STRATTEC SECURITY CORP
Form 10-Q
November 07, 2013

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 10-Q

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

For the quarterly period ended September 29, 2013

or

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

For the transition period from to

Commission File Number 0-25150

STRATTEC SECURITY CORPORATION

(Exact Name of Registrant as Specified in Its Charter)

Wisconsin	39-1804239
(State of Incorporation)	(I.R.S. Employer Identification No.)

3333 West Good Hope Road, Milwaukee, WI 53209

(Address of Principal Executive Offices)

(414) 247-3333

(Registrant s Telephone Number, Including Area Code)

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

Large Accelerated filer	¨	Accelerated filer	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

Indicate the number of shares outstanding of each of the issuer s classes of common stock as of the latest practicable date.

Common stock, par value $0.01 per share: 3,456,882 shares outstanding as of September 29, 2013 (which includes any restricted shares previously awarded that have not vested as of such date).

STRATTEC SECURITY CORPORATION

FORM 10-Q

September 29, 2013

INDEX

PROSPECTIVE INFORMATION

A number of the matters and subject areas discussed in this Form 10-Q contain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These statements may be identified by the use of forward-looking words or phrases such as anticipate, believe, would, expect, intend, may, planned, poter will, and could, or the negative of these terms or words of similar meaning. These statements include expected future financial results, product offerings, global expansion, liquidity needs, financing ability, planned capital expenditures, management's or the Company s expectations and beliefs, and similar matters discussed in this Form 10-Q. The discussions of such matters and subject areas are qualified by the inherent risks and uncertainties surrounding future expectations generally, and also may materially differ from the Company s actual future experience.

The Company s business, operations and financial performance are subject to certain risks and uncertainties, which could result in material differences in actual results from the Company s current expectations. These risks and uncertainties include, but are not limited to, general economic conditions, in particular relating to the automotive industry, consumer demand for the Company s and its customers products, competitive and technological developments, customer purchasing actions, foreign currency fluctuations, fluctuations in costs of operations (including fluctuations in the cost of raw materials) and other matters described in the section titled Risk Factors in the Company s Form 10-K report filed on September 9, 2013 with the Securities and Exchange Commission for the year ended June 30, 2013.

Shareholders, potential investors and other readers are urged to consider these factors carefully in evaluating the forward-looking statements and are cautioned not to place undue reliance on such forward-looking statements. The forward-looking statements made herein are only made as of the date of this Form 10-Q and the Company undertakes no obligation to publicly update such forward-looking statements to reflect subsequent events or circumstances occurring after the date of this Form 10-Q.

Item 1 Financial Statements

STRATTEC SECURITY CORPORATION AND SUBSIDIARIES

Condensed Consolidated Statements of Income and Comprehensive Income

(In Thousands, Except Per Share Amounts)

(Unaudited)

	Three Months Ended	
	September 29, 2013	September 30, 2012
Net sales	$ 79,595	$ 70,807
Cost of goods sold	65,080	57,094
Gross profit	14,515	13,713
Engineering, selling and administrative expenses	9,470	9,120
Income from operations	5,045	4,593
Interest income	6	3
Equity earnings (loss) of joint ventures	294	(12)
Interest expense	(14)	(5)
Other income (expense), net	279	(18)
Income before provision for income taxes	5,610	4,561
Provision for income taxes	1,756	1,246
Net income	3,854	3,315
Net income attributable to non-controlling interest	643	645
Net income attributable to STRATTEC SECURITY CORPORATION	$ 3,211	$ 2,670
Comprehensive Income:		
Net income	$ 3,854	$ 3,315
Retirement and postretirement plans, net of tax	435	
Foreign currency translation adjustments	(336)	732
Other comprehensive income, net of tax	99	732
Comprehensive income	3,953	4,047
Comprehensive income attributable to non-controlling interest	623	670
Comprehensive income attributable to STRATTEC SECURITY CORPORATION	$ 3,330	$ 3,377
Earnings per share:		
Basic	$ 0.93	$ 0.79
Diluted	$ 0.91	$ 0.78
Average shares outstanding:		
Basic	3,382	3,309
Diluted	3,460	3,340

Cash dividends declared per share	$	0.11	$	0.10

The accompanying notes are an integral part of these condensed consolidated statements of income and comprehensive income.

STRATTEC SECURITY CORPORATION AND SUBSIDIARIES

Condensed Consolidated Balance Sheets

(In Thousands, Except Share Amounts)

	September 29, 2013 (Unaudited)	June 30, 2013
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 12,806	$ 20,307
Receivables, net	52,013	47,514
Inventories		
Finished products	8,673	6,966
Work in process	6,156	6,164
Purchased materials	14,141	12,682
Excess and obsolete reserve	(1,626)	(1,500)
Inventories, net	27,344	24,312
Other current assets	15,308	14,366
Total current assets	107,471	106,499
Investment in joint ventures	9,464	9,166
Other long-term assets	5,258	2,420
Property, plant and equipment	165,726	163,437
Less: accumulated depreciation	(113,748)	(112,022)
Net property, plant and equipment	51,978	51,415
	$ 174,171	$ 169,500
LIABILITIES AND SHAREHOLDERS EQUITY		
Current Liabilities:		
Accounts payable	$ 28,452	$ 25,543
Borrowings under credit facility	3,000	2,250
Accrued Liabilities:		
Payroll and benefits	10,513	13,993
Environmental reserve	1,410	1,414
Warranty	2,691	2,500
Other	6,252	5,025
Total current liabilities	52,318	50,725
Deferred income taxes	1,020	1,009
Accrued pension obligations	1,537	1,464
Accrued postretirement obligations	2,644	2,717
Other long-term liabilities	1,729	1,705
Shareholders Equity:		
Common stock, authorized 12,000,000 shares, $.01 par value, issued 7,020,092 shares at September 29, 2013 and 6,998,702 shares at June 30, 2013	70	70
Capital in excess of par value	83,133	82,684
Retained earnings	182,446	179,614
Accumulated other comprehensive loss	(22,093)	(22,212)

Less: treasury stock, at cost (3,626,410 shares at September 29, 2013 and 3,626,673 shares at June 30, 2013)	(135,934)	(135,938)
Total STRATTEC SECURITY CORPORATION shareholders equity	107,622	104,218
Non-controlling interest	7,301	7,662
Total shareholders equity	114,923	111,880
	$ 174,171	$ 169,500

The accompanying notes are an integral part of these condensed consolidated balance sheets.

STRATTEC SECURITY CORPORATION AND SUBSIDIARIES

Condensed Consolidated Statements of Cash Flows

(In Thousands)

(Unaudited)

	Three Months Ended	
	September 29, 2013	September 30, 2012
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 3,854	$ 3,315
Adjustments to reconcile net income to net cash (used in) provided by operating activities:		
Depreciation and amortization	2,112	1,758
Foreign currency transaction (gain) loss	(212)	455
Stock based compensation expense	354	76
Equity (earnings) loss of joint ventures	(294)	12
Unrealized gain on foreign currency option contracts		(311)
Change in operating assets and liabilities:		
Receivables	(4,544)	(413)
Inventories	(3,032)	(4,246)
Other assets	(3,216)	1,116
Accounts payable and accrued liabilities	752	(29)
Other, net	86	(30)
Net cash (used in) provided by operating activities	(4,140)	1,703
CASH FLOWS FROM INVESTING ACTIVITIES:		
Investment in joint ventures		(200)
Purchase of property, plant and equipment	(2,876)	(2,711)
Proceeds received on sale of property, plant and equipment	8	30
Net cash used in investing activities	(2,868)	(2,881)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Borrowings under credit facility	750	1,500
Dividends paid to non-controlling interests of subsidiaries	(984)	(1,131)
Dividends paid	(380)	(336)
Exercise of stock options and employee stock purchases	98	19
Net cash (used in) provided by financing activities	(516)	52
Foreign currency impact on cash	23	(87)
NET DECREASE IN CASH AND CASH EQUIVALENTS	(7,501)	(1,213)
CASH AND CASH EQUIVALENTS		
Beginning of period	20,307	17,487
End of period	$ 12,806	$ 16,274
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:		
Income taxes paid	$ 372	$ 168

Interest paid	$	13	$	12

The accompanying notes are an integral part of these condensed consolidated statements of cash flows.

STRATTEC SECURITY CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

(Unaudited)

Basis of Financial Statements

STRATTEC SECURITY CORPORATION designs, develops, manufactures and markets automotive access control products, including mechanical locks and keys, electronically enhanced locks and keys, steering column and instrument panel ignition lock housings, latches, power sliding door systems, power lift gate systems, power deck lid systems, door handles and related products for primarily North American automotive customers. We also supply global automotive manufacturers through a unique strategic relationship with WITTE Automotive of Velbert, Germany, and ADAC Automotive of Grand Rapids, Michigan. Under this relationship, STRATTEC, WITTE and ADAC market each company s products to global customers under the VAST brand name.

During April 2013, we acquired a 51 percent ownership interest in NextLock LLC, a newly formed joint venture which will introduce a new generation of biometric security products based upon the designs of Actuator Systems LLC, our partner and the owner of the remaining 49 percent interest. We anticipate shipment of new biometric security products to begin in the second half of our 2014 fiscal year through this new NextLock joint venture. STRATTEC products are shipped to customer locations in the United States, Canada, Mexico, Europe, South America, Korea and China, and we provide full service and aftermarket support for our products.

The accompanying condensed consolidated financial statements reflect the consolidated results of STRATTEC SECURITY CORPORATION, its wholly owned Mexican subsidiary, STRATTEC de Mexico, and its majority owned subsidiaries, ADAC-STRATTEC, LLC and STRATTEC POWER ACCESS LLC. STRATTEC SECURITY CORPORATION is located in Milwaukee, Wisconsin. STRATTEC de Mexico is located in Juarez, Mexico. ADAC-STRATTEC, LLC and STRATTEC POWER ACCESS LLC have operations in El Paso, Texas and Juarez, Mexico. Equity investments in Vehicle Access Systems Technology LLC (VAST LLC) and NextLock LLC for which we exercise significant influence but do not control and are not the primary beneficiary, are accounted for using the equity method. VAST LLC consists primarily of three wholly owned subsidiaries in China and one joint venture in Brazil. NextLock LLC is located in El Paso, Texas. We have only one reporting segment.

In the opinion of management, the accompanying condensed consolidated balance sheet as of June 30, 2013, which has been derived from our audited financial statements, and the related unaudited interim condensed consolidated financial statements included herein contain all adjustments, consisting only of normal recurring items, necessary for their fair presentation in conformity with accounting principles generally accepted in the United States of America (U.S. GAAP) and in accordance with Rule 10-01 of Regulation S-X. All significant intercompany transactions have been eliminated.

Interim financial results are not necessarily indicative of operating results for an entire year. The information included in this Form 10-Q should be read in conjunction with Management s Discussion and Analysis and the financial statements and notes thereto included in the STRATTEC SECURITY CORPORATION 2013 Annual Report, which was filed with the Securities and Exchange Commission as an exhibit to our Form 10-K on September 9, 2013.

New Accounting Pronouncement Adopted

In February 2013, the Financial Accounting Standards Board (FASB) issued an amendment to the accounting guidance for the reporting of amounts reclassified out of accumulated other comprehensive income (AOCI). The amendment expands the existing disclosure by requiring entities to present information about significant items reclassified out of AOCI by component. In addition, an entity is required to provide information about the effects on net income of significant amounts reclassified out of each component of AOCI to net income either on the face of the statement where net income is presented or as a separate disclosure in the notes of the financial statements. The amendment is effective prospectively for annual or interim reporting periods beginning after December 15, 2012. The adoption of this accounting pronouncement did not have a material impact on our financial statement disclosures. See Accumulated Other Comprehensive Loss included herein.

Subsequent Event

On October 8, 2013, our Board of Directors approved certain amendments to our Amended and Restated Supplemental Executive Retirement Plan (the SERP Plan) which will be effective as of December 31, 2013. The SERP Plan provides certain benefits to our executive officers under a defined benefit formula which was designed to provide benefits in addition to the STRATTEC SECURITY CORPORATION Retirement Plan (the Pension Plan). We froze our Pension Plan effective as of December 31, 2009 and the SERP Plan provided benefits to participants as if the Pension Plan had not been frozen. Because the Pension Plan was frozen and because new employees do not participate in the Pension Plan our Board of Directors adopted amendments to the SERP Plan on October 8, 2013 that are effective as of December 31, 2013 to simplify the SERP Plan calculation. Under the amended SERP Plan, participants will receive an accrued lump-sum benefit as of December 31, 2013 to be credited to each participant s account. Going forward after that date, each eligible participant will receive a supplemental retirement benefit equal to the foregoing lump sum benefit, plus an annual benefit accrual equal to 8% of the participant s base salary and cash bonus, plus annual credited interest on the participant s account balance. All current participants are fully vested in their account balances with any new individuals participating in the SERP Plan on or after January 1, 2014 being subject to a five year vesting schedule. The SERP Plan, which is considered a defined benefit plan under applicable rules and regulations, will continue to be funded through use of a Rabbi Trust to hold investment assets to be used in part to fund any future required lump sum benefit payments to participants. We do not expect the above amendment to have a material effect on our financial statements.

Derivative Instruments

We own and operate manufacturing operations in Mexico. As a result, a portion of our manufacturing costs are incurred in Mexican pesos, which causes our earnings and cash flows to fluctuate as a result of changes in the U.S. dollar / Mexican peso exchange rate. During fiscal 2013, we had agreements with Bank of Montreal that provided for two weekly Mexican peso currency option contracts to cover a portion of our weekly estimated peso denominated operating costs. The contracts with Bank of Montreal expired June 28, 2013. The two weekly option contracts were for equivalent notional amounts and provided for the purchase of Mexican pesos at an average U.S. dollar / Mexican peso exchange rate of 12.40 if the spot rate at the weekly expiry date was below an average of 12.40 or for the purchase of Mexican pesos at an average U.S. dollar / Mexican peso exchange rate of 13.40 if the spot rate at the weekly expiry date was above an average of 13.40. Our objective in entering into these currency option contracts was to minimize our earnings volatility resulting from changes in exchange rates affecting the U.S. dollar cost of our Mexican operations. The Mexican peso option contracts were not used for speculative purposes and were not designated as hedges. As a result, all currency option contracts were recognized in our accompanying consolidated financial statements at fair value and changes in the fair value of the currency option contracts were reported in current earnings as part of Other Income (Expense), net. The premiums paid and received under the weekly Mexican peso currency option contracts netted to zero. As a result, premiums related to the contracts did not impact our earnings. No Mexican peso currency option contracts were outstanding as of September 29, 2013 or June 30, 2013.

The pre-tax effects of the Mexican peso option contracts on the accompanying Condensed Consolidated Statements of Income and Comprehensive Income consisted of the following (thousands of dollars):

	Other Income (Expense), net	
	Three Months Ended	
	September 29, 2013	September 30, 2012

Not Designated as Hedging Instruments:		
Realized Gain	$	$
Realized Loss	$	$ (34)
Unrealized Gain	$	$ 311

Fair Value of Financial Instruments

The fair value of our cash and cash equivalents, accounts receivable, accounts payable and borrowings under our credit facility approximated book value as of September 29, 2013 and June 30, 2013. Fair value is defined as the exchange price that would be received for an asset or paid for a liability in the principal or most advantageous market in an orderly transaction between market participants on the measurement date.

The following table summarizes our financial assets and liabilities measured at fair value on a recurring basis as of September 29, 2013 (in thousands of dollars):

	Fair Value Inputs		
	Level 1 Assets: Quoted Prices In Active Markets	Level 2 Assets: Observable Inputs Other Than Market Prices	Level 3 Assets: Unobservable Inputs
Assets:			
Rabbi Trust Assets:			
Stock Index Funds:			
Small Cap	$ 205	$	$
Mid Cap	144		
Large Cap	255		
International	239		
Cash and Cash Equivalents		742	
Total Assets at Fair Value	$ 842	$ 742	$

The Rabbi Trust assets fund our amended and restated supplemental executive retirement plan and are included in Other Long-term Assets in the accompanying Condensed Consolidated Balance Sheets. There were no transfers between Level 1 and Level 2 assets during the three months ended September 29, 2013.

Equity Earnings (Loss) of Joint Ventures

We hold a one-third interest in a joint venture company, Vehicle Access Systems Technology LLC (VAST LLC), with WITTE Automotive of Velbert, Germany (WITTE), and ADAC Automotive of Grand Rapids, Michigan (ADAC). VAST LLC exists to seek opportunities to manufacture and sell all three companies products in areas of the world outside of North America and Europe. VAST LLC consists primarily of three wholly owned subsidiaries in China and one joint venture in Brazil. Our investment in VAST LLC, for which we exercise significant influence but do not control and are not the primary beneficiary, is accounted for using the equity method.

The following are summarized statements of operations for VAST LLC (thousands of dollars):

	Three Months Ended	
	September 29, 2013	September 30, 2012
Net Sales	$ 24,529	$ 21,281
Cost of Goods Sold	20,415	17,241
Gross Profit	4,114	4,040
Engineering, Selling and Administrative Expenses	3,490	4,042

Income (Loss) From Operations		624		(2)
Other (Expense) Income, net		(2)		40
Income before Provision for Income taxes		622		38
(Benefit from) Provision for Income Taxes		(454)		80
Net Income (Loss)	$	1,076	$	(42)
STRATTEC s Share of VAST LLC Net Income (Loss)	$	359	$	(14)
Intercompany Profit Elimination		(6)		2
STRATTEC s Equity Earnings (Loss) of VAST LLC	$	353	$	(12)

During April 2013, we acquired a 51% ownership interest in a newly formed joint venture company, NextLock LLC, which will introduce a new generation of biometric security products based upon designs of Actuator Systems LLC, our partner. We anticipate shipment of the biometric security products to begin in the second half of our 2014 fiscal year through this new joint venture. Our investment in NextLock, for which we exercise significant influence but do not control, is accounted for using the equity method.

The following are summarized statements of operations for NextLock LLC (thousands of dollars):

	Three Months Ended	
	September 29, 2013	September 30, 2012
Engineering, Selling and Administrative Expenses	$ 116	$
Loss From Operations	(116)	
Net Loss	$ (116)	$
STRATTEC s Equity Loss of NextLock LLC	$ (59)	$

Credit Facilities and Guarantees

STRATTEC has a $25 million secured revolving credit facility (the STRATTEC Credit Facility) with BMO Harris Bank N.A. The STRATTEC Credit Facility expires August 1, 2014. ADAC-STRATTEC LLC has a $5 million secured revolving credit facility (the ADAC-STRATTEC Credit Facility) with BMO Harris Bank N.A, which is guaranteed by STRATTEC. The ADAC-STRATTEC Credit Facility expires June 28, 2015. Borrowings under either credit facility are secured by our U.S. cash balances, accounts receivable, inventory and fixed assets located in the U.S. Interest on borrowings under the STRATTEC Credit Facility is at varying rates based, at our option, on the London Interbank Offering Rate plus 1.0 percent or the bank s prime rate. Interest on borrowings under the ADAC-STRATTEC Credit Facility is at varying rates based, at our option, on the London Interbank Offering Rate plus 1.75 percent or the bank s prime rate. Both credit facilities contain a restrictive financial covenant that requires the applicable borrower to maintain a minimum net worth level. The ADAC-STRATTEC Credit Facility includes an additional restrictive financial covenant that requires the maintenance of a minimum fixed charge coverage ratio. There were no outstanding borrowings under the STRATTEC Credit Facility at September 29, 2013 or June 30, 2013. There were no borrowings under the STRATTEC Credit Facility during fiscal 2014 to date or during fiscal 2013. Borrowings under the ADAC-STRATTEC Credit Facility totaled $3.0 million at September 29, 2013 and $2.25 million at June 30, 2013. The average outstanding borrowings and weighted average interest rate on the ADAC-STRATTEC Credit Facility loans were approximately $2.8 million and 1.90 percent, respectively, during the three months ended September 29, 2013. The average outstanding borrowings and weighted average interest rate on the ADAC-STRATTEC Credit Facility loans were approximately $1.0 million and 2.02 percent, respectively, during the three months ended September 30, 2012.

Environmental Reserve

In 1995, we recorded a provision of $3 million for estimated costs to remediate an environmental contamination site at our Milwaukee facility. The site was contaminated by a solvent spill, which occurred in 1985, from a former above ground solvent storage tank located on the east side of the facility. The reserve was originally established based on third party estimates to adequately cover the cost for active remediation of the contamination. Due to changing technology and related costs associated with active remediation of the contamination, an updated analysis and estimate was obtained during fiscal 2010. As a result of this analysis, the reserve was reduced by approximately $1.1 million, to $1.5 million in 2010, to reflect the revised monitoring and remediation cost estimate. From 1995 through September 29, 2013, costs of approximately $465,000 have been incurred related to the installation of monitoring wells on the property and ongoing monitoring costs. We continue to monitor and evaluate the site with the use of these groundwater monitoring wells. An environmental consultant samples these wells one or two times a year to determine the status of the contamination and the potential for remediation of the contamination by natural attenuation, the dissipation of the contamination over time to concentrations below applicable standards. If such sampling evidences a sufficient degree of and trend toward natural attenuation of the contamination at the site, we may be able to obtain a closure letter from the regulatory authorities resolving the issue without the need for active remediation. If a sufficient degree and trend toward natural attenuation is not evidenced by sampling, a more active form of remediation beyond natural attenuation may be required. The sampling has not yet satisfied all of the requirements for closure by natural attenuation. As a result, sampling continues and the reserve remains at an amount to reflect the estimated cost of active remediation. The reserve is not measured on a discounted basis. We believe, based on findings-to-date and known environmental regulations, that the remaining environmental reserve of $1.4 million at September 29, 2013, is adequate.

Shareholders Equity

A summary of activity impacting shareholders equity for the three month period ended September 29, 2013 was as follows (in thousands):

Total Shareholders Equity