KEY TRONIC CORP
Form 10-Q
November 08, 2018

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

FORM 10-Q

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x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934
FOR THE PERIOD ENDED SEPTEMBER 29, 2018
OR
¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934
FOR THE PERIOD FROM TO .
Commission File Number 0-11559

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

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

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements during the past 90 days. Yes x No ¨
Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulations S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No ¨
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer	¨	Accelerated filer	x
Non-accelerated filer	¨	Smaller reporting company	¨
Emerging growth company	¨		

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ¨
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No x

As of November 6, 2018, 10,759,680 shares of common stock, no par value (the only class of common stock), were outstanding.

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* Items are not applicable

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

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

	September 29, 2018	June 30, 2018
ASSETS		
Current assets:		
Cash and cash equivalents	$ 1,359	$ 343
Trade receivables	64,599	70,262
Contract assets	16,772	—
Inventories, net	99,534	110,315
Other	17,026	13,600
Total current assets	199,290	194,520
Property, plant and equipment, net	27,606	27,548
Other assets:		
Deferred income tax asset	7,145	7,882
Goodwill	9,957	9,957
Other intangible assets, net	3,496	3,726
Other	3,490	2,895
Total other assets	24,088	24,460
Total assets	$ 250,984	$ 246,528
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 77,583	$ 76,198
Accrued compensation and vacation	7,199	8,105
Current portion of debt, net	5,841	5,841
Other	6,977	8,769
Total current liabilities	97,600	98,913
Long-term liabilities:		
Term loans	11,472	12,932
Revolving loan	18,170	16,222
Other long-term obligations	322	380
Total long-term liabilities	29,964	29,534
Total liabilities	127,564	128,447
Commitments and contingencies (Note 9)		
Shareholders' equity:		
Common stock, no par value—shares authorized 25,000; issued and outstanding 10,760 and 10,760 shares, respectively	46,412	46,244
Retained earnings	74,928	72,806
Accumulated other comprehensive gain (loss)	2,080	(969)
Total shareholders' equity	123,420	118,081
Total liabilities and shareholders' equity	$ 250,984	$ 246,528

See accompanying notes to consolidated financial statements.

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

	Three Months Ended	
	September 29, 2018	September 30, 2017
Net sales	$127,472	$109,217
Cost of sales	117,939	101,372
Gross profit	9,533	7,845
Research, development and engineering expenses	1,700	1,510
Selling, general and administrative expenses	5,288	5,171
Total operating expenses	6,988	6,681
Operating income	2,545	1,164
Interest expense, net	677	594
Income before income taxes	1,868	570
Income tax provision	275	138
Net income	$1,593	$432
Net income per share — Basic	$0.15	$0.04
Weighted average shares outstanding — Basic	10,760	10,760
Net income per share — Diluted	$0.15	$0.04
Weighted average shares outstanding — Diluted	10,979	10,760

See accompanying notes to consolidated financial statements.

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

	Three Months Ended	
	September 29, 2018	September 30, 2017
Comprehensive income:		
Net income	$ 1,593	$ 432
Other comprehensive income:		
Unrealized gain on hedging instruments, net of tax	3,049	1,012
Comprehensive income	$ 4,642	$ 1,444

Other comprehensive income for the three months ended September 29, 2018 and September 30, 2017, is reflected net of tax expense of approximately $0.8 million and $0.5 million, respectively.
See accompanying notes to consolidated financial statements.

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

	Three Months Ended	
	September 29, 2018	September 30, 2017
Operating activities:		
Net income	$1,593	$ 432
Adjustments to reconcile net income to cash provided by operating activities:		
Depreciation and amortization	1,913	1,964
Amortization of deferred loan costs	8	8
Provision for obsolete inventory	13	8
Provision for warranty	12	11
Recovery of doubtful accounts	—	(84)
Loss on disposal of assets	2	12
Share-based compensation expense	168	104
Deferred income taxes	(263)	(569)
Changes in operating assets and liabilities:		
Trade receivables	(2,997)	7,542
Contract assets	(4,866)	—
Cash received from arbitration settlement	6,684	—
Inventories	(442)	(4,076)
Other assets	(1,703)	(4,575)
Accounts payable	1,385	3,584
Accrued compensation and vacation	(906)	(2,440)
Other liabilities	(280)	(580)
Cash provided by operating activities	321	1,341
Investing activities:		
Purchase of property and equipment	(1,674)	(1,287)
Proceeds from sale of fixed assets	—	981
Cash receipts from deferred purchase price of factored receivables	1,893	1,378
Cash provided by investing activities	219	1,072
Financing activities:		
Payment of financing costs	(4)	(6)
Repayments of long term debt	(1,468)	(1,468)
Borrowings under revolving credit agreement	51,856	43,387
Repayments of revolving credit agreement	(49,908)	(43,722)
Cash provided by (used in) financing activities	476	(1,809)
Net increase in cash and cash equivalents	1,016	604
Cash and cash equivalents, beginning of period	343	373
Cash and cash equivalents, end of period	$1,359	$ 977
Non-cash investing activities:		
Beneficial interest in transferred receivables	(1,976)	(2,128)
Supplemental cash flow information:		
Interest payments	$685	$ 545
Income tax payments (refunds), net of refunds	$(226)	$ 483

See accompanying notes to consolidated financial statements.

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

	Shares	Common Stock	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total Shareholders' Equity
Balances, June 30, 2018	10,760	$ 46,244	$ 72,806	$ (969)	$ 118,081
Net income	—	—	1,593	—	1,593
ASC 606 Opening Balance Sheet Adjustment	—	—	529	—	529
Unrealized gain on hedging instruments, net	—	—	—	3,049	3,049
Share-based compensation	—	168	—	—	168
Balances, September 29, 2018	10,760	$ 46,412	$ 74,928	$ 2,080	$ 123,420

See accompanying notes to consolidated financial statements.

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

1. Basis of Presentation

The consolidated financial statements included herein have been prepared by Key Tronic Corporation and subsidiaries (the Company) pursuant to the rules and regulations of the Securities and Exchange Commission (SEC). Certain information and footnote disclosures normally included in our annual consolidated financial statements have been condensed or omitted. The year-end condensed consolidated balance sheet information was derived from audited financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States of America. The financial statements reflect all normal and recurring adjustments which, in the opinion of management, are necessary for a fair presentation of the financial position, results of operations and cash flows for the interim periods presented. The preparation of financial statements in accordance with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the reported amounts of revenues and expenses during the reporting period. The results of operations for the periods presented are not necessarily indicative of the results to be expected for the full year. The accompanying unaudited condensed consolidated financial statements should be read in conjunction with the financial statements and notes included in the Company’s Annual Report on Form 10-K for the fiscal year ended June 30, 2018.
The Company’s reporting period is a 52/53 week fiscal year ending on the Saturday closest to June 30. The quarters ended September 29, 2018 and September 30, 2017, were both 13 week periods. Fiscal year 2019 will end on June 29, 2019, which is a 52 week year. Fiscal year 2018 which ended on June 30, 2018, was also a 52 week year.

2. Significant Accounting Policies

Earnings Per Common Share

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

Derivative Instruments and Hedging Activities

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

Income Taxes

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

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

We utilize a two-step approach to recognizing and measuring uncertain tax positions. The first step is to evaluate the tax position for recognition by determining if the weight of available evidence indicates it is more likely than not that the position will be sustained on audit, including resolution of related appeals or litigation processes, if any. The second step is to measure the tax benefit as the largest amount which is more than 50% likely of being realized upon ultimate settlement. We consider many factors when evaluating and estimating our tax positions and tax benefits, which may require periodic adjustments based on new assessments and changes in estimates and which may not accurately forecast actual outcomes. Our policy is to recognize interest and penalties related to the underpayment of income taxes as a component of income tax expense. The tax years 1998 through the present remain open to examination by the major U.S. taxing jurisdictions to which we are subject. Refer to Note 6 for further discussions.

Impairment of Goodwill and Other Intangible Assets

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

Recently Issued Accounting Standards

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update 2014-09 (ASU 2014-09), Revenue from Contracts with Customers (Topic 606) (also referred to as Accounting Standard Codification 606 (“ASC 606”). The standard’s core principle is that a company will recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration to which the company expects to be entitled in exchange for those goods or services. In doing so, companies will need to use more judgment and make more estimates than under current guidance. This may include identifying performance obligations in the contract, estimating the amount of variable consideration to include in the transaction price and allocating the transaction price to each separate performance obligation. Additionally, disclosures required for revenue recognition will include qualitative and quantitative information about contracts with customers, significant judgments and changes in judgments, and assets recognized from costs to obtain or fulfill a contract. Such disclosures are more extensive than what is required under existing GAAP. The Company adopted the standard on July 1, 2018 using the modified retrospective approach by applying the guidance to all open contracts at the adoption date and has implemented revised accounting policies, new operational and financial reporting processes, enhanced systems capabilities and relevant internal controls. As part of adopting ASC 606, revenue for certain customer contracts where the Company is manufacturing products for which there is no alternative use and the Company has an enforceable right to payment including a reasonable profit for work-in-progress inventory will be recognized over time instead of upon shipment of products. In addition to the following disclosures, footnote 13 provides further disclosures required by the new standard.

The cumulative effect of change made to our July 1, 2018 consolidated balance sheet for the adoption of ASC 606 was as follows:

Consolidated Balance Sheet

	Impact of Adopting ASC 606 (Unaudited, in thousands)		
	Balance at June 30, 2018	Adjustments	Balance at July 1, 2018
ASSETS			
Contract assets	—	11,906	11,906
Inventories	110,315	(11,210)	99,105
Deferred income tax asset	7,882	(167)	7,715
LIABILITIES AND SHAREHOLDERS' EQUITY			
Retained earnings	72,806	529	73,335

The following tables summarize the impacts of ASC 606 adoption on the Company's consolidated balance sheets and consolidated statements of income:

Consolidated Balance Sheet

As of September 29, 2018

	Impact of Adopting ASC 606 (Unaudited, in thousands)		
	September 29, 2018	606 Adjustment	Balance without 606 Adoption
ASSETS			
Contract assets	16,772	(16,772)	—
Inventories	99,534	16,154	115,688
Deferred income tax asset	7,145	167	7,312
LIABILITIES AND SHAREHOLDERS' EQUITY			
Retained earnings	74,928	451	75,379

Consolidated Statement of Income

Three months ended September 29, 2018

	Impact of Adopting ASC 606 (Unaudited, in thousands)		
	September 29, 2018	606 Adjustment	Balance without 606 Adoption
Net sales	127,472	4,865	122,607
Cost of sales	117,939	4,944	112,995
Gross profit	9,533	(79)	9,612
Net income	1,593	(79)	1,672

Revenue and gross profit, as reported, for the period ended September 29, 2018 was approximately $127.5 million and $9.5 million, respectively. This reflects the adoption of ASC 606 as revenue would have been approximately $4.9

million less and gross profit $79,000 more without ASC 606 adoption. This is primarily due to the change from 'point-in-time' to 'over-time' recognition as the standard requires. There was not a material tax impact for the three months ended September 29, 2018 from adopting ASC 606.

In February 2016, the FASB issued Accounting Standards Update 2016-02, Leases which supersedes ASC 840 Leases and creates a new topic, ASC 842 Leases. This update requires lessees to recognize a lease asset and a lease liability for all leases, including operating leases, with a term greater than 12 months on its balance sheet. The update also expands the required quantitative and qualitative disclosures surrounding leases. This update will be applied using a modified retrospective transition approach for leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements. Upon initial evaluation, the Company believes the new guidance will have a material impact on its consolidated balance sheets when adopted. The Company intends to adopt the new lease guidance when it becomes effective in the first quarter of fiscal year 2020.
In August 2016, the FASB issued Accounting Standards Update 2016-15, Classification of Certain Cash Receipts and Cash Payments. The update is intended to provide guidance on how certain cash receipts and payments are presented and classified in the statement of cash flows. Under the guidance, cash receipts from the deferred purchase price of the Company's factored receivables will be classified as cash flows from investing activities instead of the Company's former presentation as cash flows from operations. The Company adopted the guidance during the first quarter of fiscal year 2019 and retrospectively adjusted cash flows from operating and investing activities for three-month period ended September 29, 2018 and September 30, 2017; respectively. Upon adoption of the standard, the Company recorded $1.9 million of cash receipts on the deferred purchase price from receivables factored by the Company during the three-months ended September 29, 2018, and reclassified $1.4 million of cash receipts on the deferred purchase price from receivables factored by the Company for the three months end September 30, 2017, from cash flows from operating activities to cash flows from investing activities.
In January 2017, the FASB issued Accounting Standards Update 2017-04, Simplifying the Test for Goodwill Impairment. Under the new standard, goodwill impairment would be measured as the amount by which a reporting unit’s carrying value exceeds its fair value, not to exceed the carrying value of goodwill. This ASU eliminates existing guidance that requires an entity to determine goodwill impairment by calculating the implied fair value of goodwill by hypothetically assigning the fair value of a reporting unit to all of its assets and liabilities as if that reporting unit had been acquired in a business combination. This update is effective prospectively to impairment tests beginning January 1, 2020, with early adoption permitted. The Company would apply this guidance to applicable impairment tests after the adoption date. The Company believes this new guidance will not have a material effect on its consolidated financial statements.
In May 2017, the FASB issued Accounting Standards Update 2017-09, Compensation - Stock Compensation. This update provides guidance about which changes to the terms or conditions of a share-based payment award require an entity to apply modification accounting. The Company adopted the new guidance during the first quarter of fiscal year 2019 and the result had an immaterial impact on its consolidated financial statements.
In August 2017, the FASB issued Accounting Standards Update 2017-12, Derivatives and Hedging, which amends the hedge accounting recognition and presentation requirements in ASC 815. The Board’s objectives in issuing this update are to (1) improve the transparency and understandability of information about an entity’s risk management activities by better aligning the entity’s financial reporting for hedging relationships with those risk management activities and (2) simplify the application of hedge accounting. This update is effective for fiscal years beginning after December 15, 2018. Early adoption is permitted. The Company is currently evaluating the effect of this update on its consolidated financial statements. The Company expects the new guidance will have an immaterial impact on its consolidated financial statements, and it intends to adopt the guidance when it becomes effective in the first quarter of fiscal year 2020.

3. Inventories

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

	September 29, 2018	June 30, 2018
Finished goods	$ 9,507	$ 14,927
Work-in-process	16,966	22,254
Raw materials and supplies	73,061	73,134
	$ 99,534	$ 110,315

As a result of the adoption of ASC 606, amounts that would have been reported as inventory under prior guidance are now included in contract assets on the Consolidated Balance Sheet as disclosed in footnote 2. As a result of this accounting change, finished goods as of September 29, 2018 are $8.3 million less than they would have been had we not adopted ASC 606 and work-in-process inventory as of September 29, 2018 is $7.9 million less than they would have been had we not adopted ASC 606. The comparative information as of June 30, 2018, has not been restated and continues to be reported under the accounting standards in effect at that time.

4. Long-Term Debt

On September 30, 2018, the Company entered into a Fourth amendment to the amended and restated credit agreement to extend the maturity date to August 31, 2021 on the term loan in the amount of $35.0 million that was used to acquire all of the outstanding shares of CDR Manufacturing, Inc. (dba Ayrshire Electronics). The term loan requires quarterly payments of $1.25 million through June 15, 2021, with a final payment of the remaining outstanding balance on August 31, 2021. The Company had an outstanding balance of $15.0 million and $16.3 million under the term loan as of September 29, 2018 and June 30, 2018, respectively.

On August 6, 2015, the Company entered into a First Amendment to the amended and restated credit agreement extending the limit on our line of credit facility to $45.0 million as evidenced by the Second Replacement Revolving Note. The agreement specifies that the proceeds of the revolving line of credit be used primarily for working capital and general corporate purposes. The line of credit is secured by substantially all of the assets of the Company. On September 30, 2018, the Company entered into a Fourth amendment to the amended and restated credit agreement to extend the maturity date to November 1, 2023, at which time all outstanding balances are payable. As of September 29, 2018, the Company had an outstanding balance under the credit facility of $18.2 million, $0.4 million in outstanding letters of credit and $26.4 million available for future borrowings. As of June 30, 2018, the Company had an outstanding balance under the credit facility of $16.2 million, $0.4 million in outstanding letters of credit and $28.4 million available for future borrowings.

On December 28, 2016, the Company entered into an equipment term loan agreement in the amount of $3.9 million in order to further invest in production equipment. The equipment term loan is collateralized by production equipment. Under this loan agreement, equal quarterly payments of approximately $0.2 million commenced on March 31, 2017 and will continue through the maturity of the equipment term loan on June 30, 2021. Amortization of the debt issuance costs is reported as interest expense on the consolidated income statement. As of September 29, 2018, the Company had an outstanding balance of $2.4 million. As of June 30, 2018, the Company had an outstanding balance of $2.6 million. The Company has available an additional $2.1 million which can be borrowed in the future under this agreement.

Borrowings under the revolving line of credit, term loan and equipment term loan bear interest at either a “Base Rate” or a “Fixed Rate,” as elected by the Company. The base rate is the higher of the Wells Fargo Bank prime rate, daily one month London Interbank Offered Rate (LIBOR) plus 1.5%, or the Federal Funds rate plus 1.5%. The fixed rate is LIBOR plus 1.75%, LIBOR plus 2.00%, or LIBOR plus 2.25% depending on the level of the Company’s trailing four quarters Earnings Before Interest, Taxes, Depreciation and Amortization (EBITDA). The interest rates on outstanding debt as of September 29, 2018 range from 4.07% - 5.25% compared to 4.09% - 5.00% as of June 30, 2018.

Debt maturities as of September 29, 2018 for the next five years and thereafter are as follows (in thousands):

Fiscal Years Ending	Amount
2019 [1]	$4,403
2020	5,871
2021	5,871
2022	1,250
2023	—
Thereafter	18,170
Total debt	$35,565
Unamortized debt issuance costs	$(82)
Long-term debt, net of debt issuance costs	$35,483

(1) Represents scheduled payments for the remaining nine-month period ending June 29, 2019.

The Company must comply with certain financial covenants, including a cash flow leverage ratio, an asset coverage ratio, and a fixed charge coverage ratio. The credit agreement requires the Company to maintain a minimum profit threshold, limits the maximum capital lease expenditures and restricts the Company from declaring or paying dividends in cash or stock without prior bank approval. The Company was not in compliance with all financial covenants as of June 30, 2018 due to the loss recognized by the arbitration settlement. However, the Company obtained a waiver from Wells Fargo Bank with respect to the noncompliance as of June 30, 2018. The Company was in compliance with all financial covenants as of September 29, 2018.

5. Trade Accounts Receivable Purchase Programs

Sale Programs

The Company utilizes an Account Purchase Agreement with Wells Fargo Bank, N.A. ("WFB") which allows the Company to sell and assign to WFB and WFB may purchase from the Company the accounts receivable of certain Company customers in a maximum aggregate amount outstanding of $25.0 million. This agreement may be cancelled at any time by either party. The Company also has an Account Purchase Agreement with Orbian Financial Services ("Orbian"). This agreement allows the Company to sell accounts receivable of certain customers to Orbian and the agreement may be cancelled at any time by either party.

Total accounts receivables sold during the three months ended September 29, 2018 and September 30, 2017 was approximately $22.2 million and $28.0 million, respectively. Accounts receivables sold and not yet collected were $2.0 million and $2.0 million as of September 29, 2018 and June 30, 2018, respectively. The receivables that were sold were removed from the condensed consolidated balance sheets and the cash received is reflected as cash provided by operating activities in the condensed consolidated statements of cash flows. Cash receipts related to the deferred purchase price from receivables factored by the Company is reflected as cash provided by investing activities.

6. Income Taxes

On December 22, 2017, the Tax Cuts and Jobs Act ("Tax Act") was signed into law. The Tax Act reduced Federal corporate tax rates effective January 1, 2018 and changed certain other provisions, many of which were not effective until fiscal year 2019.

As a result of the change of the U.S. tax system under the Tax Act from a global to a territorial model, a deemed one-time repatriation of all accumulated earnings and profits (AE&P) in Mexico and China occurred on December 31, 2017. For purposes of calculating the toll tax associated with this deemed repatriation, AE&P pools are stratified into two asset categories, subjected to certain allowable deductions and then the net amounts are subjected to the toll tax (15.5% for cash/cash equivalents and 8% for illiquid assets). Management has previously relied upon estimates of AE&P and the related tax pools in Mexico and China in order to calculate the amount of foreign earnings that may potentially be repatriated and the resulting potential U.S. tax liability (see further discussion below). Management has undertaken formal studies of the AE&P and tax pools in both Mexico and China and increased its provisional calculation of the toll tax liability in the fourth quarter of fiscal year 2018.

Compliance with the 2017 Tax Act will require significant complex computations not previously required by U.S. tax law. It is unclear how certain provisions of the 2017 Tax Act will be applied absent further legislative, regulatory, or accounting clarification and guidance. Also, on December 22, 2017, the staff of the SEC issued Staff Accounting Bulletin No. 118 ("SAB No. 118"). SAB No. 118 provides guidance on accounting for the tax effects of the 2017 Tax Act and allows registrants to record provisional amounts for a period of up to one year from the date of enactment of the 2017 Tax Act. We expect to refine and complete the accounting for the 2017 Tax Act during the second quarter of fiscal year 2019 as we finalize the formal AE&P and tax pools studies and as additional legislative, regulatory, and accounting guidance and interpretations become available.

In future years, because of the toll tax on AE&P described above, repatriations of cash will generally be tax-free in the U.S. However, withholding taxes in China and Mexico may still apply to any such future repatriations. Management has not changed its indefinite investment assertions with regards to the portion of AE&P in each jurisdiction that may be repatriated in the future. Accordingly, management estimates that future repatriations of cash from China may result in approximately $0.8 million of withholding tax. There would be no offsetting foreign tax credits in the U.S. and as such, this potential liability is a direct cost associated with actual repatriations.

A similar analysis was conducted with anticipated future repatriations in Mexico. Under Mexican tax law, any previously taxed earnings from before 2014 ("CUFIN") are not subject to withholding when monies are repatriated to another country. Based on management's estimated future repatriations from Mexico and based on the estimated AE&P in Mexico as of December 31, 2013, no withholding tax liability has been recognized as of September 29, 2018. If, in the future, estimated future repatriations exceed CUFIN, the Company will be required to recognize a withholding tax as a deferred tax liability at that time. Similar to China, this withholding would not be creditable and would be a direct cost associated with the actual repatriation.

The Company expects to repatriate a portion of its foreign earnings based on increased net sales growth driving additional capital requirements domestically, cash requirements for potential acquisitions and to implement certain tax strategies. The Company currently expects to repatriate approximately $15.1 million of foreign earnings in the future. All other unremitted foreign earnings are expected to remain permanently reinvested for planned fixed assets purchases and improvements in foreign locations.

The Company has available approximately $8.2 million of gross federal research and development tax credits as of September 29, 2018. ASC 740 requires the Company to recognize in its financial statements uncertainties in tax positions taken that may not be sustained upon examination by the taxing authorities. Accordingly, as of September 29, 2018, the Company has recorded $4.0 million of unrecognized tax benefits associated with these federal tax credits, resulting in a net deferred tax benefit of approximately $4.2 million.

7. Earnings Per Share

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

	Three Months Ended (in thousands, except per share information)	
	September 29, 2018	September 30, 2017
Net income	$ 1,593	$ 432
Weighted average shares outstanding—basic	10,760	10,760
Effect of dilutive common stock awards	219	—
Weighted average shares outstanding—diluted	10,979	10,760
Net income per share—basic	$ 0.15	$ 0.04
Net income per share—diluted	$ 0.15	$ 0.04
Antidilutive SARs not included in diluted earnings per share	793	1,140

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8. Share-based Compensation

The Company's incentive plan provides for equity and liability awards to employees and non-employee directors in the form of stock options, stock appreciation rights (SARs), restricted stock, restricted stock units, stock awards, stock units, performance shares, performance units, and other stock-based or cash-based awards. Compensation cost is recognized on a straight-line basis over the requisite employee service period, which is generally the vesting period, and is recorded as employee compensation expense in cost of goods sold, research, development and engineering, and selling, general and administrative expenses. Share-based compensation is recognized only for those awards that are expected to vest, with forfeitures estimated at the date of grant based on historical experience and future expectations. In addition to service conditions, SARs contain a performance condition. The additional performance condition is based upon the achievement of Return on Invested Capital (ROIC) goals relative to a peer group. All awards with performance conditions are evaluated quarterly to determine the likelihood that performance metrics will be achieved during the performance period. These awards are charged to compensation expense over the requisite service period based on the number of shares expected to vest. The SARs cliff vest after a three-year period from date of grant and expire five years from date of grant.

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

	July 27, 2018	July 28, 2017
SARs Granted	161,250	272,500
Strike Price	$ 8.17	$ 7.26
Fair Value	$ 2.27	$ 1.89

Total share-based compensation expense recognized during the three months ended September 29, 2018 and September 30, 2017 was approximately $168,000 and $104,000, respectively. As of September 29, 2018, total unrecognized compensation expense related to unvested share-based compensation arrangements was approximately $0.7 million. This expense is expected to be recognized over a weighted average period of 2.07 years. No SARs were exercised during the three months ended September 29, 2018 or September 30, 2017.

9. Commitments and Contingencies

Litigation and Other Matters

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

Warranties

The Company provides warranties on certain product sales. Allowances for estimated warranty costs are recorded during the period of sale. The determination of such allowances requires the Company to make estimates of product return rates and expected costs to repair or to replace the products under warranty. If actual return rates and/or repair and replacement costs differ significantly from management's estimates, adjustments to recognize additional cost of sales may be required in future periods. The Company's warranty reserve was approximately $18,000 as of September 29, 2018 and $20,000 as of June 30, 2018, respectively.

10. Fair Value Measurements

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

The following table summarizes the fair value of assets (liabilities) of the Company's derivatives that are required to be measured on a recurring basis as of September 29, 2018 and June 30, 2018 (in thousands):

	September 29, 2018			
	Level 1	Level 2	Level 3	Total Fair Value
Financial Assets:				
Interest rate swaps	$ —	$ 24	$ —	$ 24
Foreign currency forward contracts & swaps	$ —	$ 2,801	$ —	$ 2,801
Financial Liabilities:				
Foreign currency forward contracts & swaps	$ —	$ (94)	$ —	$ (94)

	June 30, 2018			
	Level 1	Level 2	Level 3	Total Fair Value
Financial Assets:				
Interest rate swaps	$ —	$ 24	$ —	$ 24