

LSI INDUSTRIES INC
Form 10-Q
November 04, 2016
UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

X QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT
OF 1934 FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2016.

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT
OF 1934 FOR THE TRANSITION PERIOD FROM _____ TO _____.

Commission File No. 0-13375

LSI Industries Inc.

State of Incorporation - Ohio IRS Employer I.D. No. 31-0888951

10000 Alliance Road

Cincinnati, Ohio 45242

(513) 793-3200

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Indicate by checkmark 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 checkmark whether the registrant has submitted electronically and posted on its corporate web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T 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 checkmark whether the Registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer [☐] Accelerated filer [☒]
Non-accelerated filer [☐] Smaller reporting company [☐]

Indicate by checkmark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes _____ NO X

As of October 27, 2016 there were 25,014,252 shares of the Registrant's common stock, no par value per share, outstanding.

LSI INDUSTRIES INC.

FORM 10-Q

FOR THE QUARTER ENDED SEPTEMBER 30, 2016

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"Safe Harbor" Statement under the Private Securities Litigation Reform Act of 1995

This Form 10-Q contains certain forward-looking statements that are subject to numerous assumptions, risks or uncertainties. The Private Securities Litigation Reform Act of 1995 provides a safe harbor for forward-looking statements. Forward-looking statements may be identified by words such as "estimates," "anticipates," "projects," "plans," "expects," "intends," "believes," "seeks," "may," "will," "should" or the negative versions of those words and similar expressions, and by the context in which they are used. Such statements, whether expressed or implied, are based upon current expectations of the Company and speak only as of the date made. Actual results could differ

materially from those contained in or implied by such forward-looking statements as a result of a variety of risks and uncertainties over which the Company may have no control. These risks and uncertainties include, but are not limited to, the impact of competitive products and services, product demand and market acceptance risks, potential costs associated with litigation and regulatory compliance, reliance on key customers, financial difficulties experienced by customers, the cyclical and seasonal nature of our business, the adequacy of reserves and allowances for doubtful accounts, fluctuations in operating results or costs whether as a result of uncertainties inherent in tax and accounting matters or otherwise, unexpected difficulties in integrating acquired businesses, the ability to retain key employees of acquired businesses, unfavorable economic and market conditions, the results of asset impairment assessments and the other risk factors that are identified herein. You are cautioned to not place undue reliance on these forward-looking statements. In addition to the factors described in this paragraph, the risk factors identified in our Form 10-K and other filings the Company may make with the SEC constitute risks and uncertainties that may affect the financial performance of the Company and are incorporated herein by reference. The Company does not undertake and hereby disclaims any duty to update any forward-looking statements to reflect subsequent events or circumstances.

PART I. FINANCIAL INFORMATION**ITEM 1. FINANCIAL STATEMENTS**

LSI INDUSTRIES INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

| | Three Months Ended September 30 | |
|--|---------------------------------------|----------|
| <i>(In thousands, except per share data)</i> | 2016 | 2015 |
| Net sales | \$84,159 | \$85,925 |
| Cost of products and services sold | 62,821 | 62,576 |
| Restructuring costs | 503 | -- |
| Gross profit | 20,835 | 23,349 |
| Restructuring costs | 153 | -- |
| Selling and administrative expenses | 19,616 | 17,586 |
| Operating income | 1,066 | 5,763 |
| Interest (income) | (27) | (8) |
| Interest expense | 13 | 8 |
| Income before income taxes | 1,080 | 5,763 |
| Income tax expense | 251 | 2,013 |
| Net income | \$829 | \$3,750 |
| Earnings per common share (see Note 4) | | |
| Basic | \$0.03 | \$0.15 |

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| | | |
|---------|--------|--------|
| Diluted | \$0.03 | \$0.15 |
|---------|--------|--------|

Weighted average common shares outstanding

| | | |
|---------|--------|--------|
| Basic | 25,275 | 24,764 |
| Diluted | 25,912 | 25,194 |

The accompanying Notes to Condensed Consolidated Financial Statements are an integral part of these financial statements.

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LSI INDUSTRIES INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(Unaudited)

(In thousands, except shares)

| | September 30, 2016 | June 30, 2016 |
|--|--------------------------|------------------|
| ASSETS | | |
| Current Assets | | |
| Cash and cash equivalents | \$ 30,714 | \$33,835 |
| Accounts receivable, less allowance for doubtful accounts of \$293 and \$226, respectively | 46,234 | 46,975 |
| Inventories | 43,600 | 44,141 |
| Other current assets | 3,455 | 2,792 |
| Total current assets | 124,003 | 127,743 |
| Property, Plant and Equipment, at cost | | |
| Land | 6,995 | 6,978 |
| Buildings | 39,382 | 39,317 |
| Machinery and equipment | 78,514 | 82,628 |
| Construction in progress | 1,731 | 838 |
| | 126,622 | 129,761 |
| Less accumulated depreciation | (78,931) | (82,299) |
| Net property, plant and equipment | 47,691 | 47,462 |
| Goodwill | 10,508 | 10,508 |
| Other Intangible Assets, net | 5,479 | 5,586 |
| Other Long-Term Assets, net | 5,144 | 4,261 |
| Total assets | \$ 192,825 | \$195,560 |

The accompanying Notes to Condensed Consolidated Financial Statements are an integral part of these financial statements.

LSI INDUSTRIES INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(Unaudited)

| | September 30, 2016 | June 30, 2016 |
|--|--------------------------|------------------|
| <i>(In thousands, except shares)</i> | | |
| LIABILITIES & SHAREHOLDERS' EQUITY | | |
| Current Liabilities | | |
| Accounts payable | \$ 14,284 | \$ 13,892 |
| Accrued expenses | 20,506 | 25,341 |
| Total current liabilities | 34,790 | 39,233 |
| Other Long-Term Liabilities | 1,144 | 807 |
| Commitments and Contingencies (Note 12) | | |
| Shareholders' Equity | | |
| Preferred shares, without par value; Authorized 1,000,000 shares, none issued | — | — |
| Common shares, without par value; Authorized 40,000,000 shares; Outstanding 24,997,531 and 24,982,219 shares, respectively | 115,451 | 113,653 |
| Retained earnings | 41,440 | 41,867 |
| Total shareholders' equity | 156,891 | 155,520 |
| Total liabilities & shareholders' equity | \$ 192,825 | \$ 195,560 |

The accompanying Notes to Condensed Consolidated Financial Statements are an integral part of these financial statements.

LSI INDUSTRIES INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

| <i>(In thousands)</i> | Three Months Ended September 30 | |
|--|---------------------------------------|----------|
| | 2016 | 2015 |
| Cash Flows from Operating Activities | | |
| Net income | \$ 829 | \$ 3,750 |
| Non-cash items included in net income: | | |
| Depreciation and amortization | 1,835 | 1,576 |
| Deferred income taxes | (825) | (396) |
| Deferred compensation plan | 198 | 175 |
| Stock compensation expense | 1,741 | 1,775 |
| Issuance of common shares as compensation | 103 | 49 |
| Loss on disposition of fixed assets | 1 | 1 |
| Fixed asset impairment | 273 | -- |
| Allowance for doubtful accounts | 113 | 94 |
| Inventory obsolescence reserve | 573 | 367 |
| Changes in certain assets and liabilities – excluding sale of subsidiary | | |
| Accounts receivable | 628 | (2,853) |
| Inventories | (32) | (2,065) |
| Refundable income taxes | -- | 99 |
| Accounts payable | 121 | 224 |
| Accrued expenses and other | (5,487) | (275) |
| Customer prepayments | 268 | 431 |
| Net cash flows provided by operating activities | 339 | 2,952 |
| Cash Flows from Investing Activities | | |
| Purchases of property, plant and equipment | (1,960) | (1,362) |
| Net cash flows provided by (used in) investing activities | (1,960) | (1,362) |
| Cash Flows from Financing Activities | | |
| Cash dividends paid | (1,256) | (735) |
| Proceeds and tax benefits from exercises of stock options | 58 | 1,335 |
| Purchase of treasury shares | (344) | (228) |
| Issuance of treasury shares | 42 | 14 |
| Net cash flows provided by (used in) financing activities | (1,500) | 386 |
| Increase (decrease) in cash and cash equivalents | (3,121) | 1,976 |

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| | | |
|--|----------|----------|
| Cash and cash equivalents at beginning of period | 33,835 | 26,409 |
| Cash and cash equivalents at end of period | \$30,714 | \$28,385 |

The accompanying Notes to Condensed Consolidated Financial Statements are an integral part of these financial statements.

LSI INDUSTRIES INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

NOTE 1 - INTERIM CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

The interim condensed consolidated financial statements are unaudited and are prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information, and rules and regulations of the Securities and Exchange Commission. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to such rules and regulations. In the opinion of management, the interim financial statements include all normal adjustments and disclosures necessary to present fairly the Company's financial position as of September 30, 2016, the results of its operations for the three month periods ended September 30, 2016 and 2015, and its cash flows for the three month periods ended September 30, 2016 and 2015. These statements should be read in conjunction with the financial statements and footnotes included in the fiscal 2016 Annual Report on Form 10-K. Financial information as of June 30, 2016 has been derived from the Company's audited consolidated financial statements.

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Consolidation:

The consolidated financial statements include the accounts of LSI Industries Inc. (an Ohio corporation) and its subsidiaries (collectively, the "Company"), all of which are wholly owned. All intercompany transactions and balances have been eliminated in consolidation.

Revenue Recognition:

Revenue is recognized when title to goods and risk of loss have passed to the customer, there is persuasive evidence of a purchase arrangement, delivery has occurred or services have been rendered, and collectability is reasonably

assured. Revenue is typically recognized at time of shipment. In certain arrangements with customers, as is the case with the sale of some of our solid-state LED (light emitting diode) video screens, revenue is recognized upon customer acceptance of the video screen at the job site. Sales are recorded net of estimated returns, rebates and discounts. Amounts received from customers prior to the recognition of revenue are accounted for as customer pre-payments and are included in accrued expenses.

The Company has five sources of revenue: revenue from product sales; revenue from installation of products; service revenue generated from providing integrated design, project and construction management, site engineering and site permitting, and commissioning of lighting controls; revenue from the management of media content and digital hardware related to active digital signage; and revenue from shipping and handling.

Product revenue is recognized on product-only orders upon passing of title and risk of loss, generally at time of shipment. However, product revenue related to orders where the customer requires the Company to install the product is recognized when the product is installed. The Company provides product warranties and certain post-shipment service, support and maintenance of certain solid state LED video screens.

Installation revenue is recognized when the products have been fully installed. The Company is not always responsible for installation of products it sells and has no post-installation responsibilities, other than normal warranties.

Service revenue from integrated design, project and construction management, and site permitting is recognized when all products at each customer site have been installed.

Revenue from the management of media content and digital hardware related to active digital signage is recognized evenly over the service period with the customer. Media content service periods with most customers range from one month to one year.

Shipping and handling revenue coincides with the recognition of revenue from sale of the product.

In situations where the Company is responsible for re-imaging programs with multiple sites, each site is viewed as a separate unit of accounting and has stand-alone value to the customer. Revenue is recognized upon the Company's complete performance at the location, which may include a site survey, graphics products, lighting products, and installation of products. The selling price assigned to each site is based upon an agreed upon price between the Company and its customer and reflects the estimated selling price for that site relative to the selling price for sites with similar image requirements.

The Company also evaluates the appropriateness of revenue recognition in accordance with the accounting standards on software revenue recognition. Our solid-state LED video screens and active digital signage contain software elements which the Company has determined are incidental.

Credit and Collections:

The Company maintains allowances for doubtful accounts receivable for probable estimated losses resulting from either customer disputes or the inability of its customers to make required payments. If the financial condition of the Company's customers were to deteriorate, resulting in their inability to make the required payments, the Company may be required to record additional allowances or charges against income. The Company determines its allowance for doubtful accounts by first considering all known collectability problems of customers' accounts, and then applying certain percentages against the various aging categories based on the due date of the remaining receivables. The resulting allowance for doubtful accounts receivable is an estimate based upon the Company's knowledge of its business and customer base, and historical trends. Receivables deemed uncollectable are written-off against the allowance for doubtful accounts receivable after all reasonable collection efforts have been exhausted. The Company also establishes allowances, at the time revenue is recognized, for returns, discounts, pricing and other possible customer deductions. These allowances are based upon historical trends.

The following table presents the Company's net accounts receivable at the dates indicated.

| <i>(In thousands)</i> | September 30, 2016 | June 30, 2016 |
|---------------------------------------|--------------------------|------------------|
| Accounts receivable | \$ 46,527 | \$47,201 |
| Less: Allowance for doubtful accounts | (293) | (226) |
| Accounts receivable, net | \$ 46,234 | \$46,975 |

Cash and Cash Equivalents:

The cash balance includes cash and cash equivalents which have original maturities of less than three months. Cash and cash equivalents consist primarily of bank deposits and a bank money market account that is stated at cost, which approximates fair value. The Company maintains balances at financial institutions in the United States. In the United States, the FDIC limit for insurance coverage on non-interest bearing accounts is \$250,000. As of September 30, 2016 and June 30, 2016, the Company had bank balances of \$34,816,000 and \$37,883,000, respectively, without insurance coverage.

Inventories and Inventory Reserves:

Inventories are stated at the lower of cost or market. Cost of inventories includes the cost of purchased raw materials and components, direct labor, as well as manufacturing overhead which is generally applied to inventory based on direct labor and on material content. Cost is determined on the first-in, first-out basis.

The Company maintains an inventory reserve for probable obsolescence of its obsolete and excess inventory. The Company first determines its obsolete inventory reserve by considering specific known obsolete items, and then by applying certain percentages to specific inventory categories based upon inventory turns. The Company uses various tools, in addition to inventory turns, to identify which inventory items have the potential to become obsolete. Judgment is used to establish excess and obsolete inventory reserves and management adjusts these reserves as more information becomes available about the ultimate disposition of the inventory item.

Property, Plant and Equipment and Related Depreciation:

Property, plant and equipment are stated at cost. Major additions and betterments are capitalized while maintenance and repairs are expensed. For financial reporting purposes, depreciation is computed on the straight-line method over the estimated useful lives of the assets as follows:

| | |
|------------------------------------|-------|
| Buildings (in years) | 28-40 |
| Machinery and equipment (in years) | 3 -10 |
| Computer software (in years) | 3 -8 |

Costs related to the purchase, internal development, and implementation of the Company's fully integrated enterprise resource planning/business operating software system are either capitalized or expensed. Leasehold improvements are depreciated over the shorter of fifteen years or the remaining term of the lease.

The Company recorded \$1,728,000 and \$1,450,000 of depreciation expense in the first quarter of fiscal 2017 and 2016, respectively.

Intangible Assets:

Intangible assets consisting of customer relationships, trade names and trademarks, patents, technology and software, and non-compete agreements are recorded on the Company's balance sheet. The definite-lived intangible assets are being amortized to expense over periods ranging between seven and twenty years. The Company evaluates definite-lived intangible assets for permanent impairment when triggering events are identified. Neither indefinite-lived intangible assets nor the excess of cost over fair value of assets acquired ("goodwill") are amortized, however they are subject to review for impairment. See additional information about goodwill and intangibles in Note 7.

Fair Value:

The Company has financial instruments consisting primarily of cash and cash equivalents, revolving lines of credit, accounts receivables, accounts payable, and on occasion, long-term debt. The fair value of these financial instruments approximates carrying value because of their short-term maturity and/or variable, market-driven interest rates. The Company has no financial instruments with off-balance sheet risk.

Fair value measurements of nonfinancial assets and nonfinancial liabilities are primarily used in goodwill and other intangible asset impairment analyses, long-lived asset impairment analysis, in the purchase price of acquired companies (if any), and in the valuation of the contingent earn-out. The accounting guidance on fair value measurement was used to measure the fair value of these nonfinancial assets and nonfinancial liabilities.

Product Warranties:

The Company offers a limited warranty that its products are free from defects in workmanship and materials. The specific terms and conditions vary somewhat by product line, but generally cover defective products returned within one to five years, with some exceptions where the terms extend to 10 years, from the date of shipment. The Company records warranty liabilities to cover the estimated future costs for repair or replacement of defective returned products as well as products that need to be repaired or replaced in the field after installation. The Company calculates its liability for warranty claims by applying estimates to cover unknown claims, as well as estimating the total amount to be incurred for known warranty issues. The Company periodically assesses the adequacy of its recorded warranty liabilities and adjusts the amounts as necessary.

Changes in the Company's warranty liabilities, which are included in accrued expenses in the accompanying consolidated balance sheets, during the periods indicated below were as follows:

| | Three Months Ended September 30, 2016 | Three Months Ended September 30, 2015 | Fiscal Year Ended June 30, 2016 |
|---|--|--|--|
| <i>(In thousands)</i> | | | |
| Balance at beginning of the period | \$ 5,069 | \$ 3,408 | \$3,408 |
| Additions charged to expense | 903 | 877 | 5,069 |
| Deductions for repairs and Replacements | (624) | (615) | (3,408) |
| Balance at end of the period | \$ 5,348 | \$ 3,670 | \$5,069 |

Research and Development Costs:

Research and development expenses are costs directly attributable to new product development, including the development of new technology for both existing and new products, and consist of salaries, payroll taxes, employee benefits, materials, outside legal costs and filing fees related to obtaining patents, supplies, depreciation and other administrative costs. The Company expenses as research and development all costs associated with development of software used in solid-state LED products. All costs are expensed as incurred and are included in selling and administrative expenses. Research and development costs related to both product and software development totaled \$1,401,000 and \$1,311,000 for the three months ended September 30, 2016 and 2015, respectively.

Cost of Products and Services Sold:

Cost of products sold is primarily comprised of direct materials and supplies consumed in the manufacture of products, as well as manufacturing labor, depreciation expense and direct overhead expense necessary to acquire and convert the purchased materials and supplies into finished product. Cost of products sold also includes the cost to distribute products to customers, inbound freight costs, internal transfer costs, warehousing costs and other shipping and handling activity. Cost of services sold is primarily comprised of the internal and external labor costs required to support the Company's service revenue along with the management of media content.

Earnings Per Common Share:

The computation of basic earnings per common share is based on the weighted average common shares outstanding for the period net of treasury shares held in the Company's nonqualified deferred compensation plan. The computation of diluted earnings per share is based on the weighted average common shares outstanding for the period and includes common share equivalents. Common share equivalents include the dilutive effect of stock options, restricted stock units, contingently issuable shares and common shares to be issued under a deferred compensation plan, all of which totaled 914,000 and 693,000 shares for the three month ended September 30, 2016 and 2015, respectively. See further discussion of earnings per share in Note 4.

Income Taxes:

The Company accounts for income taxes in accordance with the accounting guidance for income taxes. Accordingly, deferred income taxes are provided on items that are reported as either income or expense in different time periods for financial reporting purposes than they are for income tax purposes. Deferred income tax assets and liabilities are

reported on the Company's balance sheet. Significant management judgment is required in developing the Company's income tax provision, including the estimation of taxable income and the effective income tax rates in the multiple taxing jurisdictions in which the Company operates, the estimation of the liability for uncertain income tax positions, the determination of deferred tax assets and liabilities, and any valuation allowances that might be required against deferred tax assets.

New Accounting Pronouncements:

In June 2014, the Financial Accounting Standards Board issued ASU 2014-09, "Revenue from Contracts with Customers." This amended guidance supersedes and replaces all existing U.S. GAAP revenue recognition guidance. The guidance established a new revenue recognition model, changes the basis for deciding when revenue is recognized, provides new and more detailed guidance on specific revenue topics, and expands and improves disclosures about revenue. In April 2016, the FASB issued ASU 2016-10, "Revenue from Contracts with Customers: Identifying Performance Obligations and Licensing." In May 2016, the FASB issued ASU 2016-12, "Revenue from Contracts with Customers: Narrow Scope Improvements and Practical Expedients." Both of these standards clarify or improve guidance from ASU 2014-09. These standards are effective for fiscal years and interim periods within those years, beginning after December 15, 2017, or the Company's fiscal year 2019. The Company is evaluating the impact the amended guidance will have on its financial statements.

In November 2015, the FASB issued ASU 2015-17, "Balance Sheet Classification of Deferred Taxes," which eliminates the current requirement to separate deferred income tax liabilities and assets into current and noncurrent amounts in the statement of financial position. This update requires that deferred tax liabilities and assets be classified as noncurrent. This update is effective for financial statements issued for fiscal years beginning April 1, 2017. This update may be applied either prospectively or retrospectively. However, early adoption is permitted and we have chosen to adopt the standard retrospectively as of June 30, 2016. As a result, prior periods have been adjusted to reflect this change. This update impacted the presentation, but not the measurement of deferred tax liabilities and assets.

Comprehensive Income:

The Company does not have any comprehensive income items other than net income.

Subsequent Events:

The Company has evaluated subsequent events for potential recognition and disclosure through the date the consolidated financial statements were filed. No items were identified during this evaluation that required adjustment to or disclosure in the accompanying financial statements.

Reclassifications:

Certain prior year balance sheet amounts have been reclassified to conform to new accounting guidance on balance sheet classification of deferred taxes. These reclassifications have no impact on net income, earnings per share, or operating cash flows.

Use of Estimates:

The preparation of the financial statements in conformity with accounting principles generally accepted in the United States of America requires the Company to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

NOTE 3 - SEGMENT REPORTING INFORMATION

The accounting guidance on Segment Reporting establishes standards for reporting information regarding operating segments in annual financial statements and requires selected information of those segments to be presented in financial statements. Operating segments are identified as components of an enterprise for which separate discrete financial information is available for evaluation by the chief operating decision maker (the Company's Chief Executive Officer or "CODM") in making decisions on how to allocate resources and assess performance. The Company's three operating segments are Lighting, Graphics, and Technology, each of which has a president who is responsible for that

business and reports to the CODM. Corporate and Eliminations, which captures the Company's corporate administrative activities, will also be reported in the segment information.

The Lighting Segment includes outdoor and indoor lighting utilizing both traditional and LED light sources that have been fabricated and assembled for the commercial, industrial market, the petroleum / convenience store market, the automotive dealership market, the quick service restaurant market, along with other markets the Company serves.

The Graphics Segment designs, manufactures and installs exterior and interior visual image elements such as traditional graphics, active digital signage along with the management of media content related to digital signage, LED video screens, and menu board systems that are either digital or traditional by design. These products are used in visual image programs in several markets, including the petroleum / convenience store market, multi-site retail operations, banking, and restaurants. The Graphics Segment implements, installs and provides program management services related to products sold by the Graphics Segment and by the Lighting Segment.

LED video screens that were previously reported in the Technology Segment in prior years' results have been reclassified to report LED video screen sales in the Graphics Segment. The movement of the LED video screen product line was the result of a change in management responsibility of this product line to the Graphics Segment president during the first quarter of fiscal 2017. This movement aligns the product line with other digital visual image elements sold to graphics customers and is consistent with how the Company's CODM manages the business. The movement of the video screen product line resulted in a reclassification of \$73,000 of operating income from the Technology Segment to the Graphics Segment in the first quarter of fiscal 2016. The distribution channels and corresponding projected future cash flows that support a customer relationship intangible asset related to the LED video screen product line have been deemed to be adequate to support the asset. The net book value of the asset is \$505,000 as of September 30, 2016 and the cash flows generated from this asset will continue to be monitored in future quarters.

The Technology Segment designs, engineers, and manufactures electronic circuit boards, assemblies and sub-assemblies, and various control system products used in other applications (primarily the control of solid-state LED lighting). This operating segment sells its products directly to customers (primarily in the transportation, original equipment manufacturers, sports, and medical markets) and also has significant inter-segment sales to the Lighting Segment.

The Company's corporate administration activities are reported in a line item titled Corporate and Eliminations. This primarily includes intercompany profit in inventory eliminations, expense related to certain corporate officers and support staff, the Company's internal audit staff, expense related to the Company's Board of Directors, stock option expense for options granted to corporate administration employees, certain consulting expenses, investor relations activities, and a portion of the Company's legal, auditing and professional fee expenses. Corporate identifiable assets primarily consist of cash, invested cash (if any), refundable income taxes (if any), and deferred income tax assets.

There was no concentration of consolidated net sales in the three months ended September 30, 2016 or 2015. There was no concentration of accounts receivable at June 30, 2016 or 2015.

Summarized financial information for the Company's operating segments is provided for the indicated periods and as of September 30, 2016 and September 30, 2015:

| <i>(In thousands)</i> | Three Months Ended September 30 | |
|---------------------------------------|---------------------------------------|----------|
| | 2016 | 2015 |
| Net Sales: | | |
| Lighting Segment | \$60,370 | \$59,075 |
| Graphics Segment | 18,894 | 22,330 |
| Technology Segment | 4,895 | 4,520 |
| | \$84,159 | \$85,925 |
| Operating Income (Loss): | | |
| Lighting Segment | \$2,791 | \$5,682 |
| Graphics Segment | 1,017 | 2,234 |
| Technology Segment | 728 | 1,267 |
| Corporate and Eliminations | (3,470) | (3,420) |
| | \$1,066 | \$5,763 |
| Capital Expenditures: | | |
| Lighting Segment | \$1,084 | \$689 |
| Graphics Segment | 366 | 588 |
| Technology Segment | 12 | 33 |
| Corporate and Eliminations | 498 | 52 |
| | \$1,960 | \$1,362 |
| Depreciation and Amortization: | | |
| Lighting Segment | \$847 | \$705 |
| Graphics Segment | 360 | 234 |
| Technology Segment | 345 | 336 |
| Corporate and Eliminations | 283 | 301 |

\$1,835 \$1,576

| | September 30, 2016 | June 30, 2016 |
|-----------------------------|------------------------------|----------------------|
| Identifiable Assets: | | |
| Lighting Segment | \$ 92,293 | \$ 95,168 |
| Graphics Segment | 35,612 | 33,490 |
| Technology Segment | 27,910 | 28,348 |
| Corporate and Eliminations | 37,010 | 38,554 |
| | \$ 192,825 | \$ 195,560 |

The segment net sales reported above represent sales to external customers. Segment operating income, which is used in management's evaluation of segment performance, represents net sales less all operating expenses. Identifiable assets are those assets used by each segment in its operations. Corporate identifiable assets primarily consist of cash, invested cash (if any), refundable income taxes (if any), and deferred income tax assets.

The Company records a 10% mark-up on intersegment revenues. Any intersegment profit in inventory is eliminated in consolidation. Intersegment revenues were eliminated in consolidation as follows:

| | Three Months Ended September 30 | |
|--|---------------------------------------|---------|
| <i>(In thousands)</i> | 2016 | 2015 |
| Lighting Segment inter-segment net sales | \$774 | \$614 |
| Graphics Segment inter-segment net sales | \$132 | \$444 |
| Technology inter-segment net sales | \$8,785 | \$9,384 |

The Company's operations are located solely within the United States. As a result, the geographic distribution of the Company's net sales and long-lived assets originate within the United States.

NOTE 4 - EARNINGS PER COMMON SHARE

The following table presents the amounts used to compute basic and diluted earnings per common share, as well as the effect of dilutive potential common shares on weighted average shares outstanding (in thousands, except per share data):

| | Three Months Ended September 30 | |
|---|---------------------------------------|---------|
| | 2016 | 2015 |
| <u>BASIC EARNINGS PER SHARE</u> | | |
| Net income | \$829 | \$3,750 |
| Weighted average shares outstanding, net of treasury shares (a) | 24,998 | 24,501 |
| Weighted average vested restricted stock units outstanding | 37 | 27 |
| Weighted average shares outstanding in the Deferred Compensation Plan | 240 | 236 |
| Weighted average shares outstanding | 25,275 | 24,764 |
| Basic earnings per share | \$0.03 | \$0.15 |
| <u>DILUTED EARNINGS PER SHARE</u> | | |
| Net income | \$829 | \$3,750 |
| Weighted average shares outstanding | | |
| Basic | 25,275 | 24,764 |
| Effect of dilutive securities (b): | | |
| Impact of common shares to be issued under stock option plans, and contingently issuable shares, if any | 637 | 430 |
| Weighted average shares outstanding (c) | 25,912 | 25,194 |
| Diluted earnings per share | \$0.03 | \$0.15 |

(a) Includes shares accounted for like treasury stock.

- (b) Calculated using the "Treasury Stock" method as if dilutive securities were exercised and the funds were used to purchase common shares at the average market price during the period.

Options to purchase 1,654,450 common shares and 1,683,500 common shares at September 30, 2016 and 2015, respectively, were not included in the computation of the three month period for diluted earnings per share, respectively, because the exercise price was greater than the average fair market value of the common shares.

NOTE 5 - INVENTORIES

The following information is provided as of the dates indicated:

| | September 30, 2016 | June 30, 2016 |
|-----------------------|--------------------------|------------------|
| <i>(In thousands)</i> | | |
| Inventories: | | |
| Raw materials | \$ 28,533 | \$28,979 |
| Work-in-process | 4,242 | 4,418 |
| Finished goods | 10,825 | 10,744 |
| Total Inventories | \$ 43,600 | \$44,141 |

NOTE 6 - ACCRUED EXPENSES

The following information is provided as of the dates indicated:

| | September 30, 2016 | June 30, 2016 |
|---------------------------|--------------------------|------------------|
| <i>(In thousands)</i> | | |
| Accrued Expenses: | | |
| Compensation and benefits | \$ 6,554 | \$11,983 |
| Customer prepayments | 1,321 | 1,053 |
| Accrued sales commissions | 1,924 | 2,792 |
| Accrued warranty | 5,348 | 5,069 |
| Other accrued expenses | 5,359 | 4,444 |
| Total Accrued Expenses | \$ 20,506 | \$25,341 |

NOTE 7 - GOODWILL AND OTHER INTANGIBLE ASSETS

Carrying values of goodwill and other intangible assets with indefinite lives are reviewed at least annually for possible impairment. The Company may first assess qualitative factors in order to determine if goodwill and indefinite-lived

intangible assets are impaired. If through the qualitative assessment it is determined that it is more likely than not that goodwill and indefinite-lived assets are not impaired, no further testing is required. If it is determined more likely than not that goodwill and indefinite-lived assets are impaired, or if the Company elects not to first assess qualitative factors, the Company's impairment testing continues with the estimation of the fair value of goodwill and indefinite-lived intangible assets using a combination of a market approach and an income (discounted cash flow) approach, at the reporting unit level, that requires significant management judgment with respect to revenue and expense growth rates, changes in working capital and the selection and use of an appropriate discount rate. The estimates of fair value of reporting units are based on the best information available as of the date of the assessment. The use of different assumptions would increase or decrease estimated discounted future operating cash flows and could increase or decrease an impairment charge. Company management uses its judgment in assessing whether assets may have become impaired between annual impairment tests. Indicators such as adverse business conditions, economic factors and technological change or competitive activities may signal that an asset has become impaired.

The Company identified its reporting units in conjunction with its annual goodwill impairment testing. The Company relies upon a number of factors, judgments and estimates when conducting its impairment testing. These include operating results, forecasts, anticipated future cash flows and marketplace data, to name a few. There are inherent uncertainties related to these factors and judgments in applying them to the analysis of goodwill impairment.

The following table presents information about the Company's goodwill on the dates or for the periods indicated:

| Goodwill (In thousands) | Lighting Segment | Graphics Segment | Technology Segment | All Other Category | Total |
|--|---------------------|---------------------|-----------------------|--------------------------|----------|
| Balance as of June 30, 2016 | | | | | |
| Goodwill | \$34,913 | \$28,690 | \$11,621 | \$ -- | \$75,224 |
| Accumulated impairment losses | (34,778) | (27,525) | (2,413) | -- | (64,716) |
| Goodwill, net as of June 30, 2016 | \$135 | \$1,165 | \$9,208 | \$ -- | \$10,508 |
| Balance as of September 30, 2016 | | | | | |
| Goodwill | \$34,913 | 28,690 | 11,621 | -- | 75,224 |
| Accumulated impairment losses | (34,778) | (27,525) | (2,413) | -- | (64,716) |
| Goodwill, net as of September 30, 2016 | \$135 | \$1,165 | \$9,208 | \$ -- | \$10,508 |

The gross carrying amount and accumulated amortization by major other intangible asset class is as follows:

| Other Intangible Assets (In thousands) | September 30, 2016 | | |
|---|-----------------------------|-----------------------------|---------------|
| | Gross Carrying Amount | Accumulated Amortization | Net Amount |
| Amortized Intangible Assets | | | |
| Customer relationships | \$9,316 | \$7,654 | \$1,662 |
| Patents | 338 | 163 | 175 |
| LED technology firmware, software | 11,228 | 11,008 | 220 |
| Trade name | 460 | 460 | -- |
| Non-compete agreements | 710 | 710 | -- |
| Total Amortized Intangible Assets | 22,052 | 19,995 | 2,057 |
| Indefinite-lived Intangible Assets | | | |
| Trademarks and trade names | 3,422 | -- | 3,422 |
| Total Indefinite-lived Intangible Assets | 3,422 | -- | 3,422 |
| Total Other Intangible Assets | \$25,474 | \$19,995 | \$5,479 |

| Other Intangible Assets (In thousands) | June 30, 2016 | | |
|---|-----------------------------|-----------------------------|---------------|
| | Gross Carrying Amount | Accumulated Amortization | Net Amount |

Amortized Intangible Assets

| | | | |
|-----------------------------------|---------|----------|----------|
| Customer relationships | \$9,316 | \$ 7,581 | \$ 1,735 |
| Patents | 338 | 154 | 184 |
| LED technology firmware, software | 11,228 | 10,989 | 239 |
| Trade name | 460 | 460 | -- |
| Non-compete agreements | 710 | 704 | 6 |
| Total Amortized Intangible Assets | 22,052 | 19,888 | 2,164 |

Indefinite-lived Intangible Assets

| | | | |
|--|-------|----|-------|
| Trademarks and trade names | 3,422 | -- | 3,422 |
| Total Indefinite-lived Intangible Assets | 3,422 | -- | 3,422 |

| | | | |
|-------------------------------|----------|-----------|----------|
| Total Other Intangible Assets | \$25,474 | \$ 19,888 | \$ 5,586 |
|-------------------------------|----------|-----------|----------|

(In thousands)

| | |
|--|----------------------------|
| | Amortization Expense of |
| | Other Intangible Assets |
| | September 30, 2016 |
| | September 30, 2015 |

Three Months Ended \$ 107 \$ 126

The Company expects to record annual amortization expense as follows:

(In thousands)

| | |
|------------|-------|
| 2017 | \$419 |
| 2018 | \$401 |
| 2019 | \$401 |
| 2020 | \$327 |
| 2021 | \$323 |
| After 2021 | \$293 |

NOTE 8 - REVOLVING LINE OF CREDIT

In March 2016, the Company renewed its \$30 million unsecured revolving credit line. The line of credit expires in the third quarter of fiscal 2019. Interest on the revolving line of credit is charged based upon an increment over the LIBOR rate as periodically determined, or at the bank's base lending rate, at the Company's option. The increment over the LIBOR borrowing rate, as periodically determined, fluctuates between 150 and 190 basis points depending upon the ratio of indebtedness to earnings before interest, taxes, depreciation and amortization ("EBITDA"), as defined in the credit facility. The fee on the unused balance of the \$30 million committed line of credit is 12.5 basis points. Under the terms of this credit facility, the Company has agreed to a negative pledge of assets and is required to comply with financial covenants that limit the amount of debt obligations, require a minimum amount of tangible net worth, and limit the ratio of indebtedness to EBITDA. As of September 30, 2016, \$0.4 million of the \$30 million line of credit was reserved for one letter of credit with a foreign supplier.

The Company is in compliance with all of its loan covenants as of September 30, 2016.

NOTE 9 - CASH DIVIDENDS

The Company paid cash dividends of \$1,256,000 and \$735,000 in the three months ended September 30, 2016 and 2015, respectively. Dividends on restricted stock units in the amount of \$13,898 and \$2,160 were accrued as of September 30, 2016 and 2015, respectively. These dividends will be paid upon the vesting of the restricted stock units when shares are issued to the award recipients. In October 2016, the Board of Directors declared a regular quarterly cash dividend of \$0.05 per share payable November 15, 2016 to shareholders of record as of November 7, 2016. The indicated annual cash dividend rate is \$0.20 per share.

NOTE 10 - EQUITY COMPENSATION

Stock Based Compensation

The Company has an equity compensation plan that was approved by shareholders in November 2012 and that covers all of its full-time employees, outside directors and certain advisors. This 2012 Stock Incentive Plan replaced all previous equity compensation plans. The options granted or stock awards made pursuant to this plan are granted at fair market value at the date of grant or award. Service-based options granted to non-employee directors become exercisable 25% each ninety days (cumulative) from the date of grant and options granted to employees generally become exercisable 25% per year (cumulative) beginning one year after the date of grant. Performance-based options granted to employees become exercisable 33.3% per year (cumulative) beginning one year after the date of grant. The maximum contractual term of the Company's stock options is ten years. If a stock option holder's employment with the Company terminates by reason of death, disability or retirement, as defined in the Plan, the Plan generally provides for acceleration of vesting. The number of shares reserved for issuance is 911,875 shares, all of which were available for future grant or award as of September 30, 2016. This plan allows for the grant of incentive stock options, non-qualified stock options, stock appreciation rights, restricted and unrestricted stock awards, performance stock awards, and other stock awards. Service based and performance based stock options were granted and restricted stock units ("RSU's") were awarded during the three months ended September 30, 2016. As of September 30, 2016, a total of 3,647,927 options for common shares were outstanding from this plan as well as one previous stock option plan (which has also been approved by shareholders), and of these, a total of 1,586,188 options for common shares were vested and exercisable. As of September 30, 2016, the approximate unvested stock option expense that will be recorded as expense in future periods is \$4,013,412. The weighted average time over which this expense will be recorded is approximately 29 months. Additionally, as of September 30, 2016 a total of 118,575 restricted stock units were outstanding. The approximate unvested stock compensation expense that will be recorded as expense in future periods for the RSU's is \$691,432. The weighted average time over which this expense will be recorded is approximately 35 months.

Stock Options

The fair value of each option on the date of grant was estimated using the Black-Scholes option pricing model. The below listed weighted average assumptions were used for grants in the periods indicated.

| | | |
|--------------------------|---|---|
| | Three Months Ended September 30 2016 | |
| Dividend yield | 1.8 | % |
| Expected volatility | 42.9 | % |
| Risk-free interest rate | 1 | % |
| Expected life (in years) | 6.0 | |

At September 30, 2016, the 832,500 options granted during the first three months of fiscal 2017 to employees had exercise prices ranging from \$10.08 to \$11.06 per share, fair values ranging from of \$3.39 to \$3.83 per share, and remaining contractual lives of between nine years, nine months and nine years, eleven months.

At September 30, 2015, the 942,800 options granted during the first three months of fiscal 2016 to employees had exercise prices ranging from \$8.84 to \$9.99 per share, fair values ranging from of \$3.28 to \$3.88 per share, and remaining contractual lives of between nine years, nine months and nine years, eleven months.

The Company calculates stock option expense using the Black-Scholes model. Stock option expense is recorded on a straight line basis, or sooner if the grantee is retirement eligible as defined in the 2012 Stock Incentive Plan, with an estimated 3.4% forfeiture rate effective July 1, 2016. Previous estimated forfeiture rates were between 2.0% and 3.3% between the periods January 1, 2013 through June 30, 2016. The expected volatility of the Company's stock was calculated based upon the historic monthly fluctuation in stock price for a period approximating the expected life of option grants. The risk-free interest rate is the rate of a five year Treasury security at constant, fixed maturity on the approximate date of the stock option grant. The expected life of outstanding options is determined to be less than the contractual term for a period equal to the aggregate group of option holders' estimated weighted average time within which options will be exercised. It is the Company's policy that when stock options are exercised, new common shares shall be issued.

The Company recorded \$1,438,443 and \$1,488,753 of expense related to stock options in the three months ended September 30, 2016 and 2015, respectively. As of September 30, 2016, the Company had 3,583,341 stock options that were vested and that were expected to vest, with a weighted average exercise price of \$9.17 per share, an aggregate intrinsic value of \$8,698,736 and weighted average remaining contractual terms of 7.3 years.

Information related to all stock options for the three months ended September 30, 2016 and 2015 is shown in the following tables:

| Three Months Ended September 30, 2016 | | | | |
|---------------------------------------|------------|----------|-------------|-------------|
| | | Weighted | Average | Aggregate |
| | Shares | Average | Remaining | Intrinsic |
| | | Exercise | Contractual | Value |
| | | Price | Term | |
| | | | (in years) | |
| Outstanding at 6/30/16 | 2,976,490 | \$ 8.97 | 6.6 | \$8,338,974 |
| Granted | 832,500 | \$ 11.06 | | |
| Forfeitures | (140,250) | \$ 15.95 | | |
| Exercised | (20,813) | \$ 8.32 | | |
| Outstanding at 9/30/16 | 3,647,927 | \$ 9.18 | 7.3 | \$8,783,980 |
| Exercisable at 9/30/16 | 1,586,188 | \$ 8.91 | 5.1 | \$4,982,876 |

| Three Months Ended September 30, 2015 | | | | |
|---------------------------------------|-----------|------------------------------|---------------------|-------------|
| | Shares | Weighted | | |
| | | Average Exercise Price | Average | Aggregate |
| | | | Remaining | Intrinsic |
| | | | Contractual Term | Value |
| | | | (in years) | |
| Outstanding at 6/30/15 | 2,677,436 | \$ 8.85 | 6.1 | \$4,914,601 |
| Granted | 942,800 | \$ 9.39 | | |
| Forfeitures | (20,800) | \$ 15.36 | | |

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| | | | | |
|------------------------|------------|----------|-----|-------------|
| Exercised | (181,899) | \$ 7.31 | | |
| Outstanding at 9/30/15 | 3,417,537 | \$ 9.04 | 7.0 | \$2,759,444 |
| Exercisable at 9/30/15 | 1,537,151 | \$ 10.15 | 4.1 | \$1,270,934 |

The following table presents information related to unvested stock options:

| | | Weighted-Average | |
|--------------------------------|------------|------------------|--|
| | Shares | Grant Date | |
| | | Fair Value | |
| Unvested at June 30, 2016 | 1,663,505 | \$ 3.39 | |
| Granted | 832,500 | \$ 3.83 | |
| Vested | (408,766) | \$ 3.26 | |
| Forfeited | (25,500) | \$ 3.50 | |
| Unvested at September 30, 2016 | 2,061,739 | \$ 3.59 | |

The weighted average grant date fair value of options granted during the three months ended September 30, 2016 and 2015 was \$3.83 and \$3.65, respectively. The aggregate intrinsic value of options exercised during the three months ended September 30, 2016 and 2015 was \$50,160 and \$429,294, respectively. The aggregate grant date fair value of options that vested during the three months ended September 30, 2016 and 2015 was \$1,334,248 and \$336,634, respectively. The Company received \$173,185 and \$1,328,907 of cash from employees who exercised options in the three month periods ended September 30, 2016 and 2015, respectively. In the first three months of fiscal 2017 the Company recorded \$78,040 as a reduction of federal income taxes payable, \$165,856 as an increase in common stock, \$8,880 as a reduction of income tax expense, and \$183,665 as a reduction of the deferred tax asset related to the issuance of RSU's and the exercises of stock options in which the employees sold the common shares prior to the passage of twelve months from the date of exercise. In the first three months of fiscal 2016 the Company recorded \$150,253 as a reduction of federal income taxes payable, \$6,640 as an increase in common stock, \$20,464 as a reduction of income tax expense, and \$123,149 as a reduction of the deferred tax asset related to the exercises of stock options in which the employees sold the common shares prior to the passage of twelve months from the date of exercise.

Restricted Stock Units

A total of 71,700 restricted stock units with a fair value of \$11.06 per share were awarded to employees during the three months ended September 30, 2016. A total of 72,000 restricted stock units with a fair value of \$9.39 per share were awarded to employees during the three months ended September 30, 2015. The Company determined the fair value of the awards based on the closing price of the Company stock on the date the restricted stock units were awarded. The RSU's have a four year ratable vesting period. The restricted stock units are non-voting, but accrue cash dividends at the same per share rate as those cash dividends declared and paid on LSI's common stock. Dividends on RSU's in the amount of \$13,898 and \$2,160 were accrued as of September 30, 2016 and 2015, respectively. Accrued dividends are paid to the holder upon vesting of the RSU's and issuance of shares.

The following table presents information related to restricted stock units:

| | Shares | Weighted-Average Grant Date Fair Value |
|--------------------------------|-----------|--|
| Unvested at June 30, 2016 | 62,500 | \$ 9.39 |
| Awarded | 71,700 | \$ 11.06 |
| Shares Issued | (15,625) | \$ 9.39 |
| Unvested at September 30, 2016 | 118,575 | \$ 10.40 |

As of September 30, 2016, the 118,575 restricted stock units had a remaining contractual life of between 2 years 9 months and 3 years 9 months. Of the 118,575 RSU's outstanding, 113,868 are vested and expected to vest in the future. An estimated forfeiture rate of 3.4% was used in the calculation of expense related to the restricted stock units. The Company recorded \$302,301 of expense related to restricted stock units in the three months ended September 30, 2016.

As of September 30, 2015, the 72,000 outstanding restricted stock units had a remaining contractual life of 3 years, 9 months. Of the 72,000 RSU's outstanding, 69,081 are expected to vest as of September 30, 2015. An estimated forfeiture rate of 3.3% was used in the calculation of expense related to the restricted stock units. The Company recorded \$286,257 of expense related to restricted stock units in the three months ended September 30, 2015.

Director and Employee Stock Compensation Awards

The Company awarded a total of 9,470 and 5,260 common shares in the three months ended September 30, 2016 and 2015, respectively, as stock compensation awards. These common shares were valued at their approximate \$103,100 and \$49,300 fair market values based on their stock price at dates of issuance multiplied by the number of common shares awarded, respectively, pursuant to the compensation programs for non-employee directors who receive a portion of their compensation as an award of Company stock and for employees who received a nominal recognition award in the form of company stock. Stock compensation awards are made in the form of newly issued common shares of the Company.

Deferred Compensation Plan

The Company has a non-qualified deferred compensation plan providing for both Company contributions and participant deferrals of compensation. This plan is fully funded in a Rabbi Trust. All plan investments are in common shares of the Company. As of September 30, 2016 there were 30 participants, all with fully vested account balances. A total of 258,699 common shares with a cost of \$2,469,034, and 228,103 common shares with a cost of \$2,167,717 were held in the plan as of September 30, 2016 and June 30, 2016, respectively, and, accordingly, have been recorded as treasury shares. The change in the number of shares held by this plan is the net result of share purchases and sales on the open stock market for compensation deferred into the plan and for distributions to terminated employees. The Company does not issue new common shares for purposes of the non-qualified deferred compensation plan. The Company used approximately \$343,700 and \$228,200 to purchase 34,587 and 24,914 common shares of the Company in the open stock market during the three months ended September 30, 2016 and 2015, respectively, for either employee salary deferrals or Company contributions into the non-qualified deferred compensation plan. For fiscal year 2017, the Company estimates the Rabbi Trust for the Nonqualified Deferred Compensation Plan will make net repurchases in the range of 45,000 to 50,000 common shares of the Company. The Company does not currently repurchase its own common shares for any other purpose.

NOTE 11 - SUPPLEMENTAL CASH FLOW INFORMATION

| | Three Months Ended | |
|-----------------------|-----------------------|-------|
| <i>(In thousands)</i> | September 30 2016 | 2015 |
| Cash payments: | | |
| Interest | \$ 13 | \$ 13 |
| Income taxes | \$ 1,022 | \$ 74 |

NOTE 12 - COMMITMENTS AND CONTINGENCIES

As part of the acquisition of Virticus Corporation in March 2012, a contingent earn-out liability of \$877,000 was recorded based on the fair value of estimated earn-out payments. This discounted liability was to be paid over a five year period, contingent upon reaching certain sales in each year over the five year period (fiscal year 2013 through fiscal year 2017). In fiscal 2013, as a result of modified sales forecasts for LSI Virticus, the fair value of the earn-out liability was adjusted to zero. As of September 30, 2016, the maximum potential undiscounted liability related to the earn-out is \$236,000, which is based upon the achievement of a defined level of sales of lighting control systems in fiscal year 2017. The likelihood of this occurring is not considered probable.

The Company is party to various negotiations, customer bankruptcies, and legal proceedings arising in the normal course of business. The Company provides reserves for these matters when a loss is probable and reasonably estimable. The Company does not disclose a range of potential loss because the likelihood of such a loss is remote. In the opinion of management, the ultimate disposition of these matters will not have a material adverse effect on the Company's financial position, results of operations, cash flows or liquidity.

The Company may occasionally issue a standby letter of credit in favor of third parties. As of September 30, 2016, there was a standby letter of credit totaling \$0.4 million to a foreign supplier related to the purchase of inventory.

NOTE 13 – SEVERANCE COSTS

The Company recorded severance expense of \$145,000 and \$13,000 in the three months ended September 30, 2016 and 2015, respectively. This severance expense was related to reductions in staffing not related to plant restructuring. See further discussion of restructuring expenses in Note 14.

The activity in the Company's Accrued Severance Liability is as follows for the periods indicated:

| | Three Months Ended September 30, 2016 | Three Months Ended September 30, 2015 | Fiscal Year Ended June 30, 2016 |
|------------------------------------|--|--|--|
| <i>(In thousands)</i> | | | |
| Balance at beginning of the period | \$ 39 | \$ 379 | \$ 379 |
| Accrual of expense | 145 | 13 | 469 |
| Payments | (119) | (200) | (742) |
| Adjustments | -- | (58) | (67) |
| Balance at end of the period | \$ 65 | \$ 134 | \$ 39 |

NOTE 14 – RESTRUCTURING COSTS

On September 22, 2016, the Company announced plans to close its lighting facility in Kansas City, Kansas. The decision was based upon the market shift away from fluorescent and other technologies and the rapid movement to LED lighting which is produced at other LSI facilities. The Company expects to continue to meet the demand for products containing both fluorescent and high intensity discharge light sources as long as these products are commercially viable. The Company anticipates that the closure of the Kansas City facility will occur not later than December 31, 2016. Total restructuring costs related to the closure of the Kansas City facility are expected to be approximately \$1.0 million. These costs primarily include employee-related costs (primarily severance), the impairment of manufacturing equipment, plant shut down expenses, expenses related to the preparation of the facility for sale, legal expenses, and other related costs. In addition, there was also an inventory write-down of \$400,000 recorded in the first quarter of fiscal 2017. The write-down was related to inventory that was previously realizable until the decision in the first quarter of fiscal 2017 to shut down the Kansas City plant due to the planned curtailment of the manufacturing of fluorescent light fixtures. The Company owns the facility in Kansas City and expects to realize a gain when the facility is sold. The closure of this facility is expected to result in annual net operating profit improvement and cost savings of approximately \$1.4 million before consideration of the restructuring and inventory write-down expenses. The savings as result of closure of the facility are expected to be realized starting in the third quarter of fiscal 2017.

The Company also announced the consolidation of the Beaverton, Oregon facility into other LSI facilities. The light assembly of products in the Beaverton facility was moved to the company's Columbus, Ohio facility, and the administration and engineering functions were moved to an LSI facility in Cincinnati, Ohio. This consolidation was completed September 30, 2016. As a result of this consolidation, a restructuring charge of \$365,000 was recorded in the first quarter of fiscal 2017, with the majority of this representing the costs related to the remaining period of the facility's lease and severance costs for employees who formerly worked in the Beaverton facility. The consolidation of this facility and net reduction of employment is expected to result in annual cost savings of approximately \$450,000. The savings as a result of the consolidation of this facility are expected to be realized starting in the second quarter of fiscal 2017.

The following table presents information about restructuring costs for the periods indicated:

| | Three Months Ended | Total Expected to be Recognized in Remainder of Fiscal 2017 | Total Fiscal 2017 Restructuring Expenses |
|----------------|--------------------------|--|---|
| | | | |
| (In thousands) | September 30, 2016 | | |

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| | | | |
|---|--------|--------|----------|
| Severance and other termination benefits | \$ 165 | \$ 471 | \$ 636 |
| Lease obligation | 213 | -- | 213 |
| Impairment of fixed assets and accelerated depreciation | 273 | 90 | 363 |
| Other | 5 | 125 | 130 |
| Total | \$ 656 | \$ 686 | \$ 1,342 |

Impairment charges of \$273,000 were recorded in the first quarter of fiscal 2017 related to machinery and equipment at the Kansas City and Beaverton facilities. Of the \$273,000 of impairment expense, \$242,000 was recorded in the Lighting Segment and \$31,000 was recorded in the Technology Segment. The fair value of the equipment evaluated for impairment was determined by comparing the future undiscounted cash flows to the carrying value of the assets. The future cash flows are from the remaining use of the assets as well as the cash flows expected to result from the future sale of the assets.

The following table presents restructuring costs incurred by line item in the consolidated statement of operations in which the costs are included:

| | |
|-----------------------|---|
| | Three Months Ended September 30 2016 |
| <i>(In thousands)</i> | |
| Cost of Goods Sold | \$ 503 |
| Operating Expenses | 153 |
| Total | \$ 656 |

The following table presents information about restructuring costs by segment for the periods indicated:

| | Three Months Ended September 30, 2016 | Total Expected to be Recognized In Remainder of Fiscal 2017 | Total Fiscal 2017 Restructuring Expenses |
|----------------------------|--|--|---|
| <i>(In thousands)</i> | | | |
| Lighting Segment | \$ 291 | \$ 686 | \$ 977 |
| Graphics Segment | -- | -- | -- |
| Technology Segment | 254 | -- | 254 |
| Corporate and Eliminations | 111 | -- | 111 |
| Total | \$ 656 | \$ 686 | \$ 1,342 |

The above tables exclude the expected gain on the sale of the Kansas City facility. Additionally, the tables do not include expense of \$400,000 recorded during the first quarter of fiscal 2017 related to the write-down of inventory included as cost of sales as part of the Kansas City facility closure.

The following table presents a roll forward of the beginning and ending liability balances related to the restructuring costs:

| | Balance as of June 30, 2016 | Restructuring Expense | Payments | Adjustments | Balance as of September 30, 2016 |
|------------------------------------|---|--------------------------|----------|-------------|---|
| <i>(In thousands)</i> | | | | | |
| Severance and termination benefits | \$ -- | \$ 165 | \$ (67) | \$ -- | \$ 98 |
| Lease obligation | -- | 213 | -- | -- | 213 |
| Other | -- | 5 | -- | -- | 5 |
| Total | \$ -- | \$ 383 | \$ (67) | \$ -- | \$ 316 |

The above table does not include fixed asset impairment expense of \$273,000 recorded in the first three months of fiscal 2017.

Refer to Note 13 for information regarding additional severance expenses that are not included in the restructuring costs identified in this footnote.

NOTE 15 – INCOME TAXES

The Company's effective income tax rate is based on expected income, statutory rates and tax planning opportunities available in the various jurisdictions in which it operates. For interim financial reporting, the Company estimates the annual income tax rate based on projected taxable income for the full year and records a quarterly income tax provision or benefit in accordance with the anticipated annual rate. The Company refines the estimates of the year's taxable income as new information becomes available, including actual year-to-date financial results. This continual estimation process often results in a change to the expected effective income tax rate for the year. When this occurs, the Company adjusts the income tax provision during the quarter in which the change in estimate occurs so that the year-to-date provision reflects the expected income tax rate. Significant judgment is required in determining the effective tax rate and in evaluating tax positions.

Three
Months
Ended
September 30
2016 2015

Reconciliation to effective tax rate:

| | | |
|---|---------------|---------------|
| Provision for income taxes at the anticipated annual tax rate | 32.0% | 35.6% |
| Uncertain tax positions | (1.3) | (0.3) |
| Deferred tax asset adjustment | (6.7) | -- |
| Other | (0.8) | (0.4) |
| Effective tax rate | 23.2 % | 34.9 % |

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The Company's condensed consolidated financial statements, accompanying notes and the "Safe Harbor" Statement, each as appearing earlier in this report, should be referred to in conjunction with this Management's Discussion and Analysis of Financial Condition and Results of Operations.

Net Sales by Business Segment

(In thousands)

Three
Months
Ended
September
30