14 — RELATED PARTY TRANSACTIONS**

The Company has recorded expense for the following related party transactions in the fiscal years indicated (amounts in thousands):

|  | <b>2014</b>  | 2013  | 2012  |
|--|--------------|-------|-------|
| Keating Muething & Klekamp PLL         | <b>\$98</b>  | \$84  | \$172 |
| American Engineering and Metal Working | <b>\$215</b> | \$394 | \$272 |
| 3970957 Canada Inc.                    | <b>\$161</b> | \$182 | \$190 |
| Synergy Electronic LTD                 | <b>\$171</b> | \$232 | \$195 |

As of the balance sheet date indicated, the Company had the following liabilities recorded with respect to related party transactions (amounts in thousands):

|  | <b>June<br/>30,<br/>2014</b> | June<br>30,<br>2013 |
|--|------------------------------|---------------------|
| Keating Muething & Klekamp PLL         | <b>\$ 5</b>                  | \$ 19               |
| American Engineering and Metal Working | <b>\$ --</b>                 | \$ 5                |
| Synergy Electronic LTD                 | <b>\$ 8</b>                  | \$ 5                |

The law firm of Keating Muething & Klekamp PLL, of which one of the Company's independent outside directors is a senior partner, is the Company's primary outside law firm providing legal services in most all areas required other than patents and intellectual property. The manufacturing firm of American Engineering and Metal Working, which is owned and operated by the son of the president of the Company's Graphics Segment, provides metal fabricated components. 3970957 Canada Inc., which is owned by the former president and another executive of the Company's LSI Saco Technologies subsidiary, owns the building that the Canadian operation occupies and rents. Synergy Electronic LTD, which is owned and operated by the brother of an executive at LSI Saco Technologies, manufactures molds and materials used in video screens and research and development projects.



**NOTE 15 — SUMMARY OF QUARTERLY RESULTS (UNAUDITED)**

|   | Quarter Ended |          |          |          | Fiscal    |     |
|---|---------------|----------|----------|----------|-----------|-----|
| <i>(In thousands except per share data)</i> | Sept. 30      | Dec. 31  | March 31 | June 30  | Year      |     |
| <b>2014</b>                                 |               |          |          |          |           |     |
| Net sales                                   | \$80,486      | \$76,123 | \$68,996 | \$73,858 | \$299,463 |     |
| Gross profit                                | 19,122        | 16,757   | 13,715   | 15,704   | 65,298    |     |
| Net income (loss)                           | 1,865         | 870      | (1,009)  | (796)    | 930       |     |
| Earnings (loss) per share                   |               |          |          |          |           |     |
| Basic                                       | \$0.08        | \$0.04   | \$(0.04) | \$(0.03) | \$0.04    | (a) |
| Diluted                                     | \$0.08        | \$0.04   | \$(0.04) | \$(0.03) | \$0.04    | (a) |
| Range of share prices                       |               |          |          |          |           |     |
| High  | \$9.00        | \$9.60   | \$9.67   | \$8.78   | \$9.67    |     |
| Low   | \$6.65        | \$7.76   | \$7.54   | \$7.10   | \$6.65    |     |
| <b>2013</b>                                 |               |          |          |          |           |     |
| Net sales                                   | \$74,719      | \$71,082 | \$66,152 | \$68,837 | \$280,790 |     |
| Gross profit                                | 17,871        | 13,882   | 13,921   | 14,736   | 60,410    |     |
| Net income (loss)                           | 1,830         | (2,450)  | (315)    | 812      | (123)     |     |
| Earnings (loss) per share                   |               |          |          |          |           |     |
| Basic                                       | \$0.08        | \$(0.10) | \$(0.01) | \$0.03   | \$(0.01)  | (a) |
| Diluted                                     | \$0.08        | \$(0.10) | \$(0.01) | \$0.03   | \$(0.01)  | (a) |
| Range of share prices                       |               |          |          |          |           |     |
| High  | \$7.42        | \$7.38   | \$7.77   | \$8.46   | \$8.46    |     |
| Low   | \$6.19        | \$6.10   | \$6.80   | \$6.78   | \$6.10    |     |
| <b>2012</b>                                 |               |          |          |          |           |     |
| Net sales                                   | \$65,495      | \$68,774 | \$62,937 | \$71,196 | \$268,402 |     |
| Gross profit                                | 15,464        | 14,926   | 13,316   | 16,607   | 60,313    |     |
| Net income                                  | 1,324         | 772      | (377)    | 1,505    | 3,224     |     |
| Earnings per share                          |               |          |          |          |           |     |
| Basic                                       | \$0.05        | \$0.03   | \$(0.02) | \$0.06   | \$0.13    | (a) |
| Diluted                                     | \$0.05        | \$0.03   | \$(0.02) | \$0.06   | \$0.13    | (a) |
| Range of share prices                       |               |          |          |          |           |     |
| High  | \$8.91        | \$7.04   | \$7.70   | \$7.64   | \$8.91    |     |
| Low   | \$5.93        | \$5.45   | \$5.85   | \$5.81   | \$5.45    |     |

The total of the earnings per share for each of the four quarters does not equal the total earnings per share for the (a) full year because the calculations are based on the average shares outstanding during each of the individual periods.

At August 26, 2014, there were 522 shareholders of record. The Company believes this represents approximately 3,000 beneficial shareholders.

**LSI INDUSTRIES INC.**  
**SELECTED FINANCIAL DATA**  
(In thousands except per share data)

The following data has been selected from the Consolidated Financial Statements of the Company for the periods and dates indicated:

**Statement of Operations Data:**

|  | <b>2014</b>      | 2013      | 2012      | 2011      | 2010      |
|--|------------------|-----------|-----------|-----------|-----------|
| Net sales                                    | <b>\$299,463</b> | \$280,790 | \$268,402 | \$293,501 | \$254,402 |
| Cost of products and services sold           | <b>234,165</b>   | 220,380   | 208,089   | 221,156   | 198,030   |
| Loss on sale of a subsidiary                 | --               | —         | —         | —         | 639       |
| Selling and administrative expenses          | <b>62,175</b>    | 57,367    | 53,724    | 56,041    | 53,671    |
| Goodwill and intangible asset impairment (a) | <b>805</b>       | 2,413     | 258       | —         | 153       |
| Operating income (loss)                      | <b>2,318</b>     | 630       | 6,331     | 16,304    | 1,909     |
| Interest (income)                            | <b>(17 )</b>     | (47 )     | (25 )     | (43 )     | (28 )     |
| Interest expense                             | <b>68</b>        | 62        | 165       | 180       | 153       |
| Income (loss) before income taxes            | <b>2,267</b>     | 615       | 6,191     | 16,167    | 1,784     |
| Income taxes                                 | <b>1,337</b>     | 738       | 2,967     | 5,339     | 360       |
| Net income (loss)                            | <b>\$930</b>     | \$(123 )  | \$3,224   | \$10,828  | \$1,424   |
| Earnings (loss) per common share             |                  |           |           |           |           |
| Basic  | <b>\$0.04</b>    | \$(0.01 ) | \$0.13    | \$0.45    | \$0.06    |
| Diluted                                      | <b>\$0.04</b>    | \$(0.01 ) | \$0.13    | \$0.44    | \$0.06    |
| Cash dividends paid per share                | <b>\$0.24</b>    | \$0.36    | \$0.23    | \$0.20    | \$0.20    |
| Weighted average common shares               |                  |           |           |           |           |
| Basic  | <b>24,388</b>    | 24,313    | 24,298    | 24,287    | 24,128    |
| Diluted                                      | <b>24,546</b>    | 24,313    | 24,352    | 24,339    | 24,134    |

**Balance Sheet Data:**

(At June 30)

|  | <b>2014</b>     | 2013     | 2012     | 2011     | 2010     |
|--|-----------------|----------|----------|----------|----------|
| Working capital                              | <b>\$76,788</b> | \$76,703 | \$83,702 | \$84,524 | \$73,568 |
| Total assets                                 | <b>169,888</b>  | 169,179  | 175,226  | 176,021  | 173,845  |
| Long-term debt, including current maturities | —               | —        | —        | 1,099    | 1,132    |
| Shareholders' equity                         | <b>138,412</b>  | 141,690  | 149,368  | 151,218  | 144,218  |

- (a) The Company recorded a significant impairment of goodwill and/or intangible assets in fiscal 2014 and 2013, and minor impairments in fiscal 2012 and 2010. See Note 6.

## LSI INDUSTRIES INC. AND SUBSIDIARIES

SCHEDULE II — VALUATION AND QUALIFYING ACCOUNTS  
FOR THE YEARS ENDED JUNE 30, 2013, 2012, AND 2011

(In Thousands)

| COLUMN A                                     | COLUMN B                          | COLUMN C  | COLUMN D                                 | COLUMN E          | COLUMN F                    |
|--|-----------------------------------|---|--|-------------------|-----------------------------|
| Description                                  | Balance<br>Beginning<br>of Period | Additions<br>Charged<br>to<br>Costs and<br>Expenses | Additions<br>from<br>Acquired<br>Company | (a)<br>Deductions | Balance<br>End of<br>Period |
| <b>Allowance for Doubtful Accounts:</b>      |                                   |   |  |                   |                             |
| Year Ended June 30, 2014                     | \$ 346                            | \$ 6  | \$ —                                     | \$ (58 )          | \$ 294                      |
| Year Ended June 30, 2013                     | \$ 385                            | \$ 269  | \$ —                                     | \$ (308 )         | \$ 346                      |
| Year Ended June 30, 2012                     | \$ 826                            | \$ 360  | \$ 4                                     | \$ (805 )         | \$ 385                      |
| <b>Inventory Obsolescence Reserve:</b>       |                                   |   |  |                   |                             |
| Year Ended June 30, 2014                     | \$ 3,087                          | \$ 1,464  | \$ —                                     | \$ (2,253 )       | \$ 2,298                    |
| Year Ended June 30, 2013                     | \$ 2,156                          | \$ 2,957  | \$ —                                     | \$ (2,026 )       | \$ 3,087                    |
| Year Ended June 30, 2012                     | \$ 1,813                          | \$ 1,453  | \$ —                                     | \$ (1,110 )       | \$ 2,156                    |
| <b>Deferred Tax Asset Valuation Reserve:</b> |                                   |   |  |                   |                             |
| Year Ended June 30, 2014                     | \$ 5,750                          | \$ 700  | \$ —                                     | \$ —              | \$ 6,450                    |
| Year Ended June 30, 2013                     | \$ 5,009                          | \$ 741  | \$ —                                     | \$ —              | \$ 5,750                    |
| Year Ended June 30, 2012                     | \$ 4,200                          | \$ 636  | \$ 173                                   | \$ —              | \$ 5,009                    |

(a) For Allowance for Doubtful Accounts, deductions are uncollectible accounts charged off, less recoveries.