SPARTON CORP
Form 10-K
September 09, 2014
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K
(Mark One)

x ANNUAL REPORT PURSUANT TO SECTION 13 OR 15 OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended: June 30, 2014
Or

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

For the transition period from to
Commission File Numbers 1-1000

Sparton Corporation
(Exact name of registrant as specified in its charter)

Ohio	38-1054690
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

425 N. Martingale Road, Suite 2050
Schaumburg, Illinois 60173
(Address of principal executive offices)
Registrant's telephone number, including area code: (847) 762-5800
Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common Stock, par value $1.25 per share	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act:
None

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

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

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 website, 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 such shorter period that the registrant was required to submit and post such files). Yes x No ¨

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements

incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. x
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 definitions of “large accelerated filer,” “accelerated filer,” and “smaller reporting company” in Rule 12b-2 of the Exchange Act. (Check one):
Large accelerated filer o Accelerated filer x Non-accelerated filer o Smaller reporting company o
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes ¨ No x
The aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the price at which the common equity was last sold (based on the closing price on the New York Stock Exchange) as of December 31, 2013 (the last business day of the registrant’s most recently completed second fiscal quarter) was approximately $261,186,000. For purposes of this computation, affiliates of the registrant include the registrant’s executive officers and directors and their respective affiliates as of December 31, 2013.
As of August 29, 2014, there were 10,129,031 shares of common stock, $1.25 par value per share, outstanding.

Documents Incorporated by Reference
Part III incorporates information by reference to the registrant’s definitive proxy statement for its 2014 Annual Meeting of Shareholders to be filed with the Securities and Exchange Commission within 120 days after the end of the fiscal year.

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FORWARD-LOOKING STATEMENTS

This Annual Report on Form 10-K contains statements about future events and expectations that are “forward-looking statements.” We may also make forward-looking statements in our other reports filed with the SEC, in materials delivered to our shareholders and in press releases. These statements relate to future events or our future financial performance and involve known and unknown risks, uncertainties and other factors that may cause our actual results, levels of activity, performance or achievements to be materially different from any future results, levels of activity, performance or achievements expressed or implied by these forward-looking statements. Certain of these risks, uncertainties and other factors are described in Item 1A, “Risk Factors” of this report. In some cases, you can identify forward-looking statements by terminology such as “may,” “will,” “should,” “expects,” “intends,” “plans,” “anticipates,” “beli “estimates,” “predicts,” “potential,” or the negative use of these terms or other comparable terminology that convey the uncertainty of future events or outcomes. Although we believe these forward-looking statements are reasonable, they are based on a number of assumptions concerning future conditions, any or all of which may ultimately prove to be inaccurate. These forward-looking statements are based on management’s views and assumptions at the time originally made, and we undertake no obligation to update these statements whether as a result of new information or future events. There can be no assurance that our expectations, projections or views will materialize, and you should not place undue reliance on these forward-looking statements. Any statement in this report that is not a statement of historical fact may be deemed to be a forward-looking statement and subject to the safe harbor created by the Private Securities Litigation Reform Act of 1995.

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PART I

ITEM 1. BUSINESS

General

Sparton Corporation and subsidiaries (the “Company” or “Sparton”) has been in continuous existence since 1900. It was last reorganized in 1919 as an Ohio corporation. The Company is a provider of design, development, and manufacturing services for complex electromechanical devices, as well as sophisticated engineered products complementary to the same electromechanical value stream. The Company serves the Medical & Biotechnology, Military & Aerospace and Industrial & Commercial markets through three reportable business segments; Medical Device (“Medical”), Complex Systems (“CS”) and Defense & Security Systems (“DSS”). Financial information by segment is presented in Note 16. All of the Company's facilities are certified to one or more of the ISO/AS standards, including ISO 9001, AS9100 or ISO 13485, with most having additional certifications based on the needs of the customers they serve. The Company's products and services include offerings for Original Equipment Manufacturers (“OEM”) and Emerging Technology (“ET”) customers that utilize microprocessor-based systems which include transducers, printed circuit boards and assemblies, sensors, and electromechanical components, as well as development and design engineering services relating to these product sales. Sparton also develops and manufactures sonobuoys, anti-submarine warfare (“ASW”) devices used by the United States Navy and other free-world countries. Many of the physical and technical attributes in the production of sonobuoys are similar to those required in the production of the Company's other electrical and electromechanical products and assemblies.

The Company's website address is www.sparton.com. Information contained on our website is not part of this Annual Report on Form 10-K. Our website provides public access to, among other items, the Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Quarterly Earnings Releases, News Releases, Governance Guidelines, and the Code of Ethics, as well as various Board of Director committee charters. Upon request, the Company provides, free of charge, copies of its periodic and current reports (e.g., Forms 10-K, 10-Q and 8-K) and amendments to such reports that are filed with the Securities and Exchange Commission (“SEC”), as well as the Board of Director committee charters. Reports are available as soon as reasonably practicable after such reports are filed with or furnished to the SEC, either at the Company's website, through a link to the SEC's website or upon request through the Company's Shareholders Relations Department.

Medical Segment

Medical segment operations are comprised of contract design, manufacturing, and aftermarket repair and refurbishment of sophisticated medical and biotechnology devices and sub-assemblies. Customers include industry leaders, emerging technologies companies and start-ups. In manufacturing devices for its customers, this business unit follows specific design and manufacturing processes to assure product reliability and safety in accordance with Food and Drug Administration (“FDA”) guidelines and approvals. This group specializes in technologies, systems and processes required by medical OEM and ET customers primarily in the diagnostic, therapeutic, surgical and laboratory device segments of the medical and biotechnology marketplaces. The Medical segment also includes some non-medical customers.

Our Medical segment's objective is to be the preferred contract design and manufacturer of medical devices for market leading OEM's as well as emerging technology customers. The market is driven by providing the total solution concept, at a competitive price to the customer. Our market advantage is our lean enterprise-based Sparton Production System, experience and knowledge of the market, breadth of services that we offer, and the referral relationships which have developed over the past 20 years. The major corporations on the customer side want to focus their time and energy supporting their major profit areas of consumables and new innovation through research and development. In addition, many companies are outsourcing certain engineering activities finding it costly and inefficient to have full time engineers available for new product development which cycles with new projects every three to five years. This is the niche that has proven to be successful to Sparton.

The contract manufacturing of highly complex medical instrumentation is a fairly fragmented industry with no dominant player in the market. In the past, large Printed Circuit Board contract manufacturers have sold their “box build" capabilities and have been very successful. The industry has continued to grow with more companies developing Printed Circuit Board Assembly ("PCBA") capabilities and others entering the market via mergers and acquisitions of smaller companies. This has led to stronger competition with larger companies that have the financial resources to offer the services that the customers are requiring. Customers will assume that quality will be 100% and will drive their decisions based on pricing and services offered that best fit their total solutions needs.

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The understanding of the medical market needs is critical for our success. We are well positioned with our engineering development, reliability engineering, manufacturing/testing, and support services to meet our current organic growth plans. Additional growth may be gained through an acquisition strategy employed to expand our market reach and footprint into other geographic areas of the U.S and abroad.

On August 6, 2010, the Company completed the acquisition of certain assets related to the contract manufacturing business of Delphi Medical Systems, LLC (“Delphi Medical” or “Delphi”) in an approximate $8.4 million all-cash transaction. The acquired business, which is reported in the Company's Medical segment, provided a new and diversified customer base and provided Sparton with a geographic presence in the western United States.

On March 4, 2011, the Company completed the acquisition of certain assets and assumption of certain liabilities of Byers Peak, Incorporated (“Byers Peak”) in an approximate $4.1 million all-cash transaction. The acquired business, which is reported in the Company's Medical segment, provided further expansion into the therapeutic device market, diversified Sparton's customer base, and further expanded the Company's geographic reach into the western United States. Additionally, the acquisition increased Sparton's offerings with the inclusion of field service and refurbishment capabilities.

On November 15, 2012, the Company completed the acquisition of Onyx EMS, LLC (“Onyx”) in a $43.25 million all-cash transaction. Additional consideration of $2.19 million was paid in relation to a post-closing working capital adjustment, which was settled in the Company's fiscal 2013 third quarter. The acquired business, which is reported in the Company's Medical segment, provided further expansion regionally into the Minneapolis medical device corridor, diversifying the Company's customer base through both existing programs and a strong business development pipeline, and increased the number of complex sub-assembly and full device programs within Sparton. Additionally, the business brought long-term customers which can utilize Sparton's expanded list of service offerings such as our low cost country footprint in Vietnam and full engineering design capabilities.

On March 17, 2014, the Company completed the acquisition of Aubrey Group, Inc. ("Aubrey”), located in Irvine, CA, in a $5.3 million all-cash transaction, subject to certain post-closing adjustments and financed through the use of borrowings under the Company's Credit Facility. Additional consideration of approximately $0.6 million was paid at closing for cash of the business in excess of net customer deposits held by the Aubrey. The transaction includes an approximate $0.5 million escrowed holdback which is available to fund any potential post-closing working capital adjustment and potential seller indemnification obligations in relation to the acquisition agreement. The acquired business, a design and manufacturing company, which is part of the Medical segment and which is expected to add $8 million (unaudited) in annualized revenue, develops new products for OEMs in the Medical and Biotechnology. Inventors, entrepreneurs, and industry leading OEMs utilize Aubrey's design and engineering teams to develop innovative solutions in a timely manner in their efforts to deliver their new products into the marketplace faster and more cost effectively.

Fenwal Blood Technologies contributed 14%, 20% and 15% of consolidated revenue during the years ended June 30, 2014, 2013 and 2012, respectively. During the Company's fiscal 2014 third quarter, Fenwal Blood Technologies began a rebalancing of its program engagements with the Company. The rebalancing of Fenwal programs negatively affected comparative sales to this customer by $10.2 million in the second half of the Company's fiscal 2014 and is expected to negatively affect comparative sales to this customer by as much as $19 million in the Company's fiscal 2015, substantially all of which will be realized during the first half of that year. The loss of Fenwal Blood Technologies as a customer could have a material adverse financial effect on the Company. We are dependent on a few large customers and the loss of such customers or reduction in their demand could substantially harm our business and operating results. See Item 1A, “Risk Factors”, for a further discussion regarding these customers. While the overall relationship with Fenwal Blood Technologies is important to Sparton, the contract with this company is such as ordinarily accompanies the kind of business conducted by Sparton, and the Company does not believe that it is substantially dependent on any individual contract or agreement with this customer. The contractual arrangement entered into with Fenwal Blood Technologies is represented by a master agreement which includes certain master terms and conditions of Sparton's relationship with this customer. This agreement does not commit the customer to any specific volume of purchases. Moreover, these terms can be amended in appropriate circumstances. Thus, until this customer submits a purchase order to Sparton, there is no guarantee of any revenue to Sparton. Rather than depending on this contract for revenue, the Company accepts purchase orders from this customer which determine volume and delivery requirements. Medical backlog was approximately $80.3 million and $74.6 million at June 30, 2014 and 2013, respectively. A majority of the June 30, 2014 Medical backlog is currently expected to be realized within the next 12 months.

As a medical device manufacturer, Sparton operates in a heavily regulated environment. Despite efforts to harmonize domestic and international regulations, inconsistencies still exist. Quality Management System requirements are generally compatible but device approval, licensing and environmental requirements vary widely and change frequently. RoHS (Restriction of Hazardous Substances) and REACH (Registration, Evaluation and Authorization of Chemicals) directives are examples of the regulatory challenges we face. Similar environmental regulations are expected from other countries and the

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United States. Non-compliance risks range from variance notifications to production/shipping prevention depending upon the agency and form of non-compliance.

Complex Systems Segment

Complex Systems segment operations are comprised of manufacturing and aftermarket repair and refurbishment of sophisticated printed circuit card assemblies, sub-assemblies, full product assemblies, and cable/wire harnesses. Customers include military and aerospace prime and sub-prime contractors, as well as industrial and commercial OEM's. In manufacturing for its customers, this segment adheres to very strict military and aerospace specifications in addition to product and process certifications. Customers are primarily engaged in applications that include: flight controls, industrial and military control systems, cockpit displays, fuel system controls, secure communications, early warning detection, security systems, satellite communications, and audio. The CS segment also includes some medical customers.

The segment competes against numerous foreign and domestic companies in addition to the internal capabilities of some of our customers. Some of our competitors have substantially greater financial, manufacturing or marketing resources than we do. Sparton's Complex Systems segment excels in providing low-volume, high-mix services. OEM's in our market segments are continually driving costs out of their respective businesses through outsourcing strategies, allowing opportunity for Sparton to capture additional value add opportunities. We believe that the principal competitive factors in our targeted electronic manufacturing services (“EMS”) markets are the lean enterprise-based Sparton Production System, engineering capabilities, product quality, flexibility, cost and timeliness in responding to design and schedule changes, reliability in meeting product delivery schedules, pricing, rapid prototyping, technological sophistication and geographic location.

Complex Systems provides to its customers support services that include engineering services, material management, obsolescence analysis and management, documentation development, and process improvement. Our engineering services, led by our rapid prototype and pilot build process, offer our customers a high quality product that can quickly be placed into their channels of distribution. Once a product has been proven viable, we offer domestic and low cost country manufacturing and distribution solutions.

The segment strives to exceed customers' expectations with high delivery and quality performance. As these attributes are demanded by Complex Systems customers that produce the aforementioned products, Complex Systems strives to exceed those expectations through utilization of contemporary management tools to ascertain the effectiveness of all business operating systems. This has allowed Complex Systems to gain competitive traction in the market place.

Sparton Complex Systems continues to engage in ongoing strategic initiatives to expand market awareness of Sparton capabilities. As we continue to execute to our growth strategy, we anticipate adding additional resources in business development, marketing, program administration and product launch services. We are engaged with local and regional economic development authorities and have developed alliances with higher education institutions' research and development programs as well as county and regional economic leadership teams. Our Vietnam location continues to be engaged with the local government authority assisting North American companies seeking to conduct business in Vietnam. These additional efforts will allow focused marketing for each of our identified markets optimizing our ability to selectively target new customers.

On June 6, 2013, the Company completed the acquisition of certain assets related to the contract manufacturing business of Creonix, LLC (“Creonix”) in a $2.0 million all-cash transaction, after settlement of a $0.1 million working capital adjustment during the second quarter of the Company's fiscal 2014 year. The transaction was financed through the use of borrowings under the Company's Credit Facility. The acquired business, which is reported in the Company's Complex Systems segment, provides the Company with the capability of cable and wire harness engineering and assembly. Additionally, the acquisition provided further expansion into the Industrial and Military & Aerospace markets, diversifies Sparton's customer base and increased utilization of the Company's existing assets through the consolidation of this business into Complex Systems' Brooksville, Florida plant.

On December 11, 2013, the Company completed the acquisition of Beckwood Services, Inc. ("Beckwood”), located in Plaistow, N.H., in a $15.3 million all-cash transaction financed through the use of cash on hand and borrowings under the Company's Credit Facility. The transaction includes an approximate $1.5 million escrowed holdback which is available to fund potential seller indemnification obligations in relation to the acquisition agreement. The acquired business, which is part of the Company's Complex Systems segment and which is expected to add $18 million (unaudited) in annualized revenue, develops electronic or electro-mechanical controls and electronic assemblies. Their customer profile includes international Fortune 1000 manufacturers of industrial control systems, analytical instruments, measuring and detecting equipment and military, defense and Homeland Security equipment.

On July 10, 2014, the Company completed the acquisition of Electronic Manufacturing Technology, LLC. (“eMT”). The purchase price of $18.5 million is subject to a final working capital adjustment and was financed through the use of borrowings under the Company's Credit Facility. The acquired business, which will be part of the Company's Complex Systems segment and which is expected to add $25 million in projected annualized revenue, is engaged in the contract services business of manufacturing electromechanical controls and electronic assemblies. Their customer profile includes international Fortune 1000 manufacturers of highly reliable industrial excimer laser products, laser eye surgery sub-assemblies, target simulators for space and aviation systems, power modules for computerized tomography products, test systems for commercial aerospace OEMs, and toll road antennas and control boxes.
Complex Systems backlog was approximately $34.4 million and $39.7 million at June 30, 2014 and 2013, respectively. A majority of the June 30, 2014 Complex Systems backlog is currently expected to be realized within the next 12 months.
The majority of Sparton's Complex Systems customers are in highly regulated industries where strict adherence to regulations such as the International Tariff and Arms Regulations (“ITAR”) and regulations issued by the FDA and the Federal Aviation Administration (“FAA”) is necessary. These requirements are highly technical in nature and require strict adherence and documentation related to operational processes. Sparton's quality system provides us the ability to service such markets, differentiating Sparton from some potential competitors which lack such systems.
DSS Segment
Defense & Security segment operations are comprised of design, development and production of products for both domestic and foreign defense as well as commercial needs. Sparton designs and manufactures anti-submarine warfare ("ASW") devices known as sonobuoys for the U.S. Navy and foreign governments that meet Department of State licensing requirements. This segment also performs an engineering development function for the United States military and prime defense contractors for advanced technologies ultimately leading to future defense products as well as replacements for existing products. The sonobuoy product line is built to stringent military specifications. These products are restricted by International Tariff and Arms Regulations (“ITAR”) and qualified by the U.S. Navy, which limits opportunities for competition. Sparton is also a provider of ruggedized flat panel display systems for military panel PC workstations, air traffic control and industrial applications. Ruggedized displays are manufactured for prime contractors to specific military grade specifications. Additionally, this business unit internally develops and markets commercial products for underwater acoustics and microelectromechanical (“MEMS”)-based inertial measurement.
Sparton is partner to a 50/50 joint venture (“JV”) with UnderSea Sensor Systems, Inc. (“USSI”), the only other major producer of U.S. derivative sonobuoys. USSI's parent company is Ultra Electronics Holdings PLC, based in the United Kingdom. The JV operates under the name ERAPSCO and allows DSS and USSI to combine their own unique and complementary backgrounds to jointly develop and produce U.S. derivative sonobuoy designs for the U.S. Navy as well as foreign countries friendly to the U.S. In concept, and in practice, ERAPSCO serves as a pass-through entity maintaining no funds or assets. While the JV provides the opportunity to maximize efficiencies in the design and development of the related sonobuoys, both venture companies function independently as subcontractors; therefore, there is no separate entity to be accounted for or consolidated. The Board of Directors of ERAPSCO has the responsibility for the overall management and operation of the JV. The six member board consists of equal representation (full time employees) from both JV partners for three year terms. Manpower for ERAPSCO, specifically a president, vice president, general manager, contract administrator and financial manager, are similarly assigned by the JV partners for rotating three year terms and the costs of these assigned individuals are borne by the party assigning the personnel. In response to a customer request for proposal (“RFP”) that ERAPSCO will bid on, the Board of Directors of ERAPSCO approves both the composition of a response to the RFP and the composite bid to be submitted to the customer. The Board of Directors strives to divide the aggregate contract awards at a 50/50 share ratio. Each JV partner bears the costs it incurs associated with the preparation and submission of proposals. Each JV partner submits to ERAPSCO a proposal for the estimated price of performing that portion of the RFP applicable to it. Upon award of a contract to the JV, separate subcontracts are generated between ERAPSCO and each of the JV partners defining the responsibilities and compensation for each JV partner. These subcontracts contain terms and conditions consistent with the prime contract. Each JV partner is responsible to ERAPSCO for the successful execution of its respective scope of work under its subcontract and each JV partner is individually accountable for the

profit or losses sustained in the execution of the subcontract against its respective bid. In some instances, either DSS or USSI handles the complete production and delivery of sonobuoys to ERAPSCO's customer. In other instances, either DSS or USSI starts the production and ship completed subassemblies to the other party for additional processing before being delivered to the customers. Under ERAPSCO, individual contract risk exposures are reduced, while the likelihood of achieving U.S. Navy and other ASW objectives is enhanced. ERAPSCO has been in existence for approximately twenty-six years and historically, the agreed upon products included under the JV were generally developmental or sonobuoys with low volume demand. Seven years ago, the JV expanded to include all future sonobuoy development and substantially all U.S. derivative sonobuoy products for customers

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outside of the United States. The JV was further expanded two years later to include all sonobuoy products for the U.S. Navy beginning with U.S. Navy's 2010 fiscal year contracts.

While the ERAPSCO agreement provides certain benefits to Sparton as described above, the Company does not believe that it is substantially dependent upon this agreement to conduct its business. If in the future, Sparton determines that this commercial arrangement is no longer beneficial, the Company has the ability to terminate the joint venture in relation to future business awards and return to independent bidding for U.S. Navy and foreign government ASW awards.

New internally funded products are under development for sale as commercial products to the navigation, heading and positioning systems applications markets. Markets for these products include autonomous underwater and ground vehicles, as well as unattended aerial vehicles as our product offerings grow. The principal example of such products is a family of precision navigation sensors for applications such as navigation or undersea petroleum exploration. Competition among companies that build these products is intense and dynamic. As such, development of our commercial products requires the identification of sustainable competitive advantages (“SCA”) prior to investment to ensure there is a viable market for our products. Each new product must advance the technology available to the market enough to overcome the inherent inertia preventing potential customers from switching from competitor's products. Likewise, existing products are evaluated periodically to ensure their SCA is still maintained and if not, either redesign or end-of-life occurs. The expansion of our commercial product lines leverages the intrinsic engineering talent at DSS and capitalizes on the sonobuoy product volumes to provide technological as well as economies of scale advantages. Pursuit of commercial markets and all sales and profits from this endeavor are not a part of the ERAPSCO JV.

Sonobuoy and related engineering services, including sales to the U.S. Navy and foreign governments, accounted for approximately 28%, 28% and 34% of consolidated revenue for the fiscal years ended June 30, 2014, 2013 and 2012, respectively. Sales to the U.S Navy, including subcontract sales through ERAPSCO, accounted for 19%, 20% and 21% of consolidated revenue for the fiscal years ended June 30, 2014, 2013 and 2012, respectively. The U.S. Navy issues multiple contracts annually for its sonobuoy and engineering requirements. The loss of U.S. Navy sonobuoy sales would have a material adverse financial effect on the Company. While the overall relationship with the U.S. Navy is important to Sparton, the contracts with the U.S. Navy, including subcontracts through ERAPSCO, are such as ordinarily accompany the kind of business conducted by Sparton and the Company does not believe that it is substantially dependent on any individual contract or agreement with this customer, other than the Subcontract effective July 17, 2014 between Sparton DeLeon Springs, LLC and ERAPSCO that is considered a material contract to the Company and is filed as an exhibit to this Annual Report on Form 10-K (the "Subcontract"). Pursuant to the Subcontract, DSS will supply sonobouys to the U.S. Navy through ERAPSCO for a total contract value of approximately $90.5 million to Sparton DeLeon Springs, LLC.

On August 30, 2013, the Company completed the acquisition of certain assets and liabilities of Aydin Displays, Inc. ("Aydin Displays" or “Aydin”), located in Birdsboro, PA, in a $15.5 million all-cash transaction, after settlement of a $0.5 million working capital adjustment during the third quarter of the Company's fiscal 2014 year. The transaction was financed through the use of borrowings under the Company's Credit Facility. Additional acquisition consideration of up to $6.6 million is contingent upon Aydin attaining certain performance thresholds during the twelve month period following the transaction. The transaction includes an approximate $1.2 million escrowed holdback which is available to fund potential seller indemnification obligations in relation to the acquisition agreement. The acquired business, which is part of the Company's DSS segment and which is expected to add $18 million in annualized revenue, develops enhanced flat panel display and touch-screen solutions with application-critical performance criteria including ruggedization, high resolution, color accuracy, response/refresh times, sunlight readability and other criteria such as magnetic interference and emanations security for the Military & Aerospace and Civil Marine markets. These products are currently specified in the U.S. Navy P8A Poseidon ASW aircraft behind-the-cockpit control center, the command and control centers of many U.S. Navy ships, Federal Aviation Administration air traffic control systems, and cockpit command centers for various civil marine applications. The acquired business will continue to operate as Aydin Displays.

DSS backlog was approximately $32.4 million and $85.5 million at June 30, 2014 and 2013, respectively. A majority of the June 30, 2014 DSS backlog is currently expected to be realized within the next 18 months.

United States Navy contracts allow Sparton to submit performance based billings, which are then applied against inventories purchased and manufacturing costs incurred by the Company throughout its performance under these contracts. Inventories were reduced by performance based payments from the U.S. Navy for costs incurred related to long-term contracts, thereby establishing inventory to which the U.S. Navy then has title, of approximately $8.0 million and $15.2 million, respectively, at June 30, 2014 and 2013. At June 30, 2014 and 2013, current liabilities include performance based payments of $3.2 million and $20.9 million, respectively, on Navy contracts. As these payments are in excess of cost, there is no inventory to which the government would claim title and, therefore, no offset to inventory has been made.

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During fiscal 2014, 2013 and 2012, DSS incurred internally funded research and development (“R&D”) expenses of $1.2 million, $1.3 million and $1.3 million, respectively, for the internal development of technologies for use in navigation and oil and gas exploration. Customer funded R&D costs, which are usually part of a larger production agreement, totaled approximately $9.7 million, $10.4 million and $8.6 million for the years ended June 30, 2014, 2013 and 2012, respectively.

DSS's business is affected by numerous laws and regulations relating to the award, administration and performance of U.S. Navy contracts. The U.S. Navy generally has the ability to terminate DSS contracts, in whole or in part, without prior notice, for convenience or for default based on performance. If any of these contracts were terminated for convenience, Sparton would generally be protected by provisions covering reimbursement for costs incurred on the contracts and profit on those costs, but not the anticipated profit that would have been earned had the contract been completed.

Other

Non-sonobuoy related manufacturing and services are sold primarily through a direct sales force. In addition, our divisional and executive management teams are an integral part of our sales and marketing teams.

While overall sales can fluctuate during the year in each of our segments, revenues for our Complex Systems and DSS segments are typically higher in the second half of the Company's fiscal year as compared to the first half. Various factors can affect the distribution of our revenue between accounting periods, including the timing of customer orders, including U.S. Navy and allied foreign government contract awards, the availability of government funding, production calendars, product deliveries and customer acceptance.

Materials for our operations are generally available from a variety of worldwide sources, except for selected components. Access to competitively priced materials is critical to success in our businesses. In certain markets, the volume purchasing power of our larger competitors creates a cost advantage for them. The Company has encountered availability and extended lead time issues on some electronic components due to strong market demand, and this condition resulted in higher prices and late deliveries. However, the Company does not expect to encounter significant long-term problems in obtaining sufficient raw materials. The risk of material obsolescence in our businesses is less significant than that which exists in many other markets since raw materials and component parts are generally purchased only upon receipt of a customer's order. However, excess material resulting from order lead-time is a risk factor due to potential order cancellation or design changes by customers.

Sparton earns revenues from United States based customers as well as international customers. Additionally, the Company has a manufacturing facility in Vietnam. Financial information regarding the Company's geographic sales concentration and locations of long-lived assets is presented in Note 17, Business, Geographic and Sales Concentration, of the Notes to Consolidated Financial Statements included in this Annual Report on Form 10-K.

At June 30, 2014, Sparton employed 1,483 people, including 98 contractors. None of the Company's employees are represented by a labor union. The Company considers employee relations to be good.

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Executive Officers of the Registrant

Information with respect to executive officers of the Registrant is set forth below. The positions have been held for the periods noted.

Cary B. Wood	Chief Executive Officer since November 2008 and President since April 2009. Previously Mr. Wood held the position of Chief Operating Officer for Citation Corporation in Novi, MI since August 2004. (Age 47)
Mark Schlei	Senior Vice President and Chief Financial Officer since November 2012. Previously, Mr. Schlei held the position of Chief Financial Officer for Paperworks Industries, Inc. in Philadelphia, PA from November 2011 to February 2012. Prior to that date, Mr. Schlei was Chief Financial Officer at Thetford Corporation in Ann Arbor, MI from September 2004 to November 2011. (Age 51)
Gordon B. Madlock	Senior Vice President, Operations since January 2009. Previously, Mr. Madlock held the position of Senior Vice President of Operations for Citation Corporation in Novi, MI since September 1999. (Age 56)
Michael W. Osborne	Senior Vice President, Corporate Development since June 2012. Previously Mr. Osborne held the position of Senior Vice President, Corporate and Business Development since January 2009. Prior to that date, Mr. Osborne held the position of Vice President, Operations at The Niven Marketing Group in Carol Stream, IL since January 2006. Prior to that date, Mr. Osborne held the position of Vice President, Operations & Engineering at Gardner Bender in Milwaukee, WI since March 2004. (Age 43)
Steven M. Korwin	Senior Vice President, Quality and Engineering since September 2009. Previously, Mr. Korwin held the position of Group Vice President, Electronic Manufacturing Services since December 2008. Prior to that date, Mr. Korwin held the position of Vice President of Quality and Engineering for Citation Corporation in Novi, MI since October 2005. (Age 51)
Mike Gaul	Group Vice President, Medical Manufacturing since January 2014. Prior to that, Mr. Gaul held the position of General Manager of the Strongsville, Ohio medical manufacturing facility since September, 2011. Prior to that, Mr. Gaul held the positions of Vice President, Operations and COO at SynCardia Systems since April 2005. Prior to that, Mr. Gaul held the position of Vice President of Manufacturing Operations for Ventana Medical since May 2003. His industry experience includes Medical Devices and Reagents, Complex Capital Automation Equipment, Public Safety Communication System's and Industrial Controls and Instrumentation. (Age 60)
James M. Lackemacher	Group Vice President, DSS Engineered Products since January 2014. Previously, Mr. Lackemacher held the position of Vice President/General Manager, Defense and Security Systems Business Unit since April 2005. (Age 52)
Jamie Shaddix	Group Vice President, Military & Aerospace Manufacturing Services since January 2014. Prior to that, Mr. Shaddix held the position of General Manager of the Frederick, Colorado medical manufacturing facility since August, 2011. Prior to that, Mr. Shaddix held various positions including General Manager for Citation Corporation since July, 1999. (Age 50)

Lawrence R. Brand	Vice President, Human Resources since May 2011. Previously, Mr. Brand held the position of Director, Corporate Human Resources since February 2010. Prior to that date, Mr. Brand held the position of Senior Manager, Human Resources for Fellowes, Inc. in Itasca, IL since November 2004. (Age 47)
Christopher A. Ratliff	Vice President, Information Technology since March 2014. Previously, Mr. Ratliff held the position of Information Technologies Director for Tootsie Roll Industries in Chicago, IL since May 2003. (Age 49)
Jake Rost	Vice President, Business Development since June 2012. Previously, Mr. Rost held the position of Vice President/General Manager, Medical Business Unit since March 2011. Prior to that date, Mr. Rost held the position of Vice President, Business Development for Byers Peak since January 2007. (Age 45)

There are no family relationships among the persons named above. All officers are elected annually and serve at the discretion of the Board of Directors.

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ITEM 1A. RISK FACTORS

We operate in a changing economic, political and technological environment that presents numerous risks, many of which are driven by factors that we cannot control or predict. The following discussion, as well as our “Critical Accounting Policies and Estimates” and “Management’s Discussion and Analysis” in Item 7, highlight some of these risks. The terms “Sparton,” “the Company,” “we,” “us,” and “our” refer to Sparton Corporation and subsidiaries.

The industry is extremely competitive and we depend on continued outsourcing by OEMs.

The Complex Systems and Medical industries in general are highly fragmented and intensely competitive. Our contract manufacturing services are available from many sources, and we compete with numerous domestic and foreign firms. Within Sparton’s target market, the high-mix, low- to medium-volume sector of the Complex Systems and Medical industries, there are substantially fewer competitors, but competition remains strong. Some competitors have substantially greater manufacturing, R&D, marketing or financial resources and, in some cases, have more geographically diversified international operations. Sparton expects competition to intensify further as more companies enter our target markets and our customers consolidate. In the future, increased competition from large electronic component manufacturers that are selling, or may begin to sell, electronics manufacturing services may occur. Future growth will depend on new outsourcing opportunities, and could be limited by OEMs performing such functions internally or delaying their decision to outsource.

DSS is partner to a 50/50 joint venture agreement with USSI, the only other major producer of U.S. derivative sonobuoys. If USSI were to terminate this joint venture, DSS would be required to return to independent bidding and production for U.S. Navy and other foreign country sonobuoy business. If this was to happen, it is possible that the Company’s future results could be negatively impacted. Starting with the 2014 U.S. Government fiscal year, the U.S. Navy opened up its sonobuoy contract bidding process potentially allowing additional competitors to vie for this business. While the Company believes that there are significant barriers to entry into the sonobuoy market, if a new competitor was able to successfully develop the necessary technical capabilities and gain entry into the market space, the Company’s future results could be negatively impacted.

In some cases, Sparton may not be able to offer prices as low as some competitors for a host of reasons. For example, those competitors may have lower cost structures for their services, they may be willing to accept business at lower margins in order to utilize more of their excess capacity, or they may be willing to take on business at low or even zero gross margins to gain entry into the Company’s markets. Upon the occurrence of any of these events, our net sales would likely decline. Periodically, we may be operating at a cost disadvantage compared to some competitors with greater direct buying power. As a result, competitors may have a competitive advantage and obtain business from our customers.

Principal competitive factors in our targeted markets are believed to be quality, reliability, the ability to meet delivery schedules, customer service, technological sophistication, geographic location and price. During periods of recession in the Complex Systems and Medical industries, our competitive advantages in the areas of adaptive manufacturing and responsive customer service may be of reduced importance due to increased price sensitivity. We also expect our competitors to continue to improve the performance of their current products or services, to reduce their current products or service sales prices and to introduce new products or services that may offer greater performance and improved pricing. Any of these could cause a decline in sales, loss of market acceptance of our products or services, profit margin compression, or loss of market share.

Our operating results are subject to general economic conditions and may vary significantly from period to period due to a number of factors.

We are subject to inflation, interest rate changes, availability of capital markets, consumer spending rates, the effects of governmental plans to manage economic conditions and other national and global economic occurrences beyond our control. Such factors, economic weakness, and constrained customer spending have resulted in the past, and may result in the future, in decreased revenue, gross margin, earnings or growth rates.

We can experience significant fluctuations in our annual and quarterly results of operations. In addition to general economic conditions, other factors that contribute to these fluctuations are our effectiveness in managing manufacturing processes and costs, as well as the level of capacity utilization of our manufacturing facilities and associated fixed costs, in order to maintain or increase profitability. The timing of our sonobuoy sales to the U.S. Navy is dependent upon access to the test range and successful passage of product tests performed by the U.S. Navy. Additionally, we rely on our customers' demands, which can and do change dramatically, sometimes with little notice. Such factors also could affect our results of operations in the future.

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Start-up costs and inefficiencies related to new or transferred programs can adversely affect our operating results and may not be recoverable.

Start-up costs, the management of labor and equipment resources in connection with new programs and new customer relationships and the need to estimate the extent and timing of required resources can adversely affect our profit margins and operating results. These factors are particularly evident with the introduction of new products and programs. The effects of these start-up costs and inefficiencies can also occur when new facilities are opened or programs are transferred from one facility to another.

If new programs or customer relationships are terminated or delayed, our operating results may be harmed, particularly in the near term. We may not be able to recoup our start-up costs or quickly replace these anticipated new program revenues.

We depend on limited or single source suppliers for some critical components; the inability to obtain components as required, with favorable purchase terms, could harm our business.

A significant portion of our costs are related to electronic components purchased to produce our products. In some cases our customers dictate that we purchase particular components from a single or limited number of suppliers. Supply shortages for a particular component can delay production, and thus delay shipments to customers and the associated revenue of all products using that component. This could cause the Company to experience a reduction in sales, increased inventory levels and costs, and could adversely affect relationships with existing and prospective customers. In the past, we have secured sufficient allocations of constrained components so that revenue was not materially impacted. The Company believes that alternative suppliers are available to provide the components, including unique components, necessary to manufacture our customers’ products. If, however, we are unable to procure necessary components under favorable purchase terms, including at favorable prices and with the order lead times needed for the efficient and profitable operation of our factories, our results of operations could suffer.

The Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”) contains provisions to improve the transparency and accountability concerning the supply of minerals originating from the conflict zones of the Democratic Republic of Congo (“DRC”) and adjoining countries. As a result, the SEC established new annual disclosure and reporting requirements for those companies who use “conflict” minerals mined from the DRC and adjoining countries in their products. These requirements could affect the sourcing and availability of minerals used in the manufacturing of our electrical components. As a result, we may not be able to obtain products at competitive prices and there may be additional costs associated with complying with the new due diligence procedures as required by the SEC. Also, since our supply chain is complex, we may face reputational challenges with our customers and other stakeholders if we are unable to sufficiently verify the origins for all metals used in our products through the due diligence procedures that we implement. We may also encounter challenges to satisfy those customers who require that all of the components of our products are certified as conflict free. If we are not able to meet customer requirements, customers may choose to disqualify us as a supplier.

We are dependent on a few large customers; the loss of such customers or reduction in their demand could substantially harm our business and operating results.

For the fiscal year ended June 30, 2014, our ten largest customers, including the U.S. Navy, accounted for approximately 55% of total net sales. The U.S. Navy, a DSS customer through the Company’s ERAPSCO agreement, represented 19% of our total net sales in the same period. Fenwal Blood Technologies, a Medical customer, contributed 14% of total net sales in fiscal 2014. We expect to continue to depend upon a relatively small number of customers, but we cannot ensure that present or future large customers will not terminate, significantly change, reduce, or delay their manufacturing arrangements with us. During the Company's fiscal 2014 third quarter, Fenwal began a rebalancing of its program engagements with the Company. The rebalancing of Fenwal programs negatively affected comparative sales to this customer by $10.2 million in the second half of the Company's fiscal 2014 and is expected to negatively affect comparative sales to this customer by as much as $19 million in the Company's fiscal 2015, substantially all of which will be realized during the first half of that year. Because our major customers represent such a large part of our business, the loss of any of our major customers or reduced sales to these customers could negatively impact our business.

Additionally, the U.S. Navy generally has the ability to terminate DSS contracts, in whole or in part, without prior notice, for convenience or for default based on performance. If any of these U.S. Navy contracts were to be terminated for convenience, Sparton would generally be protected by provisions covering reimbursement for costs incurred on the contracts and profit on those costs, but not the anticipated profit that would have been earned had the contract been completed.

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We rely on the continued growth and financial stability of our customers, including our major customers. Adverse changes in the end markets they serve can reduce demand from our customers in those markets and/or make customers in these end markets more price sensitive. Furthermore, mergers or restructurings among our customers or our customers' customers could increase concentration or reduce total demand as the combined entities rationalize their business and consolidate their suppliers. Future developments, particularly in those end markets which account for more significant portions of our revenues, could harm our business and our results of operations.

Sparton also generates large accounts receivable in connection with its manufacturing services. If one or more of our customers experiences financial difficulty and is unable to pay for the services provided, our operating results and financial condition could be adversely affected. If our customers seek bankruptcy protection, they could act to terminate all or a portion of their business with us, originate new business with our competitors and terminate or assign our long-term supply agreements. Any loss of revenue from our major customers, including the non-payment or late payment of our invoices, could materially adversely affect our business, results of operations and financial condition.

Congressional budgetary constraints or reallocations can reduce our government sales.

Our U.S. Government contracts have many inherent risks that could adversely impact our financial results. Future governmental sales could be affected by a change in defense spending by the U.S. Government, or by changes in spending allocation that could result in one or more of our programs being reduced, delayed or terminated, which could adversely affect our financial results. The Company's U.S. governmental sales are funded by the Federal budget. Changes in negotiations for program funding levels or unforeseen world events can interrupt the funding for a program or contract. The timing of sonobuoy sales to the U.S. Navy is dependent upon access to their test facilities and successful passage of their product tests. Any future reduction or interruption in access to the test range or changes in sonobuoy testing criteria may impact the consistency or predictability of our reported revenues.

Customer cancellations, reductions, or delays could adversely affect our operating results.

We generally do not obtain long-term purchase commitments from our customers. Customers may cancel orders, delay the delivery of orders or release orders for fewer products than we previously anticipated for a variety of reasons, including decreases in demand for their products and services. Such changes by a significant customer, by a group of customers, or by a single customer whose production is material to an individual facility could seriously harm results of operations in that period. In addition, since much of our costs and operating expenses are relatively fixed, a reduction in customer demand would adversely affect our margins and operating income. Although we are always seeking new opportunities, we cannot be assured that we will be able to replace deferred, reduced or cancelled orders.

Our inability to forecast the level of customer orders with much certainty makes it difficult to schedule production and maximize utilization of manufacturing capacity. Additionally, we are often required to place materials orders from vendors, some of which are non-cancelable, based on an expected level of customer volume. At June 30, 2014, non-cancelable purchase orders with vendors totaled approximately $49.9 million. If actual demand is higher than anticipated, we may be required to increase staffing and other expenses in order to meet such demand of our customers. Alternatively, anticipated orders from our customers may be delayed or fail to materialize, thereby adversely affecting our results of operations. Such customer order fluctuations and deferrals have had a material adverse effect on us in the past, and we may experience similar effects in the future.

Such order changes could cause a delay in the repayment to us for inventory expenditures we incurred in preparation for the customer's orders or, in certain circumstances, require us to return the inventory to our suppliers, resell the inventory to another customer or continue to hold the inventory. In some cases, excess material resulting from longer order lead time is a risk due to the potential of order cancellation or design changes by customers. Additionally, dramatic changes in circumstances for a customer could also negatively impact the carrying value of our inventory for that customer.

The Company and its customers may be unable to keep current with technological changes.

Our customers participate in markets that have rapidly changing technology, evolving industry standards, frequent new product introductions, and relatively short product life cycles. The introduction of products embodying new technologies or the emergence of new industry standards can render existing products obsolete or unmarketable. Our success depends upon our customers’ ability to enhance existing products and to develop and introduce new products, on a timely and cost-effective basis, that keep pace with technological developments and emerging industry standards, and address increasingly sophisticated customer requirements. There is no assurance that our customers will do so, and any failure to do so could substantially harm our customers and us.

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Additionally, our future success will depend upon our ability to maintain and enhance our own technological capabilities, develop and market manufacturing services and products which meet changing customer needs, and successfully anticipate or respond to technological changes in manufacturing processes on a cost-effective and timely basis. If we are unable to do so, business, financial condition and operating results could be materially adversely affected.

Our growth strategies could be ineffective due to the risks of further acquisitions.

Our growth strategy has included acquiring complementary businesses. We could fail to identify, finance or complete suitable acquisitions on acceptable terms and prices. Acquisition efforts could increase a number of risks, including diversion of management's attention, difficulties in integrating systems and operations, potential loss of key employees and customers of the acquired companies and exposure to unanticipated liabilities, as well as the price we pay may exceed the value we realize. Our discovery of, or failure to discover, material issues during due diligence investigations of acquisition targets, either before closing with regard to potential risks of the acquired operations, or after closing with regard to the timely discovery of breaches of representations or warranties, could materially harm our business. Acquisitions also may result in the recording of goodwill and other intangible assets which are subject to potential impairments in the future that could harm our financial results.

Our current use of performance based billings within Government contracts may not continue.

Our current contracts with the U.S. Navy include provisions for certain billing and collection of funds from the Government in advance of related inventory purchases and incurrence of manufacturing expenses. These contractual provisions are an integral part of our capital and liquidity profile. While we have other sources of liquidity including, but not limited to, our operations, existing cash balances and our revolving line-of-credit, and we believe we have sufficient liquidity for our anticipated needs over the next 12 months, no assurances regarding liquidity can be made. The discontinuance of performance based billing provisions from future U.S. Navy contracts would require us to fund the working capital requirements related to these contracts from other sources and otherwise could materially adversely impact our business, results of operations and financial condition.

Fluctuations in foreign currency exchange rates could increase operating costs.

A portion of the Company's operations and some customers are in foreign locations. As a result, transactions may occur in currencies other than the U.S. dollar. Currency exchange rates fluctuate on a daily basis as a result of a number of factors and cannot be easily predicted. Volatility in the U.S. dollar could seriously harm our business, operating results and financial condition. The primary impact of currency exchange fluctuations is on the adjustments related to the remeasurement of the Company's Vietnamese financial statements into U.S. dollars, which are included in current earnings, as well as impacting the cash, receivables, payables, property and equipment of our operating entities. The Company currently does not use financial instruments to hedge foreign currency fluctuation and unexpected expenses could occur from future fluctuations in exchange rates.

Failure to attract and retain key personnel and skilled associates could hurt operations.

Our success depends to a large extent upon the continued services of key management personnel. While we have employment contracts in place with several of our executive officers, we nevertheless cannot be assured that we will retain our key employees, and the loss of service of any of these officers or key management personnel could have a material adverse effect on our business growth and operating results.

Our future success will require an ability to attract and retain qualified employees. Competition for such key personnel is intense, and we cannot be assured that we will be successful in attracting and retaining such personnel. Changes in the cost of providing pension and other employee benefits, including changes in health care costs, investment returns on plan assets, and discount rates used to calculate pension and related liabilities, could lead to increased costs in any of our operations.

Certain of our U.S. government contracts require our employees to maintain various levels of security clearances, and we are required to maintain certain facility security clearances complying with U.S. Government requirements. If our employees are unable to obtain security clearances in a timely manner, or at all, or if our employees who hold security clearances are unable to maintain the clearances or terminate employment with us, then a customer requiring classified work could terminate the contract or decide not to renew it upon its expiration. In addition, we expect that many of the contracts on which we will bid will require us to demonstrate our ability to obtain facility security clearances and

employ personnel with specified types of security clearances.
To the extent we are not able to obtain facility security clearances or engage employees with the required security clearances for a particular contract, we may not be able to bid on or win new contracts, or effectively bid on expiring contracts.

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The occurrence of litigation in which we could be named as a defendant is unpredictable.

Our business activities expose us to risks of litigation with respect to our customers, suppliers, creditors, shareholders, product liability, or environmental-related matters. We may incur significant expense to defend or otherwise address current or future claims. Any litigation, even a claim without merit, could result in substantial costs and diversion of resources, and could have a material adverse effect on our business and results of operations. Although we maintain insurance policies, we cannot assure you that this insurance will be adequate to protect us from all material judgments and expenses related to potential future claims or that these levels of insurance will be available in the future at economical prices or at all.

Adverse regulatory developments could harm our business.

Our business operates, and certain of our customers' businesses operate, in heavily regulated environments. We must manage the risk of changes in or adverse actions under applicable law or in our regulatory authorizations, licenses and permits, governmental security clearances, government procurement regulations or other legal rights in order to operate our business, manage our work force, or import and export goods and services as needed. We also face the risk of other adverse regulatory actions, compliance costs, or governmental sanctions. The regulations and regulatory bodies include, but are not limited to, the following: the Federal Acquisition Regulations, the Truth in Negotiations Act, the False Claims Act and the False Statements Act, the Foreign Corrupt Practices Act, the Food and Drug Administration, the Federal Aviation Administration and the International Traffic in Arms Regulations.

Our failure to comply with applicable regulations, rules and approvals or misconduct by any of our employees could result in the imposition of fines and penalties, the loss of security clearances, the loss of our government contracts or our suspension or debarment from contracting with the U.S. government generally, any of which would harm our business, financial condition and results of operations. See also additional risk factors below relating to U.S. Government contract audits, securities laws regulations, environmental law regulations and foreign law regulations.

U.S. Government audits and investigations could adversely affect our business.

Federal government agencies, including the Defense Contract Audit Agency ("DCAA") and the Defense Contract Management Agency ("DCMA"), routinely audit and evaluate government contracts and government contractors' administrative processes and systems. These agencies review the Company's performance on contracts, pricing practices, cost structure, financial capability and compliance with applicable laws, regulations and standards. They also review the adequacy of the Company's internal control systems and policies, including the Company's purchasing, accounting, estimating, compensation and management information processes and systems. Any costs found to be improperly allocated to a specific contract will not be reimbursed, while such costs already reimbursed must be refunded. If an audit or investigation of our business were to uncover improper or illegal activities, then we could be subject to civil and criminal penalties and administrative sanctions, including termination of contracts, forfeiture of profits, suspension of payments, fines and suspension or prohibition from doing business with the U.S. Government. In addition, responding to governmental audits or investigations may involve significant expenses and divert management attention. If any of the forgoing were to occur, our financial condition and operating result could be materially adversely affected.

The efficiency of our operations could be adversely affected by disruptions to our Information Technology (IT) Services.

We rely in part on various IT systems to manage our operations and to provide analytical information to management. In addition, a significant portion of internal communications, as well as communication with customers and suppliers depends on information technology. We are exposed to the risk of cyber incidents in the normal course of business. Cyber incidents may be deliberate attacks for the theft of intellectual property or other sensitive information or may be the result of unintentional events. Like most companies, the Company's information technology systems may be vulnerable to interruption due to a variety of events beyond the Company's control, including, but not limited to, natural disasters, terrorist attacks, power and/or telecommunications failures, computer viruses, hackers and other security issues. The Company has technology security initiatives and disaster recovery plans in place to mitigate the Company's risk to these vulnerabilities, but these measures may not be adequate or implemented properly to ensure that the Company's operations are not disrupted. Potential consequences of a material cyber incident include damage to our reputation, litigation, inefficiencies or production down-times and increased cyber security protection and remediation costs. Such consequences could have a negative impact on our ability to meet customers' orders, resulting in a delay or decrease to our revenue and a reduction to our operating margins.

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Business disruptions could seriously harm our business and results of operations.

Increased international political instability, evidenced by threats and occurrence of terrorist attacks, conflicts in the Middle East and Asia, and strained international relations arising from these conflicts, may hinder our ability to do business. The political environment in communist countries can contribute to the threat of instability. While we have not been adversely affected as yet due to this exposure, one of our facilities is based in Vietnam, which is a communist country. These events have had and may continue to have an adverse impact on the U.S. and world economies, particularly customer confidence and spending, which in turn could affect our revenue and results of operations. The impact of these events on the volatility of the U.S. and world financial markets could increase the volatility of our securities and may limit the capital resources available to us, our customers and our suppliers.

Our operations could be subject to natural disasters, disease and other business disruptions, including earthquakes, power shortages, telecommunications failures, water shortages, tsunamis, floods, hurricanes, fires, pandemic outbreaks and other natural or manmade disasters, which could seriously harm our financial condition and increase our expenses. In the past, hurricanes have adversely impacted the performance of two of our production facilities located in Florida. We have a production facility outside Ho Chi Minh City, Vietnam. This area, in the tropics and close to the sea, may be vulnerable to storms, floods and typhoons.

If we are unable to maintain effective internal control over our financial reporting, investors could lose confidence in the reliability of our financial statements, which could result in a reduction in the value of our common stock.

As required by Section 404 of the Sarbanes-Oxley Act of 2002 (the "Sarbanes-Oxley Act"), the SEC adopted rules requiring public companies to include a report of management on the company’s internal control over financial reporting in their annual reports on Form 10-K. The report must contain an assessment by management of the effectiveness of our internal control over financial reporting. In addition, the independent registered public accounting firm auditing a company’s financial statements must attest to and report on the effectiveness of the company’s internal control over financial reporting, if the Company’s public equity float remains above certain thresholds.

We are continuing our comprehensive efforts to comply with Section 404 of the Sarbanes-Oxley Act. If we are unable to maintain effective internal control over financial reporting, this could lead us to issue a financial restatement or otherwise cause us to fail to meet our reporting obligations to the SEC or could result in a finding by our independent auditors of a significant deficiency or material weakness in our controls over financial reporting, which, in turn, could result in an adverse reaction to our stock in the financial markets due to a loss of confidence in the reliability of our financial statements.

We are subject to a variety of environmental laws, which expose us to potential liability.

Our operations are regulated under a number of federal, state, provincial, local and foreign environmental laws and regulations, which govern, among other things, the discharge of hazardous materials into the air and water, as well as the handling, storage and disposal of such materials. These laws and regulations include the Clean Air Act, the Clean Water Act, the Resource, Conservation and Recovery Act and the Comprehensive Environmental Response, Compensation and Liability Act, as well as analogous state and foreign laws. Compliance with these environmental laws is a significant consideration for us because we use various hazardous materials in our manufacturing processes. We may be liable under environmental laws for the cost of cleaning up properties we own or operate if they are or become contaminated by the release of hazardous materials, regardless of whether we caused the release, even if we fully comply with applicable environmental laws. In the event of contamination or violation of environmental laws, we could be held liable for damages including fines, penalties and the costs of remedial actions and could also be subject to revocation of our discharge permits. Any such penalties or revocations could require us to cease or limit production at one or more of our facilities, thereby harming our business. In addition, such regulations could restrict our ability to expand our facilities or could require us to acquire costly equipment, or to incur other significant expenses to comply with environmental regulations, including expenses associated with the recall of any non-compliant product.

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Sparton has been involved with ongoing environmental remediation since the early 1980's related to one of its former manufacturing facilities, located in Albuquerque, New Mexico ("Coors Road"). Although the Company entered into a long-term lease of the Coors Road property that was accounted for as a sale of property during fiscal 2010, it remains responsible for the remediation obligations related to its past operation of this facility. During the fourth quarter of fiscal 2014, Sparton completed a review of its remediation plan, which included remediation methods currently in use, desired outcomes, progress to date, anticipated progress over the next sixteen years, and estimated costs to complete the remediation plan by fiscal 2030, following the terms of a March 2000 consent decree. The Company's minimum cost estimate is based upon existing technology and excludes certain legal costs, which are expensed as incurred. The Company's estimate includes equipment and operating and maintenance costs for onsite and offsite pump and treat containment systems, as well as continued onsite and offsite monitoring. It also includes periodic reporting requirements. During this latest review, the Company found: additional concentrations of contaminants on-site that required clean-up actions previously not included within the remediation plan; progress to date on the removal of certain other on-site contaminants was taking place slower than previously anticipated; and that certain efficiencies regarding periodic reporting were not being realized as had been previously anticipated. The discovery of additional on-site contaminants, slower than expected removal rates of other on-site contaminants, and continued high periodic reporting costs added significant additional costs to the remediation project that are expected to continue for a number of years. As a result, the remaining estimated minimum future undiscounted costs of this financial liability increased to $8.2 million at June 30, 2014, thereby requiring a $4.2 million non-cash charge against operations in the fourth quarter of fiscal 2014. This charge is net of United States Department of Energy ("DOE") reimbursements of $1.5 million expected to take place in future years, under the fiscal 2003 agreement between the Company and the DOE. Uncertainties associated with environmental remediation contingencies are pervasive and often result in wide ranges of reasonably possible outcomes. Estimates developed in the early stages of remediation can vary significantly. Normally a finite estimate of cost does not become fixed and determinable at a specific point in time. Rather, the costs associated with environmental remediation become estimable over a continuum of events and activities that help to frame and define a liability. Factors which cause uncertainties for the Company include, but are not limited to, the effectiveness of the current work plans in achieving targeted results and proposals of regulatory agencies for desired methods and outcomes. It is possible that cash flows and results of operations could be materially affected by the impact of changes associated with the ultimate resolution of this contingency. At June 30, 2014, the Company estimates that it is reasonably possible, but not probable, that future environmental remediation costs associated with the Company's past operations at the Coors Road property, in excess of amounts already recorded, could be up to $3.1 million before income taxes over the next sixteen years, with such amount expected to be offset by related reimbursement from the DOE of $1.0 million. See Item 3 — "Legal Proceedings" of this Annual Report on Form 10-K.

Operations outside of the United States may be affected by legal and regulatory risks, and government reviews, inquiries or investigations could harm the Company's business.

The Company's operations in Vietnam and the business it conducts outside the United States are subject to risks relating to compliance with legal and regulatory requirements in the United States as well as in local jurisdictions. Additionally, there is a risk of potentially higher incidence of fraud or corruption in certain foreign jurisdictions and greater difficulty in maintaining effective internal controls. From time to time, the Company may conduct internal investigations and compliance reviews to ensure that the Company is in compliance with applicable laws and regulations. Additionally, the Company could be subject to inquiries or investigations by government and other regulatory bodies. Any determination that the Company's operations or activities are not in compliance with United States laws, including the Foreign Corrupt Practices Act, or various international laws and regulations could expose the Company to significant fines, penalties or other sanctions that may harm the business and reputation of the Company.

If we are not able to protect our intellectual property and other proprietary rights, we may be adversely affected.

Our success can be impacted by our ability to protect our intellectual property and other proprietary rights. We rely primarily on patents, trademarks, copyrights, trade secrets and unfair competition laws, as well as license agreements and other contractual provisions, to protect our intellectual property and other proprietary rights. However, a significant portion of our technology is not patented, and we may be unable or may not seek to obtain patent protection for this technology. Moreover, existing U.S. legal standards relating to the validity, enforceability and scope of protection of intellectual property rights offer only limited protection, may not provide us with any competitive advantages, and may be challenged by third parties. The laws of countries other than the United States may be even less protective of intellectual property rights. Accordingly, despite our efforts, we may be unable to prevent third parties from infringing upon or misappropriating our intellectual property or otherwise gaining access to our technology. If we fail to protect our intellectual property and other proprietary rights, then our business, results of operations or financial condition could be negatively impacted.

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A tightened credit market, either nationally or globally, may adversely affect the availability of funds to us for working capital, liquidity requirements, and other purposes, which may adversely affect our cash flows and financial condition.

On November 15, 2012, we replaced our previous revolving line-of-credit facility with a new $65.0 million credit facility with BMO Harris Bank N.A.The credit facility expires on November 15, 2017. In July 2014, the Company exercised the accordian feature of its Credit Facility increasing lender commitments under the Facility by $35.0 million to a total of $100.0 million. For a summary of our banking arrangements, see Note 8, Debt, of the "Notes to Consolidated Financial Statements" in this Annual Report on Form 10-K. We anticipate that our credit facility will be a component of our available working capital during fiscal 2015 and continue to be available to fund potential acquisition activity. However, there are no assurances that the line-of-credit will be sufficient for all purposes. Additionally, if vendors of electronic components restrict or reduce credit to us for purchase of raw materials as a result of general market conditions, the vendor's credit status, or our financial position, it could adversely affect liquidity, cash flows, and results of operations.

Our stock price may be volatile, and the stock is thinly traded, which may cause investors to lose most or part of their investment in our common stock.

The stock market may experience volatility that is often unrelated to the operating performance of any particular company or companies. If market-sector or industry-based fluctuations occur, our stock price could decline regardless of our actual operating performance, and investors could lose a substantial part of their investments. Moreover, if an active public market for our common stock is not sustained in the future, it may be difficult to resell such stock. Generally, our stock is thinly traded. When trading volumes are low, a relatively small buy or sell order can result in a relatively large change in the trading price of our common stock and investors may not be able to sell their securities at a favorable price.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

The following is a listing of Sparton's principal properties as of June 30, 2014. As described below, Sparton owns some of these properties and leases others. These facilities provide a total of approximately 744,000 square feet of manufacturing and administrative space. There are manufacturing and office facilities at most locations. Sparton's manufacturing facilities in aggregate are underutilized. Underutilized percentages vary by plant; however, ample space exists to accommodate expected growth. Sparton believes these facilities are suitable for its operations.

Segment/Location	Square Feet	Ownership
Medical Segment:		
Strongsville, Ohio	60,000	Owned
Frederick, Colorado	65,000	Leased
Watertown, South Dakota	130,000	Owned
Plymouth, Minnesota	10,000	Leased
Irvine, California	30,000	Leased
Complex Systems Segment:		
Brooksville, Florida	136,000	Owned
Thuan An District, Binh Duong Province, Vietnam (Outside of Ho Chi Minh City)	56,000	Owned
Plaistow, New Hampshire	20,000	Leased
DSS Segment:		
De Leon Springs, Florida	183,000	Owned
Birdsboro, Pennsylvania	41,000	Leased
Corporate Office:		
Schaumburg, Illinois	13,000	Leased

The Company’s Frederick, Colorado facility has approximately three years remaining on its initial lease term. The lease provides the Company the option to extend the term up to an additional five years.
The Company’s Plymouth, Minnesota facility has approximately seven years remaining on its lease term.

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The Company's Irvine, California facility has approximately two years remaining on its initial lease term. The lease provides the Company the option to extend the term up to an additional five years.
The Company's Plaistow, New Hampshire facility has one and a half years remaining on its initial lease term. The lease provides the Company the option to extend the term up to an additional two years.
The Company's Birdsboro, Pennsylvania facility has approximately four years remaining on its initial lease term. The lease provides the Company the option to extend the term up to an additional two periods of five years each, with the option to purchase the Premises at any time during the term.
The Company's Schaumburg, Illinois Corporate Office has five years remaining on its lease term.
While the Company owns the building and other assets in Vietnam, the land is occupied under a long-term lease covering approximately 40 years of which approximately 31 years remain. This lease is prepaid, with the cost amortized over the term of the lease, and carried in other long-term assets on our balance sheet.
As of June 30, 2014, substantially all of our assets, including real estate, are pledged as collateral to secure any potential borrowings under our revolving line-of-credit facility (see Note 8, Debt, of the "Notes to Consolidated Financial Statements" in this Annual Report on Form 10-K).

ITEM 3. LEGAL PROCEEDINGS

Environmental Remediation

Sparton has been involved with ongoing environmental remediation since the early 1980's related to one of its former manufacturing facilities, located in Albuquerque, New Mexico ("Coors Road"). Although the Company entered into a long-term lease of the Coors Road property that was accounted for as a sale of property during fiscal 2010, it remains responsible for the remediation obligations related to its past operation of this facility. During the fourth quarter of fiscal 2014, Sparton completed a review of its remediation plan, which included remediation methods currently in use, desired outcomes, progress to date, anticipated progress over the next sixteen years, and estimated costs to complete the remediation plan by fiscal 2030, following the terms of a March 2000 consent decree. The Company's minimum cost estimate is based upon existing technology and excludes certain legal costs, which are expensed as incurred. The Company's estimate includes equipment and operating and maintenance costs for onsite and offsite pump and treat containment systems, as well as continued onsite and offsite monitoring. It also includes periodic reporting requirements. During this latest review, the Company found: additional concentrations of contaminants on-site that required clean-up actions previously not included within the remediation plan; progress to date on the removal of certain other on-site contaminants was taking place slower than previously anticipated; and that certain efficiencies regarding periodic reporting were not being realized as had been previously anticipated. The discovery of additional on-site contaminants, slower than expected removal rates of other on-site contaminants, and continued high periodic reporting costs added significant additional costs to the remediation project that are expected to continue for a number of years. As a result, the remaining estimated minimum future undiscounted costs of this financial liability increased to $8.2 million at June 30, 2014, thereby requiring a $4.2 million non-cash charge against operations in the fourth quarter of fiscal 2014. This charge is net of United States Department of Energy ("DOE") reimbursements of $1.5 million expected to take place in future years, under the fiscal 2003 agreement between the Company and the DOE, as further explained below. Of the $8.2 million financial liability, $0.6 million is classified as a current liability and included on the balance sheet in other accrued expenses.
In fiscal 2003, Sparton reached an agreement with the United States Department of Energy ("DOE") and others to recover certain remediation costs. Under the settlement terms, Sparton received cash and obtained some degree of risk protection as the DOE agreed to reimburse Sparton for 37.5% of certain future environmental expenses in excess of $8.4 million incurred from the date of settlement, of which approximately $5.3 million has been expended as of June 30, 2014 toward the $8.4 million threshold. It is expected that the DOE reimbursements will commence in the years after fiscal 2020. At June 30, 2014, the Company recognized a $1.5 million long-term asset in relation to these expected reimbursements. Uncertainties associated with environmental remediation contingencies are pervasive and often result in wide ranges of reasonably possible outcomes. Estimates developed in the early stages of remediation can vary significantly. Normally a finite estimate of cost does not become fixed and determinable at a specific point in time. Rather, the costs associated with environmental remediation become estimable over a continuum of events and

activities that help to frame and define a liability. Factors which cause uncertainties for the Company include, but are not limited to, the effectiveness of the current work plans in achieving targeted results and proposals of regulatory agencies for desired methods and outcomes. It is possible that cash flows and results of operations could be materially affected by the impact of changes associated with the ultimate resolution of this contingency. At June 30, 2014, the Company estimates that it is reasonably possible, but not probable, that future environmental remediation costs associated with the Company’s past operations at the Coors Road property, in excess of

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amounts already recorded, could be up to $3.1 million before income taxes over the next sixteen years, with such amount expected to be offset by related reimbursement from the DOE of $1.0 million.

The Company and its subsidiaries are also involved in certain existing compliance issues with the EPA and various state agencies, including being named as a potentially responsible party at several sites. Potentially responsible parties (“PRP“s) can be held jointly and severally liable for the clean-up costs at any specific site. The Company’s past experience, however, has indicated that when it has contributed relatively small amounts of materials or waste to a specific site relative to other PRPs, its ultimate share of any clean-up costs has been minor. Based upon available information, the Company believes it has contributed only small amounts to those sites in which it is currently viewed as a PRP and that reasonably possible losses related to these compliance issues are immaterial.

U.S. Government Audits

Federal government agencies, including the Defense Contract Audit Agency (“DCAA”) and the Defense Contract Management Agency (“DCMA”), routinely audit and evaluate government contracts and government contractors’ administrative processes and systems. These agencies review the Company’s performance on contracts, pricing practices, cost structure, financial capability and compliance with applicable laws, regulations and standards. They also review the adequacy of the Company’s internal control systems and policies, including the Company’s purchasing, accounting, estimating, compensation and management information processes and systems.

DCAA has completed its most recent review of the Company's two Cost Accounting Standards Disclosure Statements for the Company and DSS. Corrective actions relating to this review have been implemented and during the fourth quarter of fiscal 2014, the Company received an adequate determination for both Disclosure Statements from DCMA.

Other

In addition to the foregoing, from time to time, the Company is involved in various legal proceedings relating to claims arising in the ordinary course of business. The Company is not currently a party to any other such legal proceedings, the adverse outcome of which, individually or in the aggregate, is expected to have a material adverse effect on our business, financial condition or results of operations.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

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PART II

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

Market Information. Our common stock is traded on the New York Stock Exchange ("NYSE") under the symbol "SPA". The table below sets forth the high and low closing prices of our common stock as reported by the NYSE for each quarter during the last two years:

	Quarter			
	1st	2nd	3rd	4th
Year ended June 30, 2014				
High	$25.50	$27.95	$33.36	$30.81
Low	$17.34	$24.16	$27.32	$24.87
Year ended June 30, 2013				
High	$12.69	$14.38	$15.50	$17.24
Low	$9.52	$12.05	$13.33	$12.31

Holders. As of September 2, 2014, there were 395 record holders of our common stock. The number of record holders does not include beneficial owners whose shares are held in the names of banks, brokers, nominees or other fiduciaries.

Dividends. We have not paid dividends on our common stock during either fiscal 2014 or fiscal 2013. Other than in fiscal 2006, the Company has not declared or paid cash dividends on our common stock for many years. In addition, our credit facility prohibits us from declaring or paying any dividends on our capital stock in excess of $3.0 million during any fiscal year without obtaining prior approval from our credit facility providers.

Securities Authorized for Issuance Under Equity Compensation Plans. See our disclosure below in "Part III, Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters."

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Performance Graph. The performance graph below compares the cumulative total shareholder return on our common stock for the past five years against the cumulative total return of a broad market index (Russell 2000 Index) and a peer group index, which is composed of AeroVironment, Inc., American Science and Engineering, Inc., Analogic Corporation, AngioDynamics, Inc., API Technologies Corp., Astronics Corporation, Ducommun, Inc., Exactech, Inc., Greatbatch, Inc., IEC Electronics Corp., Key Tronic Corporation, LMI Aerospace, Inc, Maxwell Technologies, Inc., Mercury Systems, Inc., Micrel, Inc., Newport Corporation, Raven Industries, Inc., Sypris Solutions, Inc., SMTC Corp., Sigmatron International Inc. and Universal Electronics, Inc. The comparative peer group was selected based on a review of publicly available information about these companies and the Company's determination that they are engaged in electronics manufacturing businesses similar to that of the Company or its reportable operating segments. The graph assumes that $100.00 was invested in our common stock and in each index on June 30, 2009. The total return for the common stock and the indices used assumes the reinvestment of dividends, if any. The comparisons in the graph below are based upon historical data and are not indicative of, nor intended to forecast, future performance of our common stock.

Comparison of Cumulative Total Return
Among Sparton Corporation,
Russell 2000 Index and Peer Group Index

	6/30/2009	6/30/2010	6/30/2011	6/30/2012	6/30/2013	6/30/2014
Sparton Corporation	100.00	173.45	352.41	341.38	594.48	956.55
Russell 2000 Index	100.00	121.48	166.93	163.46	203.03	251.03
Peer Group	100.00	111.55	155.27	131.36	151.79	181.89

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ITEM 6. SELECTED FINANCIAL DATA

The following table sets forth a summary of selected financial data for the last five fiscal years. This selected financial data should be read in conjunction with “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and our Audited Consolidated Financial Statements and, in each case, any related notes thereto included elsewhere in this report. (dollars in thousands, except per share amounts)

	2014 (a)	2013 (a) (b)	2012 (a) (b)	2011 (a) (b)	2010 (b)
Operating Results:					
Net sales	$336,139	$264,627	$226,455	$200,080	$173,977
Cost of goods sold	271,686	219,192	187,423	167,615	147,394
Gross profit	64,453	45,435	39,032	32,465	26,583
Selling and administrative expenses	35,698	26,451	22,232	20,842	18,205
Internal research and development expenses	1,169	1,300	1,293	1,110	—
Amortization of intangible assets	3,287	1,575	435	545	467
Restructuring/impairment charges	188	55	(68)	75	4,076
Gain on acquisition	—	—	—	(2,550)	—
Gain on sale of property, plant and equipment	—	—	—	(139)	(3,119)
Impairment of intangible asset	—	—	—	3,663	—
Impairment of goodwill	—	—	—	13,153	—
EPA Related - net environmental remediation	4,238	—	—	—	—
Other operating (income) expenses, net	(16)	13	65	298	1,232
Operating income (loss)	19,889	16,041	15,075	(4,532)	5,722
Other income (expense), net	(287)	131	41	(114)	(198)
Income (loss) before income taxes	19,602	16,172	15,116	(4,646)	5,524
Provision for (benefit from) income taxes	6,615	2,702	5,269	(11,657)	(1,916)
Net income	$12,987	$13,470	$9,847	$7,011	$7,440
Weighted-Average Common Shares Outstanding:					
Common stock — basic	10,109,915	10,193,530	10,174,176	10,217,494	9,972,409
Common stock — diluted	10,141,395	10,228,687	10,208,810	10,225,368	9,972,409
Per Share of Common Stock — Income:					
Common stock — basic	$1.28	$1.32	$0.97	$0.69	$0.75
Common stock — diluted	$1.28	$1.32	$0.96	$0.68	$0.75
Shareholders’ equity — Per Share	$10.87	$9.52	$8.21	$7.35	$6.30
Cash Dividends — Per Share	$—	$—	$—	$—	$—
Other Financial Data:					
Total assets	$198,980	$165,922	$144,278	$122,523	$119,522
Working capital	$75,443	$51,184	$59,839	$51,476	$38,333
Working capital ratio	2.83:1	1.92:1	2.08:1	2.23:1	1.85:1
Debt	$41,000	$11,539	$1,669	$1,796	$1,917
Shareholders’ equity	$110,115	$96,072	$82,980	$75,200	$64,872

(a) Operating results of acquired businesses have been included in the Company’s consolidated financial results since the dates of respective acquisitions. The Company's consolidated financial results have also been adjusted for the DSS revenue recognition change, as described in Note 3, Change in Accounting Principle, of the Notes to the Consolidated Financial Statements included in this Annual Report on Form 10-K.

(b) Fiscal 2011 through fiscal 2013 reflect the retroactive impact of the Company's fiscal 2014 change in its revenue recognition policy related to its DSS sonobuoy sales. The Company was not able to determine the retroactive impact of this accounting change on its fiscal 2010 statement of income and; therefore, could not retroactively apply the accounting change to this period. June 30, 2010 balance sheet items above have been adjusted to reflect the retroactive impact.

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

The following is an analysis of the Company’s results of operations, liquidity and capital resources and should be read in conjunction with the Consolidated Financial Statements and notes related thereto included in this Annual Report on Form 10-K. To the extent that the following Management’s Discussion and Analysis contains statements which are not of a historical nature, such statements are forward-looking statements which involve risks and uncertainties. These risks include, but are not limited to the risks and uncertainties discussed in “Item 1A Risk Factors” in this Annual Report on Form 10-K. The following discussion and analysis should be read in conjunction with the “Forward Looking Statements” and “Item 1A Risk Factors” each included in this Annual Report on Form 10-K.

Business Overview

General

Sparton Corporation and subsidiaries (the “Company” or “Sparton”) has been in continuous existence since 1900. It was last reorganized in 1919 as an Ohio corporation. The Company is a provider of design, development, and manufacturing services for complex electromechanical devices, as well as sophisticated engineered products complementary to the same electromechanical value stream. The Company serves the Medical & Biotechnology, Military & Aerospace and Industrial & Commercial markets through three reportable business segments; Medical Device (“Medical”), Complex Systems (“CS”) and Defense & Security Systems (“DSS”). Financial information by segment is presented in Note 16. All of the Company's facilities are certified to one or more of the ISO/AS standards, including ISO 9001, AS9100 or ISO 13485, with most having additional certifications based on the needs of the customers they serve. The Company's products and services include offerings for Original Equipment Manufacturers (“OEM”) and Emerging Technology (“ET”) customers that utilize microprocessor-based systems which include transducers, printed circuit boards and assemblies, sensors, and electromechanical components, as well as development and design engineering services relating to these product sales. Sparton also develops and manufactures sonobuoys, anti-submarine warfare (“ASW”) devices used by the United States Navy and other free-world countries. Many of the physical and technical attributes in the production of sonobuoys are similar to those required in the production of the Company's other electrical and electromechanical products and assemblies.

The Company uses an internal management reporting system, which provides important financial data to evaluate performance and allocate the Company's resources on a segment basis. Net sales are attributed to the segment in which the product is manufactured or service is performed. A segment's performance is evaluated based upon its operating income (loss). A segment's operating income (loss) includes its gross profit on sales less its selling and administrative expenses, including allocations of certain corporate operating expenses. Certain corporate operating expenses are allocated to segment results based on the nature of the service provided. Other corporate operating expenses, including certain administrative, financial and human resource activities as well as items such as interest expense, interest income, other income (expense) and income tax expense (benefit), are not allocated to operations and are excluded from segment profit. These costs are not allocated to the segments, as management excludes such costs when assessing the performance of the segments. Inter-segment transactions are generally accounted for at amounts that approximate arm's length transactions. Identifiable assets by segments are those assets that are used in each segment's operations. The accounting policies for each of the segments are the same as for the Company taken as a whole.

Medical Segment

Medical segment operations are comprised of contract design, manufacturing, and aftermarket repair and refurbishment of sophisticated medical and biotechnology devices and sub-assemblies. Customers include industry leaders, emerging technologies companies and start-ups. In manufacturing devices for its customers, this business unit follows specific design and manufacturing processes to assure product reliability and safety in accordance with Food and Drug Administration (“FDA”) guidelines and approvals. This group specializes in technologies, systems and processes required by medical OEM and ET customers primarily in the diagnostic, therapeutic, surgical and laboratory device segments of the medical and biotechnology marketplaces. The Medical segment also includes some non-medical customers.

Complex Systems Segment

Complex Systems segment operations are comprised of manufacturing and aftermarket repair and refurbishment of sophisticated printed circuit card assemblies, sub-assemblies, full product assemblies, and cable/wire harnesses. Customers include military and aerospace, as well as industrial and commercial OEM's. In manufacturing for its customers, this segment adheres to very strict military and aerospace specifications in addition to product and process certifications. Customers are primarily engaged in applications that include: flight controls, industrial and military control systems, cockpit displays, fuel system controls, secure communications, early warning detection, security systems, satellite communications, and audio. The CS segment also includes some medical customers.

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DSS Segment

Defense & Security segment operations are comprised of design, development and production of products for both domestic and foreign defense as well as commercial needs. Sparton designs and manufactures anti-submarine warfare ("ASW") devices known as sonobuoys for the U.S. Navy and foreign governments that meet Department of State licensing requirements. This segment also performs an engineering development function for the United States military and prime defense contractors for advanced technologies ultimately leading to future defense products as well as replacements for existing products. The sonobuoy product line is built to stringent military specifications. These products are restricted by International Tariff and Arms Regulations (“ITAR”) and qualified by the U.S. Navy, which limits opportunities for competition. Sparton is also a provider of ruggedized flat panel display systems for military panel PC workstations, air traffic control and industrial applications. Ruggedized displays are manufactured for prime contractors to specific military grade specifications. Additionally, this business unit internally develops and markets commercial products for underwater acoustics and microelectromechanical (“MEMS”)-based inertial measurement.

Risks and Uncertainties

Sparton, as a high-mix, low to medium volume supplier, provides rapid product turnaround for customers. High-mix describes customers needing multiple product types with generally low to medium volume manufacturing runs. As a contract manufacturer with customers in a variety of markets, the Company has substantially less visibility of end user demand and, therefore, forecasting sales can be problematic. Customers may cancel their orders, change production quantities and/or reschedule production for a number of reasons. Depressed economic conditions may result in customers delaying delivery of product, or the placement of purchase orders for lower volumes than previously anticipated. Unplanned cancellations, reductions, or delays by customers may negatively impact the Company's results of operations. As many of the Company's costs and operating expenses are relatively fixed within given ranges of production, a reduction in customer demand can disproportionately affect the Company's gross margins and operating income. The majority of the Company's sales have historically come from a limited number of customers. Significant reductions in sales to, or a loss of, one of these customers could materially impact our operating results if the Company were not able to replace those sales with new business.

Other risks and uncertainties that may affect our operations, performance, growth forecasts and business results include, but are not limited to, timing and fluctuations in U.S. and/or world economies, sharp volatility of world financial markets over a short period of time, competition in the overall contract manufacturing business, availability of production labor and management services under terms acceptable to the Company, Congressional budget outlays for sonobuoy development and production, Congressional legislation, uncertainties associated with the outcome of litigation, changes in the interpretation of environmental laws and the uncertainties of environmental remediation and customer labor and work strikes. Further risk factors are the availability and cost of materials, as well as non-cancelable purchase orders we have committed to in relation to customer forecasts that can be subject to change. A number of events can impact these risks and uncertainties, including potential escalating utility and other related costs due to natural disasters, as well as political uncertainties such as the unrest in Africa and the Middle East and increased tension between Vietnam and China over oil rights in the South China Sea. Additional trends, risks and uncertainties include dependence on key personnel, risks surrounding acquisitions, uncertainties surrounding the global economy, U.S. healthcare legislation, U.S. budget sequestration and debt ceiling negotiations and the effects of those uncertainties on OEM behavior, including heightened inventory management, product development cycles and outsourcing strategies. Finally, the Sarbanes-Oxley Act, and more recently the Dodd-Frank Act, have required or will require changes in, and formalization of, some of the Company's corporate governance and compliance practices. The SEC and the New York Stock Exchange have also passed or will pass related rules and regulations requiring additional compliance activities, including those implementing the conflict minerals provisions of the Dodd-Frank Act. Compliance with these rules has increased administrative costs and may increase these costs further in the future. A further discussion of the Company’s risk factors has been included in Part I, Item 1A, “Risk Factors”, of this Annual Report on Form 10-K. Management cautions readers not to place undue reliance on forward-looking statements, which are subject to influence by the enumerated risk factors as well as unanticipated future events.

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Acquisitions
Fiscal Year 2015
Electronic Manufacturing Technology, LLC.
On July 9, 2014, the Company completed the acquisition of Electronic Manufacturing Technology, LLC. (“eMT”). The purchase price of $18.5 million is subject to a final working capital adjustment and was financed through the use of borrowings under the Company's Credit Facility. The acquired business, which will be part of the Company's Complex Systems segment and which is expected to add $25 million (unaudited) in projected annualized revenue, is engaged in the contract services business of manufacturing electromechanical controls and electronic assemblies. Their customer profile includes international Fortune 1000 manufacturers of highly reliable industrial excimer laser products, laser eye surgery sub-assemblies, target simulators for space and aviation systems, power modules for computerized tomography products, test systems for commercial aerospace OEMs, and toll road antennas and control boxes. The transaction includes an approximate $2.4 million escrowed holdback which is available to fund any potential post-closing working capital adjustment and potential seller indemnification obligations in relation to the acquisition agreement.
The initial accounting for the acquisition is not complete pending detailed analyses of the facts and circumstances that existed as of the acquisition date.
Fiscal Year 2014
Aubrey Group, Inc.
On March 17, 2014, the Company completed the acquisition of Aubrey Group, Inc. ("Aubrey”), located in Irvine, CA, in a $5.3 million all-cash transaction, subject to certain post-closing adjustments and financed through the use of borrowings under the Company's Credit Facility. Additional consideration of approximately $0.6 million was paid at closing for cash of the business in excess of net customer deposits held by the Aubrey. At June 30, 2014, the Company has recognized accounts receivable of $0.3 million as consideration to be returned in relation to a post-closing working capital adjustment, which is expected to be settled in the first quarter of the Company's fiscal 2015 year. The transaction includes an approximate $0.5 million escrowed holdback which is available to fund any potential post-closing working capital adjustment and potential seller indemnification obligations in relation to the acquisition agreement.
The acquired business, a design and manufacturing company, which is part of the Medical segment and which is expected to add $8 million (unaudited) in annualized revenue, develops new products for OEMs in the Medical and Biotechnological markets. Inventors, entrepreneurs, and industry leading OEMs utilize Aubrey's design and engineering teams to develop innovative solutions in a timely manner in their efforts to deliver their new products into the marketplace faster and more cost effectively.
Total purchase consideration has been allocated to the tangible assets acquired and liabilities assumed based on their estimated fair values at the acquisition date. The Aubrey acquisition has resulted in approximately $4.5 million of goodwill, which is not expected to be deductible for tax purposes and has been assigned entirely to the Company's Medical segment. The Company believes that goodwill primarily relates to strategic fit, resulting synergies and the acquired workforce that this business brings to existing operations.
Included in the Company’s Consolidated Statements of Income for the year ended June 30, 2014 are net sales of approximately $2.2 million and loss before provision for income taxes of approximately $0.3 million, since the March 17, 2014 acquisition of Aubrey.
The Company incurred legal, professional and other costs related to this acquisition aggregating approximately $0.3 million. These costs were recognized as selling and administrative expenses in the year ended June 30. 2014 and reflected as non-segment corporate and other unallocated costs.
Beckwood Services, Inc.
On December 11, 2013, the Company completed the acquisition of Beckwood Services, Inc. ("Beckwood”), located in Plaistow, N.H., in a $15.3 million all-cash transaction financed through the use of cash on hand and borrowings under the Company's Credit Facility. The transaction includes an approximate $1.5 million escrowed holdback which is available to fund potential seller indemnification obligations in relation to the acquisition agreement.

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The acquired business, which is part of the Company's Complex Systems segment and which is expected to add $18 million (unaudited) in annualized revenue, develops electronic or electro-mechanical controls and electronic assemblies. Their customer profile includes international Fortune 1000 manufacturers of industrial control systems, analytical instruments, measuring and detecting equipment and military, defense and Homeland Security equipment. Total purchase consideration has been allocated to the tangible assets acquired and liabilities assumed based on their estimated fair values at the acquisition date. The Beckwood acquisition has resulted in approximately $6.7 million of goodwill, which is not expected to be deductible for tax purposes and has been assigned entirely to the Company’s Complex Systems segment. The Company believes goodwill primarily relates to strategic fit, resulting synergies and the acquired workforce that this business brings to existing operations.

Included in the Company’s Consolidated Statements of Income for the year ended June 30, 2014 are net sales of approximately $9.5 million and income before provision for income taxes of approximately $0.2 million, since the December 11, 2013 acquisition of Beckwood.

The Company incurred legal, professional and other costs related to this acquisition aggregating approximately $0.2 million for the year ended June 30, 2014. These costs were recognized as selling and administrative expenses and reflected as non-segment corporate and other unallocated costs.

Aydin Displays, Inc.

On August 30, 2013, the Company completed the acquisition of certain assets and liabilities of Aydin Displays, Inc. ("Aydin Displays" or “Aydin”), located in Birdsboro, PA, in a $15.5 million all-cash transaction, after settlement of a $0.5 million working capital adjustment during the third quarter of the Company's fiscal 2014 year. The transaction was financed through the use of borrowings under the Company's Credit Facility. Additional acquisition consideration of up to $6.6 million is contingent upon Aydin attaining certain performance thresholds during the twelve month period following the transaction. The transaction includes an approximate $1.2 million escrowed holdback which is available to fund potential seller indemnification obligations in relation to the acquisition agreement.

The acquired business, which is part of the Company's DSS segment and which is expected to add $18 million (unaudited) in annualized revenue, develops enhanced flat panel display and touch-screen solutions with application-critical performance criteria including ruggedization, high resolution, color accuracy, response/refresh times, sunlight readability and other criteria such as magnetic interference and emanations security for the Military & Aerospace and Civil Marine markets. These products are currently specified in the U.S. Navy P8A Poseidon ASW aircraft behind-the-cockpit control center, the command and control centers of many U.S. Navy ships, Federal Aviation Administration air traffic control systems, and cockpit command centers for various civil marine applications. The acquired business will continue to operate as Aydin Displays.

Total purchase consideration has been allocated to the tangible assets acquired and liabilities assumed based on their estimated fair values at the acquisition date. Additional acquisition consideration of up to $6.6 million is contingent upon Aydin attaining certain performance thresholds. The Company has assigned no fair value to this contingent liability. The Aydin acquisition has resulted in approximately $2.2 million of goodwill, which is expected to be deductible for tax purposes and has been assigned entirely to the Company’s DSS segment. The Company believes goodwill primarily relates to strategic fit, resulting synergies and the acquired workforce that this business brings to existing operations.

Included in the Company’s Consolidated Statements of Income for the year ended June 30, 2014 are net sales of approximately $14.3 million and income before provision for income taxes of approximately $0.9 million, since the August 30, 2013 acquisition of Aydin.

The Company incurred legal, professional and other costs related to this acquisition aggregating approximately $0.3 million for the year ended June 30, 2014. These costs were recognized as selling and administrative expenses and reflected as non-segment corporate and other unallocated costs.

Fiscal Year 2013

Creonix, LLC

On June 6, 2013, the Company completed the acquisition of certain assets related to the contract manufacturing business of Creonix, LLC (“Creonix”) in a $2.0 million all-cash transaction, after settlement of a $0.1 million working capital adjustment during the second quarter of the Company's fiscal 2014 year. The transaction was financed through the use of borrowings under the Company's Credit Facility.

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The acquired business, which is reported in the Company's Complex Systems segment, provides the Company with the capability of cable and wire harness engineering and assembly. Additionally, the acquisition provides further expansion into the Industrial and Military & Aerospace markets, diversifies Sparton's customer base and increases utilization of the Company's existing assets through the consolidation of this business into Complex Systems's Brooksville, Florida plant. Creonix primarily manufactures products and components for battery monitoring, high speed optical imaging, neuromuscular incapacitation, imaging and wiring assemblies for military applications, and electrical grid transformer protection systems.

Onyx EMS, LLC

On November 15, 2012, the Company completed the acquisition of Onyx EMS, LLC ("Onyx") in a $43.25 million all-cash transaction, subject to certain post-closing adjustments, which was financed through the use of Company cash and borrowings under the Company's Credit Facility. Additional consideration of $2.19 million was paid in relation to a post-closing working capital adjustment, which was settled in the Company's fiscal 2013 third quarter. The transaction includes an approximate $4.3 million escrowed holdback which is available to fund potential seller indemnification obligations in relation to the acquisition agreement.

The acquired business, which is reported in the Company's Medical segment, provides further expansion regionally into the Minneapolis medical device corridor, diversifying the Company's customer base through both existing programs and a strong business development pipeline, and increases the number of complex sub-assembly and full device programs within Sparton. Additionally, Onyx brings long-term customers which can utilize Sparton's expanded list of service offerings such as our low cost country footprint in Vietnam and full engineering design capabilities. Onyx primarily manufactures medical devices for OEM and ET companies, including products for cardiovascular diagnostics, hearing assistance, patient temperature and warming, point-of-care diagnostics, and surgical equipment used in intraosseous medicine. Onyx also produces products such as precision measurement instruments for monitoring air quality and pollution, commercial fire and smoke alarm systems, sensing tools, test fixtures, and complex LED assemblies.

Consolidated Results of Operations

Presented below are more detailed comparative data and discussions regarding our consolidated and reportable segment results of operations for the year ended June 30, 2014 compared to the year ended June 30, 2013, and the year ended June 30, 2012 compared to the year ended June 30, 2012.

For the Year ended June 30, 2014 compared to the Year ended June 30, 2013

The following table presents consolidated statements of income data as a percentage of net sales for the years ended June 30, 2014 and 2013 (dollars in thousands):

	2014 Total	% of Sales	2013 Total	% of Sales
Net sales	$336,139	100.0 %	$264,627	100.0 %
Cost of goods sold	271,686	80.8	219,192	82.8
Gross profit	64,453	19.2	45,435	17.2
Selling and administrative expenses	35,698	10.6	26,451	10.0
Internal research and development expenses	1,169	0.3	1,300	0.5
Amortization of intangible assets	3,287	1.0	1,575	0.6
Restructuring charges	188	0.1	55	—
EPA Related - net environmental remediation	4,238	1.3	—	—
Other operating (income) expense, net	(16)	—	13	—
Operating income	19,889	5.9	16,041	6.1
Total other income (expense), net	(287)	(0.1)	131	—
Income before provision for income taxes	19,602	5.8	16,172	6.1
Provision for income taxes	6,615	2.0	2,702	1.0
Net income	$12,987	3.8 %	$13,470	5.1 %

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The following table presents net sales by reportable segment for the years ended June 30, 2014 and 2013 (dollars in thousands):

	2014 Sales	% of Total	2013 Sales	% of Total	% Change
SEGMENT					
Medical	$162,648	48.4 %	$146,873	55.5 %	10.7 %
Complex Systems	83,119	24.7	60,649	22.9	37.0
DSS	109,134	32.5	75,430	28.5	44.7
Eliminations	(18,762)	(5.6)	(18,325)	(6.9)	2.4
Totals	$336,139	100.0 %	$264,627	100.0 %	27.0

The following table presents gross profit and gross profit as a percent of net sales by reportable segment for the years ended June 30, 2014 and 2013 (dollars in thousands):

	2014 Gross Profit	GP%	2013 Gross Profit	GP%
SEGMENT				
Medical	$25,190	15.5 %	$21,287	14.5 %
Complex Systems	9,230	11.1	6,388	10.5
DSS	30,033	27.5	17,760	23.5
Totals	$64,453	19.2	$45,435	17.2

The following table presents operating income (loss) and operating income (loss) as a percent of net sales for the years ended June 30, 2014 and 2013 (dollars in thousands):

	2014 Operating Income	% of Sales	2013 Operating Income	% of Sales
SEGMENT				
Medical	$12,561	7.7 %	$11,602	7.9 %
Complex Systems	4,106	4.9	3,553	5.9
DSS	19,943	18.3	11,525	15.3
Corporate and other unallocated	(16,721)	—	(10,639)	—
Totals	$19,889	5.9	$16,041	6.1

Medical

Included in the results for the Company’s Medical segment for the year ended June 30, 2014 are net sales of approximately $57.6 million resulting from the acquisition of Onyx and Aubrey compared to $31.2 million in net sales from the acquisition of Onyx in the prior year. Excluding the $26.4 million in incremental sales from the acquisition of Onyx and Aubrey, legacy Medical sales decreased approximately $10.6 million, or 9%, for the year ended June 30. 2014 as compared to the prior year. This comparative decrease primarily reflects a rebalancing of Fenwal Blood Technologies' program engagements with the Company that began in the Company's fiscal 2014 third quarter. Medical sales are dependent on a small number of key strategic customers. Fenwal Blood Technologies contributed 14% and 20% of consolidated Company net sales during the year ended June 30, 2014 and 2013 , respectively. The rebalancing of Fenwal programs negatively affected comparative sales to this customer by $10.2 million in the second half of the Company's fiscal 2014 and is expected to negatively affect comparative sales to this customer by as much as $19 million in the Company's fiscal 2015, substantially all of which will be realized during the first half of that year. Medical backlog was approximately $80.3 million at June 30, 2014 compared to $74.6 at June 30, 2013. Commercial orders, in general, may be rescheduled or canceled without significant penalty, and, as a result, may not be a meaningful measure of future sales. A majority of the June 30, 2014 Medical backlog is currently expected to be realized in the next 12 months.

Gross profit varies from period to period and can be affected by a number of factors, including product mix, production efficiencies, capacity utilization, and costs associated with new program introduction. Gross profit percentage on Medical sales increased to 15.5% from 14.5% for the years ended June 30, 2014 and 2013, respectively. This increase in margin percentage on Medical sales primarily reflects certain favorable product mix between the two years, partially offset by the negative effect of fixed overhead costs on lower legacy sales.

Selling and administrative expenses relating to the Medical segment were $10.5 million for the year ended June 30, 2014 compared to $8.1 million for the year ended June 30, 2013, primarily reflecting incremental direct and allocated expenses related to Aubrey and Onyx operations.

Amortization of intangible assets was $2.1 million and $1.6 million for the years ended June 30, 2014 and 2013, respectively. The increase relates to a full year of amortization of customer relationships and non-compete agreements acquired as part of the fiscal 2013 Onyx transaction.

Complex Systems

Included in the results for the Company's Complex Systems segment for the year ended June 30, 2014 are net sales of approximately $20.2 million resulting from the acquisitions of Creonix and Beckwood compared to $0.3 million in net sales from Creonix in the prior year. Excluding these sales and an increase in intercompany sales of $0.4 million, CS sales to legacy external customers for the year ended June 30, 2014 increased $2.2 million, or 5%, as compared with the prior year. CS intercompany sales result primarily from the production of circuit boards that are then utilized in DSS product sales. These intercompany sales are eliminated in consolidation. CS backlog was approximately $34.4 million at June 30, 2014 compared to $39.7 million at June 30, 2013. Commercial orders, in general, may be rescheduled or canceled without significant penalty, and, as a result, may not be a meaningful measure of future sales. A majority of the June 30, 2014 CS backlog is currently expected to be realized in the next 12 months.

The gross profit percentage on CS sales increased to 11.1% for the year ended June 30, 2014 compared to 10.5% for the year ended June 30, 2013, primarily reflecting increased capacity utilization and favorable product mix between the comparative years.

Selling and administrative expenses relating to the CS segment were $3.9 million and $2.8 million for the years ended June 30, 2014 and 2013, respectively, primarily due to the inclusion of operating expenses of Creonix and Beckwood.

Amortization of intangible assets was $1.0 million for the year ended June 30, 2014 due to the acquisitions of Creonix and Beckwood.

Restructuring charges related to the CS segment were $0.2 million and $0.1 million for the years ended June 30, 2014 and 2013, respectively, relating to the consolidation of the recently acquired Creonix business into the Company's Brooksville, Florida facility. For a further discussion of this restructuring activity see Note 15, Restructuring Activities, of the "Notes to Consolidated Financial Statements" in this Annual Report.

Defense and Security Systems

Included in the results for the Company's Defense and Security Systems segment for the year ended June 30, 2014 are net sales of approximately $14.3 million resulting from the acquisition of Aydin. Excluding the fiscal year 2014 incremental sales from the acquisition of Aydin, DSS legacy sales increased approximately $19.4 million, or 26%, in the year ended June 30, 2014 as compared with the period last year, reflecting increased sonobuoy sales to the U. S. Navy and foreign governments as well as increased U.S. Navy engineering sales. Total sales to the U.S. Navy for the full year ended June 30, 2014 and 2013 were approximately $63.2 million and $51.9 million, or 19% and 20%, respectively, of consolidated Company net sales for those periods. DSS backlog was approximately $32.4 million at June 30, 2014 compared to $85.5 million at June 30, 2013. A majority of the June 30, 2014 DSS backlog is currently expected to be realized in the next 14 months.