SPECTRUM CONTROL INC
Form 10-Q
October 07, 2003

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10Q

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

For the Period Ended August 31, 2003 | Commission File Number 0-8796

Spectrum Control, Inc.

Exact name of registrant as specified in its charter

Pennsylvania	25-1196447
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)
8031 Avonia Road; Fairview, Pennsylvania	16415
(Address)	(Zip Code)
Registrant's telephone number, including area code:	(814) 835-1650

Former name, former address and former fiscal year, if changed since last report

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 the filing requirements for at least the past 90 days. Yes__X__ No___

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Act). Yes__X__ No___

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the lastest practical date.

Class	Number of Shares Outstanding as of September 15, 2003
Common, no par value	12,928,977

SPECTRUM CONTROL, INC. AND SUBSIDIARIES

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SPECTRUM CONTROL, INC. AND SUBSIDIARIES
Condensed Consolidated Balance Sheets
(Unaudited)

(Dollar Amounts in Thousands)	August 31, 2003	November 30, 2002
Assets		
Current Assets		
Cash and cash equivalents	$ 24,201	$ 19,934
Accounts receivable, less allowances of $930 in 2003 and $896 in 2002	10,079	10,035
Inventories	12,757	14,494
Deferred income taxes	1,869	1,869
Income tax refund receivable	809	833
Prepaid expenses and other current assets	1,040	614
Total current assets	50,755	47,779
Property, plant and equipment, net	13,288	15,543
Other Assets		
Goodwill, net	18,019	18,019
Other noncurrent assets	444	483
Total other assets	18,463	18,502
Total Assets	$ 82,506	$ 81,824
Liabilities And Stockholders' Equity		
Current Liabilities		
Accounts payable	$ 2,989	$ 3,033
Income taxes payable	190	175
Accrued liabilities	1,916	1,685
Current portion of long-term debt	285	285
Total current liabilities	5,380	5,178
Long-Term Debt	2,117	2,391
Deferred Income Taxes	3,631	3,580
Stockholders' Equity		
Common stock, no par value, authorized 25,000,000 shares, issued 13,604,977 shares in 2003 and 2002	43,777	43,777
Retained earnings	31,561	31,116
Treasury stock, 676,600 shares in 2003 and 657,000 shares in 2002, at cost	(3,628)	(3,537)
Accumulated other comprehensive loss	(332)	(681)
Total stockholders' equity	71,378	70,675
Total Liabilities And Stockholders' Equity	$ 82,506	$ 81,824

The accompanying notes are an integral part of the financial statements.
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SPECTRUM CONTROL, INC. AND SUBSIDIARIES
Condensed Consolidated Statements of Operations
(Unaudited)

(Amounts in Thousands Except Per Share Data)

	Three Months Ended		Nine Months Ended	
	August 31,		August 31,	
	2003	2002	2003	2002
Net sales	$15,354	$15,664	$46,070	$41,510
Cost of products sold	12,349	12,720	36,315	35,059
Gross margin	3,005	2,944	9,755	6,451
Selling, general and administrative expense	2,977	2,920	9,200	8,935
Income (loss) from operations	28	24	555	(2,484)
Other income (expense) :				
Interest expense	(32)	(39)	(89)	(116)
Other income and expense, net	48	122	251	1,162
	16	83	162	1,046
Income (loss) before provision for income taxes	44	107	717	(1,438)
Provision for income taxes (benefit)	15	40	272	(543)
Net income (loss)	$ 29	$ 67	$ 445	$ (895)
Earnings (loss) per common share :				
Basic	$ -	$ 0.01	$ 0.03	$ (0.07)
Diluted	$ -	$ 0.01	$ 0.03	$ (0.07)
Average number of common shares outstanding :				
Basic	12,929	13,068	12,936	13,101
Diluted	13,004	13,104	12,975	13,101

The accompanying notes are an integral part of the financial statements.
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SPECTRUM CONTROL, INC. AND SUBSIDIARIES
Condensed Consolidated Statements of Cash Flows
(Unaudited)

(Dollar Amounts in Thousands)	Nine Months Ended

	August 31, 2003	August 31, 2002
Cash Flows From Operating Activities :		
Net income (loss)	$ 445	$ (895)
Adjustments to reconcile net income (loss) to net cash provided by operating activities :		
Depreciation	2,853	3,538
Amortization	44	44
Deferred income taxes	51	(129)
Changes in assets and liabilities, excluding effects of business acquisitions :		
Accounts receivable	261	2,566
Inventories	1,817	2,795
Prepaid expenses and other assets	(415)	3,032
Accounts payable and accrued expenses	197	(82)
Net cash provided by operating activities	5,253	10,869
Cash Flows From Investing Activities :		
Proceeds from sale of property, plant and equipment	-	1,034
Purchase of property, plant and equipment	(608)	(318)
Payment for acquired businesses, net of cash received	-	(4,945)
Net cash used in investing activities	(608)	(4,229)
Cash Flows From Financing Activities :		
Repayment of long-term debt	(274)	(370)
Purchase of common stock	(91)	(968)
Net proceeds from issuance of common stock	-	147
Net cash used in financing activities	(365)	(1,191)
Effect of exchange rate changes on cash	(13)	(34)
Net increase in cash and cash equivalents	4,267	5,415
Cash and cash equivalents, beginning of period	19,934	12,442
Cash and cash equivalents, end of period	$ 24,201	$ 17,857
Cash paid during the period for :		
Interest	$ 101	$ 114
Income taxes	214	186

The accompanying notes are an integral part of the financial statements.

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SPECTRUM CONTROL, INC. AND SUBSIDIARIES
Notes to Condensed Consolidated Financial Statements
August 31, 2003

Note 1 - Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and notes required by generally accepted accounting principles for complete financial statements. In the opinion of management, the accompanying financial statements include all adjustments which are normal, recurring and necessary to present fairly the results for the interim periods. Operating results for interim periods are not necessarily indicative of the results that may be expected for the year.

The condensed consolidated financial statements include the accounts of Spectrum Control, Inc. and its Subsidiaries ("the Company"). To facilitate timely reporting, the fiscal quarters of the Company's German subsidiary, Spectrum Control GmbH, are based upon a fiscal year which ends October 31. All significant intercompany accounts are eliminated upon consolidation.

The preparation of the consolidated financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements, the disclosure of contingent assets and liabilities, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

The balance sheet at November 30, 2002 has been derived from the audited financial statements at that date but does not include all of the information and notes required by generally accepted accounting principles for complete financial statements.

For further information, refer to the consolidated financial statements and notes thereto included in the Spectrum Control, Inc. and Subsidiaries annual report on Form 10-K for the fiscal year ended November 30, 2002.

Note 2 - Nature of Operations

The Company designs and manufactures control products and systems for the electronics industry, and has operations in the United States, Mexico, China and Germany. The Company offers a broad line of signal, power, and frequency control products which are used to condition, regulate, transmit, receive, or govern electronic performance. Although its products are used in many industries worldwide, the Company's largest markets are telecommunications equipment and military/aerospace.

Note 3 - Revenue Recognition and Product Warranties

Product sales are generally recorded at the time of shipment when title passes under the terms FOB shipping point. Sales of consigned inventories are recorded when the customer has taken title and assumed the risks and rewards of ownership as specified in the customer's purchase order or sales agreement. Sales to third party distributors are made under contractual agreements which allow for limited rights of return and replacement. The contractual agreements do not provide any price protection for unsold inventory held by a distributor. None of the Company's sales agreements include customer acceptance clauses. Service revenues are recorded when the related services are performed. Patent licensing fees are recorded when the related technology rights are transferred.

Except for product warranties, the Company does not incur any post-shipment obligations. The Company's product warranties generally extend for one year, and are limited to the repair and replacement value of the product. Sales returns and warranty expense are recorded as incurred and were not material in any of the periods presented herein.

Note 4 - Inventories

Inventories by major classification are as follows (in thousands):

	August 31,	November 30,

	2003	2002
Finished goods	$ 1,873	$ 2,510
Work - in - process	4,517	4,803
Raw materials	6,367	7,181
	$12,757	$14,494

Inventories are presented net of aggregate inventory reserves of $3,361,000 at August 31, 2003 and $3,980,000 at November 30, 2002.

Note 5 - Property, Plant and Equipment

Property, plant and equipment by major classification are as follows (in thousands):

	August 31, 2003	November 30, 2002
Land and improvements	$ 1,127	$ 1,127
Buildings and improvements	10,896	10,879
Machinery and equipment	26,979	26,357
	39,002	38,363
Less accumulated depreciation	25,714	22,820
	$13,288	$15,543

Note 6 - Goodwill

Effective December 1, 2001, the Company adopted Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets" ("SFAS No. 142"). SFAS No. 142 changes the accounting for goodwill and other intangible assets with indefinite lives from an amortization method to an impairment-only approach. Amortization of goodwill and intangible assets with indefinite lives, including such assets recorded in past business combinations, ceases upon adoption of SFAS No. 142. Accordingly, no amortization of goodwill was recognized in the accompanying condensed consolidated statements of operations for the periods ended August 31, 2003 and 2002. On an annual basis, and when there is reason to suspect that the carrying value of goodwill has been diminished or impaired, goodwill must be tested for impairment and a writedown of the asset may be necessary. No impairment losses have been recognized in any of the periods presented herein.

Goodwill by reportable segment is as follows (in thousands):

	August 31, 2003	November 30, 2002
Signal integrity products	$10,557	$10,557
Power integrity products and management systems	3,686	3,686
Frequency control products	3,776	3,776
	$18,019	$18,019

Changes in the carrying amount of goodwill are summarized as follows (in thousands):

	Three Months Ended August 31,		Nine Months Ended August 31,	
	2003	2002	2003	2002
Goodwill, beginning of period	$ 18,019	$ 14,243	$ 18,019	$ 14,243
Goodwill acquired	-	3,776	-	3,776
Goodwill impairment losses	-	-	-	-
Goodwill, end of period	$ 18,019	$ 18,019	$ 18,019	$ 18,019

Note 7 - Other Noncurrent Assets

Other noncurrent assets by major classification are as follows (in thousands):

	August 31, 2003	November 30, 2002
Intangible assets:		
Patents and patent rights	$ 574	$ 574
Debt issuance costs	205	205
	779	779
Less accumulated amortization	529	485
	250	294
Other assets:		
Forward currency exchange contracts	-	17
Deferred charges	194	172
	194	189
Other noncurrent assets	$ 444	$ 483

Amortization of intangible assets is expected to be approximately $60,000 for each of the next five fiscal years.

Note 8 - Debt Agreement

The Company maintains a $6,000,000 line of credit with its principal lending institution (the "Bank"), with interest rates on borrowings at or below the prevailing prime rate. During the periods ended August 31, 2003 and 2002, no borrowings were outstanding under this line of credit arrangement. The line of credit agreement contains certain covenants, the most restrictive of which require the Company to maintain designated minimum levels of net worth and profitability and impose certain restrictions on the Company regarding additional indebtedness. At August 31, 2003, the Company was in compliance with these debt covenants.

Effective February 28, 2003, the line of credit agreement was amended. Under the amended agreement, future borrowings if any, will be secured by the Company's accounts receivable. The amended line of credit agreement expires April 30, 2005.

Note 9 - Derivatives and Hedging Activities

From time to time, the Company enters into forward currency exchange contracts in the regular course of business to manage its exposure against foreign currency fluctuations on sales denominated in foreign currencies. The terms of these contracts are generally nine months or less.

At August 31, 2003, the Company had no forward contracts outstanding.

Note 10 - Earnings (Loss) Per Common Share

The following table sets forth the computation of basic and diluted earnings (loss) per common share for the periods indicated:

	Three Months Ended August 31,		Nine Months Ended August 31,	
	2003	2002	2003	2002
Numerator for basic and diluted earnings (loss) per common share (in thousands):				
Net income (loss)	$ 29	$ 67	$ 445	$ (895)
Denominator for basic earnings (loss) per common share (in thousands):				
Weighted average shares outstanding	12,929	13,068	12,936	13,101
Denominator for diluted earnings (loss) per common share (in thousands):				
Weighted average shares outstanding	12,929	13,068	12,936	13,101
Effect of dilutive securities:				
Stock options	75	36	39	-
Stock warrants	-	-	-	-
	13,004	13,104	12,975	13,101
Earnings (loss) per common share:				
Basic	$ -	$ 0.01	$ 0.03	$ (0.07)
Diluted	$ -	$ 0.01	$ 0.03	$ (0.07)

Options to purchase 474,800 shares of Common Stock, at a weighted average exercise price of $9.12 per share, were outstanding at August 31, 2003 but were not included in the computation of diluted earnings per share because their inclusion would be antidilutive. At August 31, 2002, options and warrants to purchase 954,483 shares of Common Stock, at a weighted average exercise price of $7.19 per share, were similarly excluded..

Note 11- Comprehensive Income (Loss)

The components of comprehensive income (loss) are as follows (in thousands):

	Three Months Ended August 31,		Nine Months Ended August 31,	
	2003	2002	2003	2002
Net income (loss)	$ 29	$ 67	$ 445	$ (895)
Foreign currency translation adjustments	1	225	366	194
Change in fair value of derivatives	-	(22)	(17)	(63)
Comprehensive income (loss)	$ 30	$ 270	$ 794	$ (764)

The components of accumulated other comprehensive loss are as follows (in thousands):

	August 31, 2003	November 30, 2002
Foreign currency translation adjustments	$ (332)	$ (698)
Derivative financial instruments gain	-	17
Accumulated other comprehensive loss	$ (332)	$ (681)

Note 12- Stock Options

The Company accounts for stock-based compensation issued to its employees and directors in accordance with Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees", and related Interpretations. Accordingly, the Company has elected to adopt the "disclosure only" provisions of Statement of Financial Accounting Standards No. 148, "Accounting for Stock-Based Compensation - Transition and Disclosure" ("SFAS No. 148"). SFAS No. 148 provides alternative methods of transition for a voluntary change to the fair value method of accounting for stock-based employee compensation. In addition, SFAS No. 148 requires new prominent disclosures in both annual and interim financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reported results.

For SFAS No. 148 purposes, the fair value of each option granted under the Company's stock option plans is estimated as of the date of grant using the Black-Scholes option pricing model with the following weighted average assumptions: risk free interest rate of 2.00% in 2003 and 2002; volatility factor of the expected market price of the Company's Common Stock of 0.50 in 2003 and 0.58 in 2002; dividend yield of 0.00% each year; and a weighted average expected option life of five years.

If the Company had elected to recognize the compensation cost of its stock option plans based on the fair value method of accounting, net income (loss) and earnings (loss) per common share would have been increased (decreased) to the pro forma amounts below (in thousands, except per share data):

	Three Months Ended August 31,		Nine Months Ended August 31,	
	2003	2002	2003	2002

Net income (loss)				
as reported	$ 29	$ 67	$ 445	$ (895)
Less: Stock-based employee				
compensation expense				
determined under fair value				
method, net of related tax effects	173	137	519	411
Pro forma net loss	$ (144)	$ (70)	$ (74)	$ (1,306)
Earnings (loss) per common share:				
Basic, as reported	$ -	$ 0.01	$ 0.03	$ (0.07)
Basic, pro forma	(0.01)	(0.01)	(0.01)	(0.10)
Diluted, as reported	-	0.01	0.03	(0.07)
Diluted, pro forma	(0.01)	(0.01)	(0.01)	(0.10)

Note 13- Reportable Operating Segments

The Company was founded as a solutions - oriented company, designing and manufacturing products to suppress or eliminate electromagnetic interference ("EMI"). In recent years, the Company has broadened its focus and product lines to become a control products and systems company, providing a wide range of components and systems used to condition, regulate, transmit, receive, or govern electronic performance. Effective December 1, 2002, the Company realigned its business segments to better reflect its current strategic focus.

The Company's current operations are conducted in three reportable segments: signal integrity products; power integrity products and management systems; and frequency control products. The Company's Signal Integrity Products Group designs and manufactures a broad range of low pass EMI filters, surface mount EMI filters, filtered arrays, filtered connectors, gaskets, and specialty ceramic capacitors. The Power Integrity Products and Management Systems Group designs and manufactures numerous power integrity products (power line filters, power entry modules, multisection filters, power terminal blocks, and custom power filter assemblies) and power management systems (power distribution units, remote power management systems, fuse interface panels, breaker interface panels, and custom power distribution systems). Our recently developed Frequency Control Products Group designs and manufactures ceramic resonators and bandpass filters, ceramic patch antennas, duplexers, lumped element filters, cavity filters, waveguide filters, and related products and systems. The reportable segments are each managed separately because they manufacture and sell distinct products with different production processes.

The Company evaluates performance and allocates resources to its reportable segments based upon numerous factors, including segment income or loss before income taxes. The accounting policies of the reportable segments are the same as those utilized in the preparation of the Company's consolidated financial statements. However, substantially all of the Company's selling expenses, general and administrative expenses, and nonoperating expenses are not allocated to the Company's reportable operating segments and, accordingly, these expenses are not deducted in arriving at segment income or loss. Segment reportable assets are comprised of certain tangible assets (property, plant, equipment, and inventories) and goodwill.

Prior period amounts in the following tables have been restated to correspond with the new business segment presentation. For each period presented, the accounting policies and procedures used to determine segment income (loss) have been consistently applied. Reportable segment information for the periods ended August 31, 2003 and 2002 is as follows (in thousands):

	Signal Integrity Products	Power Integrity Products and	Frquency Control Products	Total

		Mgt. Systems		
Three Months Ended August 31:				
2003				
Revenue from unaffiliated customers	$ 10,369	$ 3,301	$ 1,684	$ 15,354
Segment income (loss)	2,557	140	(54)	2,643
Segment assets				
Tangible assets	16,489	6,612	1,709	24,810
Goodwill	10,557	3,686	3,776	18,019
2002				
Revenue from unaffiliated customers	11,151	3,293	1,220	15,664
Segment income	2,542	14	46	2,602
Segment assets				
Tangible assets	21,284	8,046	1,080	30,410
Goodwill	10,557	3,686	3,776	