KEY TRONIC CORP
Form 10-Q
May 10, 2016

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

FORM 10-Q

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934
FOR THE PERIOD ENDED APRIL 2, 2016
OR
¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934
FOR THE PERIOD FROM TO .
Commission File Number 0-11559

KEY TRONIC CORPORATION
(Exact name of registrant as specified in its charter)

Washington	91-0849125
(State of Incorporation)	(I.R.S. Employer Identification No.)

N. 4424 Sullivan Road
Spokane Valley, Washington 99216
(509) 928-8000

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements during the past 90 days. Yes x 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 Regulations 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 x 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 “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act.

Large accelerated filer ¨	Accelerated filer x
Non-accelerated filer ¨ (Do not check if a smaller reporting company)	Smaller reporting company ¨

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

As of April 29, 2016, 10,710,606 shares of common stock, no par value (the only class of common stock), were outstanding.

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* Items are not applicable

"We," "us," "our," "Company," "KeyTronicEMS" and "KeyTronic," unless the context otherwise requires, means Key Tronic Corporation and its subsidiaries.

PART I: FINANCIAL INFORMATION
Item 1: Financial Statements
KEY TRONIC CORPORATION AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(Unaudited, in thousands)

	April 2, 2016	June 27, 2015
ASSETS		
Current assets:		
Cash and cash equivalents	$275	$372
Trade receivables, net of allowance for doubtful accounts of $112 and $97	55,600	72,852
Inventories	107,239	91,594
Other	16,211	13,646
Total current assets	179,325	178,464
Property, plant and equipment, net	27,346	26,974
Other assets:		
Deferred income tax asset	9,678	6,723
Goodwill	9,957	9,957
Other intangible assets, net	6,210	7,055
Other	1,816	1,621
Total other assets	27,661	25,356
Total assets	$234,332	$230,794
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$56,212	$61,528
Accrued compensation and vacation	7,937	9,467
Current portion of debt	5,000	5,000
Other	13,902	10,794
Total current liabilities	83,051	86,789
Long-term liabilities:		
Term loan	22,500	26,250
Revolving loan	18,543	11,631
Deferred income tax liability	—	501
Other long-term obligations	5,687	4,855
Total long-term liabilities	46,730	43,237
Total liabilities	129,781	130,026
Commitments and contingencies (Note 9)		
Shareholders' equity:		
Common stock, no par value—shares authorized 25,000; issued and outstanding 10,711 and 10,706 shares, respectively	45,148	44,136
Retained earnings	65,782	61,395
Accumulated other comprehensive loss	(6,379)	(4,763)
Total shareholders' equity	104,551	100,768
Total liabilities and shareholders' equity	$234,332	$230,794

See accompanying notes to consolidated financial statements.

KEY TRONIC CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME
(Unaudited, in thousands, except per share amounts)

	Three Months Ended		Nine Months Ended	
	April 2, 2016	March 28, 2015	April 2, 2016	March 28, 2015
Net sales	$118,448	$112,915	$361,060	$313,568
Cost of sales	108,493	103,479	333,076	290,655
Gross profit	9,955	9,436	27,984	22,913
Research, development and engineering expenses	1,634	1,510	4,696	4,143
Selling, general and administrative expenses	5,564	5,375	16,348	15,407
Total operating expenses	7,198	6,885	21,044	19,550
Operating income	2,757	2,551	6,940	3,363
Interest expense, net	620	317	1,674	910
Income before income taxes	2,137	2,234	5,266	2,453
Income tax provision	354	373	879	489
Net income	$1,783	$1,861	$4,387	$1,964
Net income per share — Basic	$0.17	$0.18	$0.41	$0.19
Weighted average shares outstanding — Basic	10,711	10,552	10,709	10,551
Net income per share — Diluted	$0.16	$0.16	$0.39	$0.17
Weighted average shares outstanding — Diluted	11,068	11,556	11,298	11,457

See accompanying notes to consolidated financial statements.

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KEY TRONIC CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
(Unaudited, in thousands)

	Three Months Ended		Nine Months Ended	
	April 2, 2016	March 28, 2015	April 2, 2016	March 28, 2015
Comprehensive income (loss):				
Net income	$ 1,783	$ 1,861	$4,387	$1,964
Other comprehensive income (loss):				
Unrealized gain (loss) on hedging instruments, net of tax	677	(1,438)	(1,616)	(6,788)
Comprehensive income (loss)	$ 2,460	$ 423	$2,771	$(4,824)

Other comprehensive income (loss) for the three months ended April 2, 2016 and March 28, 2015 is reflected net of tax provision (benefit) of approximately $0.3 million and $(0.7) million, respectively. Other comprehensive loss for the nine months ended April 2, 2016 and March 28, 2015 is reflected net of tax benefit of approximately $(0.8) million and $(3.5) million, respectively.
See accompanying notes to consolidated financial statements.

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KEY TRONIC CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOW
(Unaudited, in thousands)

	Nine Months Ended	
	April 2, 2016	March 28, 2015
Operating activities:		
Net income	$4,387	$1,964
Adjustments to reconcile net income to cash provided by operating activities:		
Depreciation and amortization	4,556	4,376
Excess tax benefit from share-based compensation	(402)	(50)
Provision for obsolete inventory	754	254
Provision for warranty	86	48
Provision for doubtful accounts	2	111
Gain on disposal of assets	—	(4)
Share-based compensation expense	630	540
Deferred income taxes	(2,624)	(904)
Changes in operating assets and liabilities, net of acquisition:		
Trade receivables	17,250	1,068
Inventories	(16,399)	(808)
Other assets	(2,712)	(5,591)
Accounts payable	(5,316)	6,748
Accrued compensation and vacation	(1,530)	(2,093)
Other liabilities	1,550	1,338
Cash provided by operating activities	232	6,997
Investing activities:		
Payment for acquisition, net of cash acquired	—	(47,964)
Purchase of property and equipment	(10,020)	(7,147)
Proceeds from sale of fixed assets	6,183	6,469
Cash used in investing activities	(3,837)	(48,642)
Financing activities:		
Payment of financing costs	(56)	(44)
Proceeds from issuance of long term debt	—	35,000
Repayments of long term debt	(3,750)	(2,500)
Borrowings under revolving credit agreement	153,835	99,379
Repayments of revolving credit agreement	(146,923)	(87,893)
Proceeds from accounts receivable purchase agreement	—	1,147
Payments towards accounts receivable purchase agreement	—	(8,969)
Excess tax benefit from share-based compensation	402	50
Proceeds from exercise of stock options	—	17
Cash provided by financing activities	3,508	36,187
Net decrease in cash and cash equivalents	(97)	(5,458)
Cash and cash equivalents, beginning of period	372	5,803
Cash and cash equivalents, end of period	$275	$345
Supplemental cash flow information:		
Interest payments	$1,713	$934
Income tax payments, net of refunds	$1,278	$3,084

See accompanying notes to consolidated financial statements.

KEY TRONIC CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY
(Unaudited, in thousands)

	Shares	Common Stock	Retained Earnings	Accumulated Other Comprehensive Loss	Total Shareholders' Equity
Balances, June 27, 2015	10,706	$44,136	$61,395	$ (4,763)	$ 100,768
Net income	—	—	4,387	—	4,387
Unrealized loss on hedging instruments, net	—	—	—	(1,616)	(1,616)
Exercise of stock appreciation rights	13	—	—	—	—
Shares withheld for taxes	(8)	(20)	—	—	(20)
Share-based compensation	—	630	—	—	630
Excess tax benefit from share-based compensation	—	402	—	—	402
Balances, April 2, 2016	10,711	$45,148	$65,782	$ (6,379)	$ 104,551

See accompanying notes to consolidated financial statements.

KEY TRONIC CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. Basis of Presentation

The consolidated financial statements included herein have been prepared by Key Tronic Corporation and subsidiaries (the Company) pursuant to the rules and regulations of the Securities and Exchange Commission (SEC). Certain information and footnote disclosures normally included in our annual consolidated financial statements have been condensed or omitted. The year-end condensed consolidated balance sheet information was derived from audited financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States of America. The financial statements reflect all normal and recurring adjustments which, in the opinion of management, are necessary for a fair presentation of the financial position, results of operations and cash flows for the interim periods presented. The preparation of financial statements in accordance with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the reported amounts of revenues and expenses during the reporting period. The results of operations for the periods presented are not necessarily indicative of the results to be expected for the full year. The accompanying unaudited condensed consolidated financial statements should be read in conjunction with the financial statements and notes included in the Company’s Annual Report on Form 10-K for the fiscal year ended June 27, 2015.
The Company’s reporting period is a 52/53 week fiscal year ending on the Saturday closest to June 30. The quarter ended April 2, 2016 was a 14 week period, whereas the quarter ended March 28, 2015 was a 13 week period. Fiscal year 2016 will end on July 2, 2016, which is a 53 week year. Fiscal year 2015 which ended on June 27, 2015, was a 52 week year.

2. Significant Accounting Policies

Reclassifications

Certain prior period reclassifications were made to conform with the current period presentation. These reclassifications had no effect on reported income, comprehensive income, cash flows, total assets, or shareholders’ equity as previously reported.

Earnings Per Common Share

Basic earnings per common share (EPS) is computed by dividing net income (loss) by the weighted average number of common shares outstanding during the period. Diluted EPS is computed by dividing net income (loss) by the combination of other potentially dilutive weighted average common shares and the weighted average number of common shares outstanding during the period using the treasury stock method. The computation assumes the proceeds from the exercise of equity awards were used to repurchase common shares at the average market price during the period. The computation of diluted EPS does not assume conversion, exercise, or contingent issuance of common stock equivalent shares that would have an anti-dilutive effect on EPS.

Derivative Instruments and Hedging Activities

The Company has entered into foreign currency forward contracts and an interest rate swap which are accounted for as cash flow hedges in accordance with ASC 815, Derivatives and Hedging. The effective portion of the gain or loss on the derivative is reported as a component of accumulated other comprehensive income (AOCI) and is reclassified into earnings in the same period in which the underlying hedged transaction affects earnings. The derivative’s effectiveness represents the change in fair value of the hedge that offsets the change in fair value of the hedged item.
The Company uses derivatives to manage the variability of foreign currency fluctuations of expenses in our Mexico facilities and interest rate risk associated with certain borrowings under the Company’s debt arrangement. The foreign currency forward contracts and interest rate swaps have terms that are matched to the underlying transactions being hedged. As a result, these transactions fully offset the hedged risk and no ineffectiveness has been recorded.
The Company’s foreign currency forward contracts and interest rate swaps potentially expose the Company to credit risk to the extent the counterparties may be unable to meet the terms of the agreement. The Company minimizes such risk by seeking high quality counterparties. The Company’s counterparties to the foreign currency forward contracts and interest rate swaps are major banking institutions. These institutions do not require collateral for the contracts, and the Company believes that the risk of the counterparties failing to meet their contractual obligations is remote. The

Company does not enter into derivative instruments for trading or speculative purposes.

Income Taxes

We compute our interim income tax provision through the use of an estimated annual effective tax rate (ETR) applied to year-to-date operating results and specific events that are discretely recognized as they occur. In determining the estimated annual ETR, we analyze various factors, including projections of our annual earnings, taxing jurisdictions in which the earnings will be generated, the impact of state and local income taxes, our ability to use tax credits and net operating loss carryforwards, and available tax planning alternatives. Discrete items, including the effect of changes in tax laws, tax rates, and certain circumstances with respect to valuation allowances or other unusual or non-recurring tax adjustments, are reflected in the period in which they occur as an addition to, or reduction from, the income tax provision, rather than included in the estimated annual ETR. Refer to Note 6 for further discussions.

Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the estimated future tax consequences and benefits attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax basis, as well as operating losses and tax credit carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which temporary differences and carryforwards are expected to be recovered or settled. The effect on deferred tax assets and liabilities for a change in tax rates is recognized in the period that includes the enactment date. Valuation allowances are established when necessary to reduce deferred tax assets to the amount that is more likely than not to be realized.

We utilize a two-step approach to recognizing and measuring uncertain tax positions. The first step is to evaluate the tax position for recognition by determining if the weight of available evidence indicates it is more likely than not that the position will be sustained on audit, including resolution of related appeals or litigation processes, if any. The second step is to measure the tax benefit as the largest amount which is more than 50% likely of being realized upon ultimate settlement. We consider many factors when evaluating and estimating our tax positions and tax benefits, which may require periodic adjustments based on new assessments and changes in estimates and which may not accurately forecast actual outcomes. Our policy is to recognize interest and penalties related to the underpayment of income taxes as a component of income tax expense. The tax years 1998 through the present remain open to examination by the major U.S. taxing jurisdictions to which we are subject.

Impairment of Goodwill and Other Intangible Assets

The Company records intangible assets that are acquired individually or with a group of other assets in the financial statements at acquisition. In accordance with ASC 350, Goodwill and Other Intangible Assets, goodwill and intangible assets acquired in a business combination and determined to have an indefinite useful life are not amortized but are required to be reviewed for impairment at least annually or when events or circumstances indicate that carrying value may exceed fair value. The Company’s acquired intangible assets are subject to amortization over their estimated useful lives and are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an intangible asset may not be recoverable.

Recently Issued Accounting Standards

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update 2014-09 (ASU 2014-09), Revenue from Contracts with Customers. The guidance in this Update affects any entity that either enters into contracts with customers to transfer goods or services or enters into contracts for the transfer of nonfinancial assets unless those contracts are within the scope of other standards (for example, insurance contracts or lease contracts). The standard’s core principle is that a company will recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration to which the company expects to be entitled in exchange for those goods or services. In doing so, companies will need to use more judgment and make more estimates than under current guidance. This may include identifying performance obligations in the contract, estimating the amount of variable consideration to include in the transaction price and allocating the transaction price to each separate performance obligation. In August 2015, the FASB issued an amendment to defer the effective date of ASU 2014-09 for all entities by one year. This Update is effective for annual reporting periods beginning after December 15, 2017, including interim periods within that reporting period. Early adoption is permitted as of annual reporting periods beginning after December 15, 2016. Companies have the option of using either a full or modified retrospective approach in applying this standard. The Company is in the process of assessing the impact of ASU

2014-09 on its consolidated financial statements.

In August 2014, the FASB issued Accounting Standards Update 2014-15 (ASU 2014-15), Presentation of Financial Statements - Going Concern. The guidance in this Update applies to all entities. The amendments require management to assess an entity's ability to continue as a going concern by incorporating and expanding upon certain principles that are currently in U.S. auditing standards. Specifically, the amendments (1) provide a definition of the term substantial doubt, (2) require an evaluation every reporting period including interim periods, (3) provide principles for considering the mitigating effect of management's plans, (4) require certain disclosures when substantial doubt is alleviated as a result of consideration of management's plans, (5) require an express statement and other disclosures when substantial doubt is not alleviated, and (6) require an assessment for a period of one year after the date that the financial statements are issued (or available to be issued). The amendments in this Update are effective for the annual period ending after December 15, 2016, and for annual periods and interim periods thereafter. Early application is permitted. The amendments of ASU 2014-15 did not have a significant impact on the Company's consolidated financial statements.

In April 2015, the FASB issued Accounting Standards Update 2015-03 (ASU 2015-03), Simplifying the Presentation of Debt Issuance Costs. The guidance in this Update changes the presentation of debt issuance costs in financial statements. Under the new guidance, an entity presents such costs in the balance sheet as a direct deduction from the related debt liability rather than as an asset. Amortization of the costs is reported as interest expense. This guidance is effective for the Company beginning in the first quarter of fiscal year 2017 and early adoption is permitted in an interim period with any adjustments reflected as of the beginning of the fiscal year that includes that interim period. The amendments of ASU 2015-03 did not have a significant impact to the Company's consolidated financial statements.

In July 2015, the FASB issued final guidance that simplifies the subsequent measurement of inventory for which cost is determined by methods other than last-in first-out ("LIFO") and the retail inventory method. For inventory within the scope of the new guidance, entities will be required to compare the cost of inventory to only one measure, its net realizable value, and not the three measures required by the existing guidance. Net realizable value is the estimated selling price in the ordinary course of business, less reasonably predictable costs of completion, disposal and transportation. The new guidance should not change how entities initially measure the cost of inventory. The guidance will be effective for the Company in the fiscal year beginning July 3, 2017. Early adoption is permitted. We have not yet determined the impact this new guidance may have on our financial statements.

In September 2015, the FASB issued Accounting Standards Update 2015-16 (ASU 2015-16), Simplifying the Accounting for Measurement-Period Adjustments. The amendments in this Update require that an acquirer recognize adjustments to provisional amounts that are identified during the measurement period in the reporting period in which the adjustment amounts are determined. The amendments in this Update require that the acquirer record, in the same period's financial statements, the effect on earnings of changes in depreciation, amortization, or other income effects, if any, as a result of the change to the provisional amounts, calculated as if the accounting had been completed at the acquisition date. We are currently evaluating the impact of adopting this new guidance on our consolidated financial statements.

In November 2015, the FASB issued Accounting Standards Update 2015-17, Income Taxes. The amendments in this Update require that deferred tax liabilities and assets be classified as noncurrent in a classified statement of financial position. The guidance will be effective for the Company beginning after December 15, 2016, and interim periods within those annual periods. Earlier application is permitted for all entities. The Company retrospectively adopted this ASU during the second quarter of fiscal year 2016. The following table summarizes the adjustments made to conform prior period classifications with the new guidance (in thousands):

	June 27, 2015		
	As Filed	Reclass	As Adjusted
Current deferred income tax assets	$6,643	$(6,643)	$—
Long-term deferred income tax assets	80	6,643	6,723
Long-term deferred income tax liabilities	(501)	—	(501)
Net deferred tax assets	$6,222	$—	$6,222

In February 2016, the FASB issued Accounting Standards Update 2016-02 (ASU 2016-02), Leases which supersedes ASC 840 Leases and creates a new topic, ASC 842 Leases. This update requires lessees to recognize a lease asset and a lease liability for all leases, including operating leases, with a term greater than 12 months on its balance sheet. The update also expands the required quantitative and qualitative disclosures surrounding leases. This update is effective for fiscal years beginning after December 15, 2018 and interim periods within those fiscal years, with earlier adoption permitted. This update will be applied using a modified retrospective transition approach for leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements. The Company is currently evaluating the effect of this update on its consolidated financial statements.

In March 2016, the FASB issued Accounting Standards Update 2016-09 (ASU 2016-09), Improvements to Employee Share-Based Payment Accounting. This update simplifies several aspects of the accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. This update is effective for fiscal years beginning after December 15, 2016, and interim periods within those fiscal years, with earlier adoption permitted. The amendments of ASU 2016-09, when adopted, are not expected to have a material impact on the Company's consolidated financial statements.

3. Inventories

The components of inventories consist of the following (in thousands):

	April 2, 2016	June 27, 2015
Finished goods	$13,450	$8,019
Work-in-process	18,391	15,220
Raw materials and supplies	75,398	68,355
	$107,239	$91,594

4. Long-Term Debt

On September 3, 2014, the Company added a five-year term loan in the amount of $35.0 million used to acquire all of the outstanding shares of CDR Manufacturing, Inc. (dba Ayrshire Electronics). For further information on the acquisition of Ayrshire, see footnote 12 of the "Notes to Consolidated Financial Statements." On August 6, 2015, the Company entered into a First Amendment to the amended and restated credit agreement extending the limit on our line of credit facility to $45.0 million as evidenced by the Second Replacement Revolving Note.

The agreement specifies that the proceeds of the revolving line of credit be used primarily for working capital and general corporate purposes of the Company and its subsidiaries. Borrowings under the revolving line of credit bear interest at either a "Base Rate" or a "Fixed Rate," as elected by the Company. The base rate is the higher of the Wells Fargo Bank prime rate, daily one month London Interbank Offered Rate (LIBOR) plus 1.5%, or the Federal Funds rate plus 1.5%. The fixed rate is LIBOR plus 1.75%, LIBOR plus 2.00%, or LIBOR plus 2.25% depending on the level of the Company's trailing four quarters Earnings Before Interest, Taxes, Depreciation and Amortization (EBITDA). The revolving line of credit is secured by substantially all of the assets of the Company.

As of April 2, 2016, the Company had an outstanding balance under the credit facility of $18.5 million, $0.4 million in outstanding letters of credit and $26.1 million available for future borrowings. The interest rate on the outstanding line of credit balance was in the range of 2.44% - 3.50%. As of June 27, 2015, the Company had an outstanding balance under the credit facility of $11.6 million, $0.3 million in outstanding letters of credit and $18.0 million available for future borrowings. The interest rate on the outstanding line of credit balance was in the range of 2.28% - 3.25%.

The outstanding principal balance of the term loan bears interest at a fixed rate per annum of the daily one month LIBOR plus 1.75%, 2.00% or 2.25% depending on the ratio of the Company's funded debt to EBITDA, except that the term loan bore interest at LIBOR plus 2.00% from September 3, 2014 through December 14, 2014 regardless of the Company's cash flow leverage ratio. Principal on the term loan is payable in equal quarterly installments of $1.25 million which commenced on December 15, 2014 and will continue through June 15, 2019, with a final installment of all remaining unpaid principal due on August 31, 2019. The Company had an outstanding balance of $27.5 million under the term loan as of April 2, 2016. As of June 27, 2015, the Company had an outstanding balance of $31.3 million under the term loan.

The Company must comply with certain financial covenants, including a cash flow leverage ratio, an asset coverage ratio, and a fixed charge coverage ratio. The credit agreement requires the Company to maintain a minimum profit threshold, limits the maximum capital lease expenditures and restricts the Company from declaring or paying dividends in cash or stock without prior bank approval. The Company is in compliance with all financial covenants for all periods presented.

5. Trade Accounts Receivable Purchase Programs

Sale Programs

On June 25, 2014, the Company entered into an Account Purchase Agreement with Wells Fargo Bank, N.A. (“WFB”) which provides that the Company may sell and assign to WFB and WFB may purchase from the Company the accounts receivable of certain Company customers in a maximum aggregate amount outstanding of $50.0 million. The initial term of the agreement is 36 months with successive 12 month renewal terms. On December 18, 2014, the Company modified the original Account Purchase Agreement with WFB to allow the Company to account for the factored receivables as a true-sale. On July 16, 2015, the Company modified the Account Purchase Agreement with WFB to decrease the maximum aggregate amount of receivables available to factor from $50.0 million to $20.0 million. The decrease in the aggregate amount available was due to a change in customer mix and to reduce fees related to the program. The Company also has an Account Purchase Agreement with Orbian Financial Services (“Orbian”) which allows the Company to account for factored receivables as a true-sale.

Total accounts receivables sold during the nine months ended April 2, 2016 and March 28, 2015 was approximately $58.2 million and $5.0 million, respectively. Accounts receivables sold and not yet collected was $2.0 million and $0.9 million as of April 2, 2016 and June 27, 2015, respectively. The receivables that were sold were removed from the condensed consolidated balance sheets and the cash received is reflected as cash provided by operating activities in the condensed consolidated statements of cash flows.

6. Income Taxes

The Company expects to repatriate a portion of its foreign earnings based on increased net sales growth driving additional capital requirements domestically, cash requirements for potential acquisitions and to implement certain tax strategies. The Company currently expects to repatriate approximately $11.7 million of foreign earnings in the future. As such, these earnings would be recognized in the United States, and the Company would be subject to U.S. federal income taxes and potential withholding taxes in foreign jurisdictions. Both the domestic tax and estimated withholding tax of expected repatriation of foreign earnings have been recorded as part of deferred taxes as of April 2, 2016. All other unremitted foreign earnings are expected to remain permanently reinvested for planned fixed assets purchases and improvements in foreign locations.

The Company has available approximately $6.9 million of gross federal research and development tax credits as of April 2, 2016. ASC 740 requires the Company to recognize in its financial statements uncertainties in tax positions taken that may not be sustained upon examination by the taxing authorities. Accordingly, as of April 2, 2016, the Company has recorded $3.7 million of unrecognized tax benefits associated with these federal tax credits, resulting in a net deferred tax benefit of approximately $3.2 million.

7. Earnings Per Share

The following tables present a reconciliation of the denominator in the basic and diluted EPS calculation and the number of antidilutive common share awards that were not included in the diluted earnings per share calculation. These antidilutive securities occur when equity awards outstanding have an option price greater than the average market price for the period.

	Three Months Ended (in thousands, except per share information)	
	April 2, 2016	March 28, 2015
Net income	$ 1,783	$ 1,861
Weighted average shares outstanding—basic	10,711	10,552
Effect of dilutive common stock awards	357	1,004
Weighted average shares outstanding—diluted	11,068	11,556
Net income per share—basic	$ 0.17	$ 0.18
Net income per share—diluted	$ 0.16	$ 0.16
Antidilutive SARs not included in diluted earnings per share	869	208

	Nine Months Ended (in thousands, except per share information)	
	April 2, 2016	March 28, 2015
Net income	$ 4,387	$ 1,964
Weighted average shares outstanding—basic	10,709	10,551
Effect of dilutive common stock awards	589	906
Weighted average shares outstanding—diluted	11,298	11,457
Earnings per share—basic	$ 0.41	$ 0.19
Earnings per share—diluted	$ 0.39	$ 0.17
Antidilutive SARs not included in diluted earnings per share	456	208

8. Share-based Compensation

The Company’s incentive plan provides for equity and liability awards to employees and non-employee directors in the form of stock options, stock appreciation rights (SARs), restricted stock, restricted stock units, stock awards, stock units, performance shares, performance units, and other stock-based or cash-based awards. Compensation cost is recognized on a straight-line basis over the requisite employee service period, which is generally the vesting period, and is recorded as employee compensation expense in cost of goods sold, research, development and engineering, and selling, general and administrative expenses. Share-based compensation is recognized only for those awards that are expected to vest, with forfeitures estimated at the date of grant based on historical experience and future expectations.

In addition to service conditions, these SARs contain a performance condition. The additional performance condition is based upon the achievement of Return on Invested Capital (ROIC) goals relative to a peer group. All awards with performance conditions are evaluated quarterly to determine the likelihood that performance metrics will be achieved during the performance period. These awards are charged to compensation expense over the requisite service period based on the number of shares expected to vest. The SARs cliff vest after a three-year period from date of grant and expire five years from date of grant.

The grant date fair value for the awards granted below were estimated using the Black Scholes option valuation method:

	July 29, 2015	October 31, 2014
SARs Granted	248,166	213,166
Strike Price	$ 10.26	$ 8.22
Fair Value	$ 3.65	$ 3.04

Total share-based compensation expense recognized during the three months ended April 2, 2016 and March 28, 2015 was approximately $204,000 and $196,000, respectively. Total share-based compensation recognized during the nine months ended April 2, 2016 and March 28, 2015 was approximately $630,000 and $540,000, respectively. As of April 2, 2016, total unrecognized compensation expense related to unvested share-based compensation arrangements was approximately $1.1 million. This expense is expected to be recognized over a weighted average period of 1.91 years.

No options to purchase shares of common stock or SARs were exercised during the three months ended April 2, 2016 or March 28, 2015. During the nine months ended April 2, 2016, 13,333 SARs were exercised, with an immaterial amount of intrinsic value. During the nine months ended March 28, 2015, 4,930 options to purchase shares of common stock were exercised, with an immaterial amount of intrinsic value.

9. Commitments and Contingencies

Litigation and Other Matters

The Company is party to certain lawsuits or claims in the ordinary course of business. The Company does not believe that these proceedings, individually or in the aggregate, will have a material adverse effect on the financial position, results of operations or cash flow of the Company.

Warranties

The Company provides warranties on certain product sales. Allowances for estimated warranty costs are recorded during the period of sale. The determination of such allowances requires the Company to make estimates of product return rates and expected costs to repair or to replace the products under warranty. If actual return rates and/or repair and replacement costs differ significantly from management’s estimates, adjustments to recognize additional cost of sales may be required in future periods. The Company’s warranty reserve was approximately $48,000 and $115,000 as of April 2, 2016 and June 27, 2015, respectively.

10. Fair Value Measurements

The Company has adopted ASC 820, Fair Value Measurements, which defines fair value, establishes a framework for assets and liabilities being measured and reported at fair value and expands disclosures about fair value measurements. There are three levels of fair value hierarchy inputs used to value assets and liabilities which include: Level 1 – inputs are quoted market prices for identical assets or liabilities; Level 2 – inputs other than quoted market prices included in Level 1 that are observable for the asset or liability, either directly or indirectly; and Level 3 – inputs are unobservable inputs for the asset or liability.

The following table summarizes the fair value of assets (liabilities) of the Company’s derivatives that are required to be measured on a recurring basis as of April 2, 2016 and June 27, 2015 (in thousands):

	April 2, 2016			
	Level 1	Level 2	Level 3	Total Fair Value
Financial Assets:				
Foreign currency forward contracts	$—	$263	$—	$263
Financial Liabilities:				
Interest rate swaps	$—	$(506)	$—	$(506)
Foreign currency forward contracts	$—	$(9,422)	$—	$(9,422)

	June 27, 2015			
	Level 1	Level 2	Level 3	Total Fair Value
Financial Assets:				