STARRETT L S CO
Form 10-Q
May 02, 2018

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D. C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2018

OR

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

For the transition period from to

Commission file number 1-367

THE L. S. STARRETT COMPANY
(Exact name of registrant as specified in its charter)

MASSACHUSETTS	04-1866480
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

121 CRESCENT STREET, ATHOL, MASSACHUSETTS	01331-1915
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code 978-249-3551

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

YES NO

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

YES NO

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

Large Accelerated Filer   Accelerated Filer
Non-Accelerated Filer   Smaller Reporting Company

Emerging Growth Company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

YES
NO

Common Shares outstanding as of	April 30, 2018
Class A Common Shares	6,272,716
Class B Common Shares	744,656

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THE L. S. STARRETT COMPANY

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

THE L. S. STARRETT COMPANY

Consolidated Balance Sheets

(in thousands except share data)

	03/31/2018 (unaudited)	06/30/2017
ASSETS		
Current assets:		
Cash	$ *15,444*	$ *14,607*
Accounts receivable (less allowance for doubtful accounts of $1,164 and $946, respectively)	*31,684*	*30,425*
Inventories	*63,799*	*58,097*
Prepaid expenses and other current assets	*7,546*	*6,994*
Total current assets	*118,473*	*110,123*
Property, plant and equipment, net	*38,659*	*39,345*
Taxes receivable	*1,888*	*2,627*
Deferred tax assets, net	*18,523*	*26,032*
Intangible assets, net	*9,452*	*9,868*
Goodwill	*4,668*	*4,668*
Other assets	*2*	*2*
Total assets	$ *191,665*	$ *192,665*
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Current maturities of long-term debt	$ *4,681*	$ *11,514*
Accounts payable	*10,464*	*8,366*
Accrued expenses	*6,328*	*5,424*
Accrued compensation	*4,597*	*5,435*
Total current liabilities	*26,070*	*30,739*
Other tax obligations	*2,889*	*3,645*
Long-term debt, net of current portion	*17,736*	*6,095*

Postretirement benefit and pension obligations	*56,258*	*58,571*
Other non-current liabilities	*1,650*	*1,589*
Total liabilities	*104,603*	*100,639*
Stockholders' equity:		
Class A Common stock $1 par (20,000,000 shares authorized; 6,272,716 outstanding at March 31, 2018 and 6,267,603 outstanding at June 30, 2017)	*6,273*	*6,268*
Class B Common stock $1 par (10,000,000 shares authorized; 745,216 outstanding at March 31, 2018 and 761,588 outstanding at June 30, 2017)	*745*	*762*
Additional paid-in capital	*55,562*	*55,579*
Retained earnings	*73,543*	*79,402*
Accumulated other comprehensive loss	*(49,061*)	*(49,985*)
Total stockholders' equity	*87,062*	*92,026*
Total liabilities and stockholders’ equity	$ *191,665*	$ *192,665*

See Notes to Unaudited Consolidated Financial Statements

THE L. S. STARRETT COMPANY

Consolidated Statements of Operations

(in thousands except per share data) (unaudited)

	3 Months Ended		9 Months Ended	
	03/31/2018	03/31/2017	03/31/2018	03/31/2017
Net sales	$54,834	$ 50,670	$158,776	$ 152,770
Cost of goods sold	36,762	36,191	108,235	107,555
Gross margin	18,072	14,479	50,541	45,215
% of Net sales	33.0 %	28.6 %	31.8 %	29.6 %
Selling, general and administrative expenses	15,859	15,326	47,435	45,689
Restructuring charges	-	6	-	400
Operating income (loss)	2,213	(853)	3,106	(874)
Other income (expense)	124	(391)	968	(466)
Gain on sale of building	-	-	-	3,089
Income (loss) before income taxes	2,337	(1,244)	4,074	1,749
Income tax expense (benefit)	700	(458)	8,532	713
Net income (loss)	$1,637	$ (786)	$(4,458)	$ 1,036
Basic income (loss) per share	$0.23	$ (0.11)	$(0.64)	$ 0.15
Diluted income (loss) per share	$0.23	$ (0.11)	$(0.64)	$ 0.15
Weighted average outstanding shares used in per share calculations:				
Basic	7,018	7,058	7,012	7,046
Diluted	7,036	7,058	7,012	7,078
Dividends per share	$ -	$ 0.10	$0.20	$ 0.30

See Notes to Unaudited Consolidated Financial Statements

THE L. S. STARRETT COMPANY

Consolidated Statements of Comprehensive Income (Loss)

(in thousands) (unaudited)

	3 Months Ended		9 Months Ended	
	03/31/2018	03/31/2017	03/31/2018	03/31/2017
Net income (loss)	$ *1,637*	$ *(786)*	$ *(4,458)*	$ *1,036*
Other comprehensive income (loss):				
Currency translation gain (loss)	*321*	*1,456*	*1,006*	*(300)*
Pension and postretirement plans, net of tax of $0, $0, $0, and $3,958, respectively	*(28)*	*(45)*	*(82)*	*6,377*
Other comprehensive income (loss)	*293*	*1,411*	*924*	*6,077*
Total comprehensive income (loss)	$ *1,930*	$ *625*	$ *(3,534)*	$ *7,113*

See Notes to Unaudited Consolidated Financial Statements

THE L. S. STARRETT COMPANY

Consolidated Statements of Stockholders' Equity

For the Nine Months Ended March 31, 2018

(in thousands except per share data) (unaudited)

	Common Stock Outstanding Class A	Common Stock Outstanding Class B	Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Loss	Total
Balance June 30, 2017	$6,268	$762	$ 55,579	$79,402	$ (49,985)	$92,026
Total comprehensive income (loss)	-	-	-	(4,458)	924	(3,534)
Dividends ($0.20 per share)	-	-	-	(1,401)	-	(1,401)
Repurchase of shares	(58)	(6)	(487)	-	-	(551)
Issuance of stock	21	13	244	-	-	278
Stock-based compensation	18	-	226	-	-	244
Conversion	24	(24)	-	-	-	-
Balance March 31, 2018	$6,273	$745	$ 55,562	$73,543	$ (49,061)	$87,062

Accumulated balance consists of:

Translation loss	$ (42,317)
Pension and postretirement plans, net of taxes	(6,744)
	$ (49,061)

See Notes to Unaudited Consolidated Financial Statements

THE L. S. STARRETT COMPANY

Consolidated Statements of Cash Flows

(in thousands) (unaudited)

	9 Months Ended	
	03/31/2018	03/31/2017
Cash flows from operating activities:		
Net income (loss)	$(4,458)	$ 1,036
Non-cash operating activities:		
Gain on sale of building	-	(3,089)
Depreciation	4,163	4,020
Amortization	1,490	1,280
Stock-based compensation	244	320
Net long-term tax obligations	32	(31)
Deferred taxes	7,649	702
Postretirement benefit and pension obligations	439	1,916
(Income) loss from equity method investment	-	223
Working capital changes:		
Accounts receivable	(254)	6,200
Inventories	(4,720)	(2,184)
Other current assets	(474)	(1,501)
Other current liabilities	1,007	(1,790)
Prepaid pension expense	(3,541)	(4,303)
Other	63	222
Net cash provided by (used in) operating activities	1,640	3,021
Cash flows from investing activities:		
Business acquisition, net of cash acquired	-	(1,324)
Additions to property, plant and equipment	(3,250)	(3,478)
Software development	(1,014)	(750)
Proceeds from sale of building	-	3,321
Net cash provided by (used in) investing activities	(4,264)	(2,231)
Cash flows from financing activities:		
Proceeds from borrowings	6,845	-
Debt repayments	(2,037)	(1,151)
Proceeds from common stock issued	278	242
Shares repurchased	(551)	(51)

Dividends paid	(1,401)	(2,113)
Net cash provided by (used in) financing activities	3,134	(3,073)
Effect of exchange rate changes on cash	327	(450)
Net increase (decrease) in cash	837	(2,733)
Cash, beginning of period	14,607	19,794
Cash, end of period	$15,444	$ 17,061
Supplemental cash flow information:		
Interest paid	$479	$ 474
Income taxes paid, net	175	(213)

See Notes to Unaudited Consolidated Financial Statements

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THE L. S. STARRETT COMPANY

Notes to Unaudited Consolidated Financial Statements

March 31, 2018

Note *1:* Basis of Presentation and Summary of Significant Account Policies

The unaudited interim financial statements as of and for the *nine* months ended *March 31, 2018* have been prepared by The L.S. Starrett Company (the "Company") in accordance with accounting principles generally accepted in the United States of America for interim financial reporting. Accordingly, they do *not* include all of the information and notes required by generally accepted accounting principles for complete financial statements. These unaudited financial statements, which, in the opinion of management, reflect all adjustments (including normal recurring adjustments) necessary for a fair presentation, should be read in conjunction with the financial statements and notes thereto included in the Company's Annual Report on Form *10*-K for the year ended *June 30, 2017.* Operating results are *not* necessarily indicative of the results that *may* be expected for any future interim period or for the entire fiscal year.

The preparation of financial statements and related disclosures in conformity with accounting principles generally accepted in the United States of America requires management to make judgments, assumptions and estimates that affect amounts reported in the consolidated financial statements and accompanying notes. Note *2* to the Company's Consolidated Financial Statements included in the Annual Report on Form *10*-K for the year ended *June 30, 2017* describes the significant accounting policies and methods used in the preparation of the consolidated financial statements.

Note *2:* Recent Accounting Pronouncements

In *May 2014,* the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") *2014-09,* "Revenues from Contracts with Customers (Topic *606*)," which outlines a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers and supersedes most current revenue recognition guidance, including industry-specific guidance. The standard requires entities to recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods and services. The new guidance also includes a cohesive set of disclosure requirements intended to provide users of financial statements comprehensive information about the nature, amounts, timing and uncertainty of revenue and cash flows arising from a company's contracts with customers. ASU *2014-09* defines a *five*-step process to achieve this core principle and in doing so, it is possible that more judgment and estimates *may* be required within the revenue recognition process than are required under existing guidance, including identifying performance obligations in the contract, estimating the amount of variable consideration to include in the transaction price and allocating the transaction price to separate performance obligations, among others. The new standard will be effective for the Company beginning *July 1, 2018.* The FASB issued *four* subsequent standards in *2016* containing implementation guidance related to the new standard. These standards provide additional guidance related to principal versus agent considerations, licensing, and identifying performance obligations. Additionally, these standards provide narrow-scope improvements and practical expedients as well as technical corrections and improvements.

The guidance permits *two* methods of adoption: retrospectively to each prior reporting period presented (full retrospective method), or retrospectively with the cumulative effect of initially applying the guidance recognized at the date of initial application (the modified retrospective method). The Company will be adopting the standard using the modified retrospective method effective *July 1, 2018.*

The Company expects to complete our implementation procedures with respect to the new revenue recognition standard during the *fourth* quarter of fiscal year *2018.* While the Company continues to assess the impact of the new standard, it should be noted that revenues are primarily generated from the sale of finished products to customers, and that sales predominantly contain a single delivery element and that revenue is recognized at a single point in time when ownership, risks and rewards transfer. The timing of revenue recognition for these product sales is *not* materially impacted by the new standard. However, the Company is utilizing a comprehensive approach to assess the impact of the guidance on its current contract portfolio by reviewing its current accounting policies and practices to identify potential differences that would result from applying the new requirements to the Company’s revenue contracts, including evaluation of performance obligations in the contract, estimating the amount of variable consideration to include in the transaction price, allocating the transaction price to each separate performance obligation and accounting treatment of costs to obtain and fulfill contracts. While certain differences *may* arise specifically related to variable consideration and consideration payable to a customer, the Company does *not* expect these differences to materially impact our consolidated financial statements. In addition, the Company is currently analyzing our internal control over financial reporting framework to determine if controls should be added or modified as a result of adopting this standard, and reviewing the tax impact, if any, the adoption of the new standard *may* have. The Company also expects that the adoption of the new standard will result in expanded and disaggregated disclosure requirements.

In *February 2016,* the FASB issued ASU *No. 2016-02,* “Leases (Topic *842*)”. The ASU requires that organizations that lease assets recognize assets and liabilities on the balance sheet for the rights and obligations created by those leases. The ASU will affect the presentation of lease related expenses on the income statement and statement of cash flows and will increase the required disclosures related to leases. This ASU is effective for fiscal years beginning after *December 15, 2018,* including interim periods within those fiscal years, with early adoption permitted. The Company is currently evaluating the impact of ASU *No. 2016-02* on its consolidated financial statements. It is expected that a key change upon adoption will be the balance sheet recognition of leased assets and liabilities and that any changes in income statement recognition will *not* be material.

In *October 2016,* the FASB issued ASU *No. 2016-16,* "Income Taxes (Topic *740*): Intra-Entity Transfers of Assets Other Than Inventory", which is intended to improve the accounting for the income tax consequences of intra-entity transfers of assets other than inventory. This update removes the current exception in GAAP prohibiting entities from recognizing current and deferred income tax expenses or benefits related to transfer of assets, other than inventory, within the consolidated entity. The current exception to defer the recognition of any tax impact on the transfer of inventory within the consolidated entity until it is sold to a *third* party remains unaffected. The amendments in this update are effective for public entities for annual reporting periods beginning after *December 15, 2017.* Early adoption is permitted. The adoption of ASU *No. 2016-16* is *not* expected to have a material impact on the Company’s consolidated financial statements.

In *January 2017,* the FASB issued ASU *No. 2017-01,* "Business Combinations (Topic *805*) - Clarifying the Definition of a Business", with the objective to assist entities with evaluating whether transactions should be accounted for as acquisitions (or disposals) of assets versus businesses. The amendments in ASU *2017-01* provide a screen to determine when a set of assets and activities is *not* a business. The screen requires that when substantially all of the fair value of the gross assets acquired (or disposed of) is concentrated in a single identifiable asset or a group of similar identifiable assets, the set is *not* a business. This screen is expected to reduce the number of transactions that need to be further evaluated. If the screen is *not* met, the amendments in ASU *2017-01* (i) require that to be considered a business, a set of assets and liabilities acquired must include, at a minimum, an input and a substantive process that together significantly contribute to the ability to create output; and (ii) remove the evaluation of whether a market participant could replace missing elements. The amendments in this ASU are effective for annual and interim periods beginning after *December 15, 2017* and should be applied prospectively. Early adoption is permitted for transactions for which the acquisition date occurs before the issuance date of ASU *2017-01,* only when the transaction has *not* been reported in financial statements that have been issued or made available for issuance. The adoption of ASU *No. 2017-01* is *not* expected to have a material impact on the Company’s consolidated financial statements.

In *January 2017,* the FASB issued ASU *No. 2017-04,* "Intangibles-Goodwill and Other (Topic *350*): Simplifying the Test for Goodwill Impairment". Under the new guidance, if a reporting unit's carrying value amount exceeds its fair value, an entity will record an impairment charge based on that difference. The impairment charge will be limited to the amount of goodwill allocated to that reporting unit. The standard eliminates the requirement to calculate goodwill impairment using Step *2,* which calculates an impairment charge by comparing the implied fair value of goodwill with its carrying amount. The standard does *not* change the guidance on completing Step *1* of the goodwill impairment test. The amendments in this ASU are effective for annual and interim periods beginning after *December 15, 2019* and should be applied prospectively for annual and any interim goodwill impairment tests. Early adoption is permitted for entities for interim or annual goodwill impairment tests performed on testing dates after *January 1, 2017.* The Company is currently evaluating the impact of the update on its consolidated financial statements.

In *February 2018,* the FASB issued ASU *No. 2018-02,* "Income Statement – Reporting Comprehensive Income (Topic *220*): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income". For deferred tax items recognized in Accumulated Other Comprehensive Income (AOCI), changes in tax rates can leave amounts "stranded" in AOCI. Under ASU *2018-02,* FASB has given companies an option to reclassify the stranded tax effects resulting from the tax law and tax rate changes under the Tax Cuts and Jobs Act of *2017* from AOCI to retained earnings. This guidance is effective for fiscal years beginning after *December 15, 2018* and requires companies to disclosure whether they are or are *not* opting to reclassify the income tax effects from the new *2017* tax act. Early adoption is permitted. The Company is currently evaluating the impact of this update on its consolidated financial statements.

In *February 2018,* the FASB issued ASU *2018-05,* "Income Taxes (Topic *740*): Amendments to SEC Paragraphs Pursuant to SEC Staff Accounting Bulletin *No. 118".* This update codified the guidance provided in SAB *118* on applying ASC *740,* Income Taxes, if the accounting for certain income tax effects of the Tax Cuts and Jobs Act of *2017* is incomplete when the financial statements are issued for a reporting period. This update was effective upon issuance. Therefore, the Company has applied the guidance in this update within our consolidated financial statements for the quarter ended *March 31, 2018.* See Note *9:* "Income Taxes", of this Form *10*-Q for more information on the adoption of this guidance.

Note *3:* Stock-based Compensation

On *September 5, 2012,* the Board of Directors adopted The L.S. Starrett Company *2012* Long Term Incentive Plan (the *"2012* Stock Plan"). The *2012* stock plan was approved by shareholders on *October 17, 2012,* and the material terms of its performance goals were recently re-approved by shareholders at the Company's Annual Meeting held on *October 18, 2017.* The *2012* Stock Plan permits the granting of the following types of awards to officers, other employees and non-employee directors: stock options; restricted stock awards; unrestricted stock awards; stock appreciation rights; stock units including restricted stock units; performance awards; cash-based awards; and awards other than previously described that are convertible or otherwise based on stock. The *2012* Stock Plan provides for the issuance of up to *500,000* shares of common stock.

Options granted vest in periods ranging from *one* year to *three* years and expire *ten* years after the grant date. Restricted stock units ("RSU") granted generally vest from *one* year to *three* years. Vested restricted stock units will be settled in shares of common stock. As of *March 31, 2018,* there were *20,000* stock options and *140,802* restricted stock units outstanding. In addition, there were *297,033* shares available for grant under the *2012* Stock Plan as of *March 31, 2018.*

For stock option grants the fair value of each grant is estimated at the date of grant using the Binomial Options pricing model. The Binomial Options pricing model utilizes assumptions related to stock volatility, the risk-free interest rate, the dividend yield, and employee exercise behavior. Expected volatilities utilized in the model are based on the historic volatility of the Company's stock price. The risk free interest rate is derived from the U.S. Treasury Yield curve in effect at the time of the grant. The expected life is determined using the average of the vesting period and contractual term of the options (Simplified Method).

No stock options were granted during the *nine* months ended *March 31, 2018* and *2017.*

The weighted average contractual term for stock options outstanding as of *March 31, 2018* was *4.75* years. The aggregate intrinsic value of stock options outstanding as of *March 31, 2018* was less than *$0.1* million. Stock options exercisable as of *March 31, 2018* were *20,000.* In recognizing stock compensation expense for the *2012* Stock Incentive Plan, management has estimated that there will be *no* forfeitures of options.

The Company accounts for stock options and RSU awards by recognizing the expense of the grant date fair value ratably over vesting periods generally ranging from *one* year to *three* years. The related expense is included in selling, general and administrative expenses.

There were *62,000* RSU awards with a fair value of *$7.22* per RSU granted during the *nine* months ended *March 31, 2018.* There were *14,400* RSUs settled, and *12,433* RSUs forfeited during the *nine* months ended *March 31, 2018.* The aggregate intrinsic value of RSU awards outstanding as of *March 31, 2018* was *$1.0* million. As of *March 31, 2018* all vested awards had been issued and settled.

On *February 5, 2013,* the Board of Directors adopted The L.S. Starrett Company *2013* Employee Stock Ownership Plan (the *"2013* ESOP"). The purpose of the plan is to supplement existing Company programs through an employer funded individual account plan dedicated to investment in common stock of the Company, thereby encouraging increased ownership of the Company while providing an additional source of retirement income. The plan is intended as an employee stock ownership plan within the meaning of Section *4975* (e) (*7*) of the Internal Revenue Code of *1986,* as amended. U.S. employees who have completed a year of service are eligible to participate.

Compensation expense related to all stock based plans for the *nine* month periods ended *March 31, 2018* and *2017* was *$0.2* million, and *$0.3* million respectively. As of *March 31, 2018,* there was *$1.5* million of total unrecognized compensation costs related to outstanding stock-based compensation arrangements. Of this cost, *$1.4* million relates to performance based RSU grants that are *not* expected to be awarded. The remaining *$0.1* million is expected to be recognized over a weighted average period of *2.0* years.

Note *4:* Inventories

ASU *No. 2015-11,* "Inventory (Topic *330*): Simplifying the Measurement of Inventory", specifies that when an entity measures inventory at the lower of cost or market that "market" is defined as "net realizable value," or the estimated selling price in the ordinary course of business, less reasonably predictable costs of completion, disposal, and transportation. The adoption of ASU *No. 2015-11* on July 1, 2017 did *not* have a material impact on our consolidated financial statements.

Inventories consist of the following (in thousands):

	03/31/2018	6/30/2017
Raw material and supplies	$ *26,098*	$ *26,293*
Goods in process and finished parts	*19,788*	*16,419*
Finished goods	*43,910*	*41,591*
	89,796	*84,303*
LIFO Reserve	*(25,997*)	*(26,206*)
	$ *63,799*	$ *58,097*

LIFO inventories were *$8.4* million and *$7.7* million at *March 31, 2018* and *June 30, 2017,* respectively, such amounts being approximately *$26.0* million and *$26.2* million, respectively, less than if determined on a FIFO basis. The use of LIFO, as compared to FIFO, resulted in a *$0.2* million decrease in cost of sales for the *nine* months ended *March 31, 2018* compared to a *$1.5* million decrease in cost of sales for the *nine* months ended *March 31, 2017.*

Note *5:* Business Acquisition

In fiscal *2010,* the Company entered into an agreement with a private software company to invest *$1.5* million in exchange for a *36%* equity interest therein. In the *third* quarter of fiscal *2017,* the Company entered into a new agreement to invest an additional *$3.6* million for an additional *64%* of equity in the company. The Company paid *$1.8* million in cash at closing and is obligated to pay an additional *$1.8* million in cash *three* years subsequent to closing (discounted to *$1.6* million on the purchase date). In addition, the agreement provides for the former owners to receive a *30%* share of operating profits of the business over the next *three* years so long as they remain employed by the Company. The Company has accrued for such profit sharing as an expense based on results of operations since the date of acquisition.

The acquisition has been accounted for as a business combination and the financial results of the company have been included in our consolidated financial statements since the date of acquisition. Under the acquisition method of accounting, the purchase price was allocated to net tangible and intangible assets based upon their estimated fair values as of the acquisition date.

The table below presents the allocation of the purchase price to the acquired net assets (in thousands):

Cash	$*509*
Accounts receivable	*273*
Inventories	*243*
Other current assets	*18*
Deferred software development costs	*2,520*
Intangible Assets	*1,220*
Goodwill	*1,634*
Fixed assets	*47*
Deferred tax liability	*(1,090*)
Accounts payable & current liabilities	*(80*)
Purchase Price (1)	$*5,294*

(*1*) *$1,833* + *1,555* (*$1.8* million discounted at *5%*) = *$3,388* purchase price divided by *64%* = *$5.294* million.

Pro-forma financial information has *not* been presented for this acquisition because it is *not* considered material to the Company’s financial position or results of operations.

Note *6*: Goodwill and Intangible Assets

The Company’s acquisition of Bytewise in *2011* and the private software company in *2017* resulted in the recognition of goodwill totaling *$4.7* million. Under ASU *2011-08,* the Company is required, on a set date, to annually assess its goodwill in order to determine whether or *not* it is more likely than *not* that the fair value of the reporting unit’s goodwill exceeded its carrying amount. Determining the fair value of a reporting unit is subjective and requires the use of significant estimates and assumptions.

For Bytewise, the annual assessment date was *October 1, 2017.* The Company performed a quantitative analysis in accordance with ASU *2011-08* for its annual assessment (commonly referred to as “Step One”). With the assistance of an independent *third*-party valuation specialist, the Company estimated the fair value using an income approach based on the present value of future cash flows. The Company believes this approach yields the most appropriate evidence of fair value. The Company also utilized the comparable company multiples method and market transaction fair value method to validate the fair value amount obtained using the income approach. The key assumptions utilized in the discounted cash flow model included estimates of future cash flows from operating activities offset by estimated capital expenditures of the reporting unit, the estimated terminal value for the reporting unit, a discount rate based on a weighted average cost of capital, and an assessment of current market capitalization.

Under the quantitative analysis, the *2017* fair value assessment of the Bytewise goodwill exceeded the carrying amount by approximately *81.1%.* Therefore *no* goodwill impairment was determined to exist. If future results significantly vary from current estimates, related projections, or business assumptions in the future due to changes in industry or market conditions, the Company *may* be required to record impairment charges.

The Company performed a qualitative analysis in accordance with ASU *2011-08* for its *February 1, 2018* annual assessment of goodwill (commonly referred to as “Step Zero”) associated with its purchase of the private software company. From a qualitative perspective, in evaluating whether it is more likely than *not* that the fair value of a reporting unit exceeds its carrying amount, relevant events and circumstances are taken into account, with greater weight assigned to events and circumstances that most affect the fair value or the carrying amounts of its assets. Items that were considered included, but were *not* limited to, the following: macroeconomic conditions, industry and market conditions, cost factors, overall financial performance and changes in management or key personnel. After assessing these and other factors the Company determined that it was more likely than *not* that the fair value of this reporting unit exceeded its carrying amount as of *February 1, 2018.*

Amortizable intangible assets consist of the following (in thousands):

	03/31/2018	6/30/2017
Non-compete agreement	$ *600*	$ *600*
Trademarks and trade names	*2,070*	*2,070*
Completed technology	*2,358*	*2,358*
Customer relationships	*5,580*	*5,580*
Software development	*7,197*	*6,184*
Other intangible assets	*325*	*325*
Total	*18,130*	*17,117*
Accumulated amortization	*(8,678*)	*(7,249*)
Total net balance	$ *9,452*	$ *9,868*

Amortizable intangible assets are being amortized on a straight-line basis over the period of expected economic benefit.

The estimated useful lives of the intangible assets subject to amortization range between *5* years for software development and *20* years for some trademark and trade name assets.

The estimated aggregate amortization expense for the remainder of fiscal *2018* and for each of the next *five* years and thereafter, is as follows (in thousands):

2018 (Remainder of year)	$*578*
2019	*2,210*
2020	*1,687*
2021	*1,284*
2022	*1,051*
2023	*708*
Thereafter	*1,934*

Note *7*: Pension and Post-retirement Benefits

The Company has *two* defined benefit pension plans, *one* for U.S. employees and another for U.K. employees. The U.K. plan was closed to new entrants in fiscal *2009.* The Company has a postretirement medical and life insurance benefit plan for U.S. employees. The Company also has defined contribution plans.

On *December 21, 2016,* the Company amended the U.S. defined benefit pension plan to freeze benefit accruals effective *December 31, 2016.* Consequently, the Plan is closed to new participants and current participants will *no* longer earn additional benefits after *December 31, 2016.*

The amendment of the defined benefit pension plan triggered a pension curtailment which required a re-measurement of the Plan's benefit obligation as of *December 31, 2016.* The re-measurement resulted in a decrease in the benefit obligation of approximately *$6.9* million primarily due to an increase in the discount rate from *3.77%* to *4.31%,* with an additional *$4.2* million decrease resulting from the impact of the curtailment. These reductions in the Plan’s benefit obligation were recorded as other comprehensive income, net of taxes.

Net periodic benefit costs for all of the Company's defined benefit pension plans consist of the following (in thousands):

	Three Months Ended		Nine Months Ended	
	03/31/2018	03/31/2017	03/31/2018	03/31/2017
Service cost	$ -	$ -	$ -	$ *1,405*
Interest cost	*1,531*	*1,574*	*4,560*	*4,659*
Expected return on plan assets	*(1,300)*	*(1,284)*	*(3,876)*	*(3,878)*
Amortization of net loss	*5*	*6*	*17*	*102*
	$ *236*	$ *296*	$ *701*	$ *2,288*

Net periodic benefit costs for the Company's Postretirement Medical Plan consists of the following (in thousands):

	Three Months Ended		Nine Months Ended	
	03/31/2018	03/31/2017	03/31/2018	03/31/2017
Service cost	$ *21*	$ *23*	$ *64*	$ *70*
Interest cost	*69*	*67*	*203*	*203*
Amortization of prior service credit	*(134)*	*(168)*	*(403)*	*(505)*
Amortization of net loss	*24*	*30*	*74*	*90*
	$ *(20)*	$ *(48)*	$ *(62)*	$ *(142)*

For the *nine* month period ended *March 31, 2018,* the Company contributed *$2.8* million to the U.S. and *$0.8* million to the UK pension plans. The Company estimates that it will contribute an additional *$1.2* million for the remainder of fiscal *2018.*

The Company's pension plans use fair value as the market-related value of plan assets and recognize net actuarial gains or losses in excess of *ten* percent (*10%*) of the greater of the market-related value of plan assets or of the plans' projected benefit obligation in net periodic (benefit) cost as of the plan measurement date. Net actuarial gains or losses that are less than *10%* of the thresholds noted above are accounted for as part of the accumulated other comprehensive loss.

Note *8*: Debt

Debt is comprised of the following (in thousands):

	03/31/2018	6/30/2017
<u>Short-term and current maturities</u>		
Loan and Security Agreement	$ *1,669*	$ *11,514*
Other Loans	*3,012*	-
<u>Long-term debt</u>		
Loan and Security Agreement, net of current portion	*17,736*	*6,095*
	$ *22,417*	$ *17,609*

The Company amended its Loan and Security Agreement, which includes a Line of Credit and a Term Loan, in *January 2018.* Borrowings under the Line of Credit *may not* exceed *$23.0* million. The Line of Credit has an interest rate of LIBOR plus *1.5%,* and expires on *April 30, 2021.* The effective interest rate on the Line of Credit under the Loan and Security Agreement for the *nine* months ended *March 31, 2018* and *2017* was *3.2%* and *2.5%,* respectively. As of *March 31, 2018, $12.9* million was outstanding on the Line of Credit.

Availability under the Line of Credit is subject to a borrowing base comprised of accounts receivable and inventory. The Company believes that the borrowing base will consistently produce availability under the Line of Credit in excess of *$23.0* million. A *0.25%* commitment fee is charged on the unused portion of the Line of Credit.

The obligations under the Credit Facility are unsecured. In the event of certain triggering events, such obligations would become secured by the assets of the Company's domestic subsidiaries. A triggering event occurs when the Company fails to achieve any of the financial covenants noted below in consecutive quarters.

The material financial covenants of the amended Loan and Security Agreement are: *1*) funded debt to EBITDA, excluding non-cash and retirement benefit expenses ("maximum leverage"), *not* to exceed *2.25* to *1.00, 2*) annual capital expenditures *not* to exceed *$15.0* million, *3*) maintain a Debt Service Coverage Rate of a minimum of *1.25* to *1.00,* and *4*) maintain consolidated cash plus liquid investments of *not* less than *$10.0* million at any time. As of *March 31, 2018,* the Company was in compliance with all the financial debt covenants related to its Loan and Security Agreement. The Company was *not* in compliance with *one* of its non-financial covenants related to additional borrowings made in *December,* but the waiver received in *January 2018* was granted until *June 30, 2018.* The Company expects to be in compliance with this covenant prior to the waiver expiration.

On *November 22, 2011,* in conjunction with the Bytewise acquisition, the Company entered into a *$15.5* million term loan (the "Term Loan") under the then existing Loan and Security Agreement. The Term Loan is a *ten* year loan bearing a fixed interest rate of *4.5%* and is payable in fixed monthly payments of principal and interest of *$160,640.* The Term Loan had a balance of *$6.5* million at *March 31, 2018.*

In *December 2017,* the Company's Brazilian subsidiary entered into *two* short-term loans with local banks in order to support the Company's strategic initiatives. The loans backed by the entity's US dollar denominated export receivables were made with Santander Bank and Bradesco Bank and totaled *$3.5* million. The Santander loan of *$1.5* million has a term of *180* days and a rate of *4.19%* and the Bradesco loan of *$2.0* million has a term of *360* days and a rate of *4.75%.* As of *March 31, 2018,* the outstanding balance on these loans was *$3.0* million.

Note *9*: Income Taxes

The Company is subject to U.S. federal income tax and various state, local, and foreign income taxes in numerous jurisdictions. The Company's domestic and foreign tax liabilities are subject to the allocation of revenues and expenses in different jurisdictions and the timing of recognizing revenues and expenses. Additionally, the amount of income taxes paid is subject to the Company's interpretation of applicable tax laws in the jurisdictions in which it files.

The Company provides for income taxes on an interim basis based on an estimate of the effective tax rate for the year. This estimate is reassessed on a quarterly basis. Discrete tax items are accounted for in the quarterly period in which they occur.

On *December 22, 2017,* the Tax Cuts and Jobs Act was signed into law in the United States. This law made numerous changes to federal taxation in the U.S., including a reduction in the federal corporate tax rate to *21%* and a *one*-time tax on historical foreign earnings that had *not* yet been repatriated. The effect of the tax rate change is that the Company's federal tax rate is reduced to a blended rate of *28%* from the previous rate of *34%* for fiscal *2018,* and then will further reduce to the enacted *21%* in Fiscal *2019* and beyond. In addition, there are also a number of other changes primarily related to U.S. taxation of income earned by foreign subsidiaries and on transactions with those subsidiaries. As a result of this legislation, in the quarter ended *December 31, 2017,* the Company performed an initial assessment of the impact of tax reform and has taken a charge to tax expense of *$7.3* million to reflect the estimated impact of the tax rate reduction on its deferred tax assets. The Company has estimated the overall federal tax impact for the *one* time transition tax to be zero. Further guidance from the Department of Treasury and various state taxing authorities as well as year-end financial data is required, however, before the various tax calculations can be considered complete.

The Company is reviewing all aspects of the tax law change and, other than the reduced tax rate on earnings going forward, which will provide a favorable benefit, the Company does *not* believe the other provisions will have a significant impact to tax expense. The Company will continue to measure the impact of these provisions and will record any changes in subsequent quarters when information and guidance becomes available.

The tax expense for the *third* quarter of fiscal *2018* was *$0.7* million on profit before tax of *$2.3* million for an effective tax rate of *30.0%.* The effective tax rate for the *third* quarter of fiscal *2017* was *36.8%.* For the *first nine* months of fiscal *2018,* tax expense was *$8.5* million on profit before tax of *$4.1* million for an effective tax rate of *209%.* Before the tax charge related to new tax legislation, tax expense was