STRATTEC SECURITY CORP
Form 10-Q
February 09, 2017
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended January 1, 2017

or

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to

Commission File Number 0-25150

STRATTEC SECURITY CORPORATION

(Exact Name of Registrant as Specified in Its Charter)

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

3333 West Good Hope Road, Milwaukee, WI 53209

(Address of Principal Executive Offices)

(414) 247-3333

(Registrant's Telephone Number, Including Area Code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. YES NO

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). YES NO

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large Accelerated filer		Accelerated filer
Non-accelerated filer	(Do not check if a smaller reporting company)	Smaller Reporting Company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). YES NO

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

Common stock, par value $0.01 per share: 3,668,787 shares outstanding as of January 2, 2017 (which number includes all restricted shares previously awarded that have not vested as of such date).

STRATTEC SECURITY CORPORATION

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PROSPECTIVE INFORMATION

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

The Company’s business, operations and financial performance are subject to certain risks and uncertainties, which could result in material differences in actual results from the Company’s current expectations. These risks and uncertainties include, but are not limited to, general economic conditions, in particular relating to the automotive industry, consumer demand for the Company’s and its customers’ products, competitive and technological developments, customer purchasing actions, changes in warranty provisions and customers’ product recall policies, foreign currency fluctuations, costs of operations, the volume and scope of product returns and warranty claims and other matters described in the section titled “Risk Factors” in the Company’s Form 10-K report filed on September 8, 2016 with the Securities and Exchange Commission for the year ended July 3, 2016.

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

Item 1 Financial Statements

STRATTEC SECURITY CORPORATION AND SUBSIDIARIES

Condensed Consolidated Statements of Income and Comprehensive (Loss) Income

(In Thousands, Except Per Share Amounts)

(Unaudited)

	Three Months Ended		Six Months Ended	
	January 1, 2017	December 27, 2015	January 1, 2017	December 27, 2015
Net sales	$98,945	$102,511	$199,189	$199,024
Cost of goods sold	85,450	83,901	171,089	163,915
Gross profit	13,495	18,610	28,100	35,109
Engineering, selling and administrative expenses	11,329	11,196	22,699	21,770
Income from operations	2,166	7,414	5,401	13,339
Interest income	39	8	80	15
Equity earnings (loss) of joint ventures	229	(22)	291	(315)
Interest expense	(98)	(23)	(176)	(44)
Other income, net	711	350	754	318
Income before provision for income taxes and non-controlling interest	3,047	7,727	6,350	13,313
Provision for income taxes	1,410	2,514	2,308	4,268
Net income	1,637	5,213	4,042	9,045
Net income attributable to non-controlling interest	1,239	1,810	2,102	2,369
Net income attributable to STRATTEC SECURITY CORPORATION	$398	$3,403	$1,940	$6,676
Comprehensive Income:				
Net income	$1,637	$5,213	$4,042	$9,045
Pension and postretirement plans, net of tax	474	364	949	728
Currency translation adjustments	(3,408)	(488)	(5,031)	(3,355)
Other comprehensive loss, net of tax	(2,934)	(124)	(4,082)	(2,627)
Comprehensive (loss) income	(1,297)	5,089	(40)	6,418
Comprehensive income attributable to non-controlling interest	346	1,779	1,099	2,179
Comprehensive (loss) income attributable to STRATTEC SECURITY CORPORATION	$(1,643)	$3,310	$(1,139)	$4,239

Earnings per share attributable to STRATTEC SECURITY CORPORATION:				
Basic	$0.11	$0.95	$0.54	$1.87
Diluted	$0.11	$0.93	$0.53	$1.83
Average shares outstanding:				
Basic	3,589	3,563	3,583	3,553
Diluted	3,667	3,624	3,664	3,621
Cash dividends declared per share	$0.14	$0.13	$0.28	$0.26

The accompanying notes are an integral part of these Condensed Consolidated Statements of Income and Comprehensive (Loss) Income.

STRATTEC SECURITY CORPORATION AND SUBSIDIARIES

Condensed Consolidated Balance Sheets

(In Thousands, Except Share Amounts)

	January 1, 2017 (Unaudited)	July 3, 2016
ASSETS		
Current Assets:		
Cash and cash equivalents	$ 8,190	$ 15,477
Receivables, net	59,393	63,726
Inventories:		
Finished products	11,740	10,137
Work in process	9,297	8,291
Purchased materials	21,392	23,055
Excess and obsolete reserve	(3,343)	(2,800)
Inventories, net	39,086	38,683
Other current assets	14,966	16,565
Total current assets	121,635	134,451
Investment in joint ventures	14,713	14,168
Deferred income taxes	4,214	5,387
Other long-term assets	8,899	3,021
Property, plant and equipment	226,382	216,859
Less: accumulated depreciation	(135,241)	(131,710)
Net property, plant and equipment	91,141	85,149
	$ 240,602	$ 242,176
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current Liabilities:		
Accounts payable	$ 32,294	$ 32,416
Accrued Liabilities:		
Payroll and benefits	10,709	11,210
Environmental	1,320	1,365
Warranty	7,805	9,228
Other	9,023	9,996
Total current liabilities	61,151	64,215
Borrowings under credit facility	20,000	20,000
Accrued pension obligations	1,517	1,466
Accrued postretirement obligations	1,144	1,262
Other long-term liabilities	1,195	721
Shareholders' Equity:		
Common stock, authorized 12,000,000 shares, $.01 par value, 7,212,353	72	72

issued shares at January 1, 2017 and 7,188,363 issued shares at

July 3, 2016		
Capital in excess of par value	93,008	92,076
Retained earnings	221,662	220,728
Accumulated other comprehensive loss	(40,752)	(37,673)
Less: treasury stock, at cost (3,621,166 shares at January 1, 2017 and 3,622,506 shares at July 3, 2016)	(135,850)	(135,871)
Total STRATTEC SECURITY CORPORATION shareholders’ equity	138,140	139,332
Non-controlling interest	17,455	15,180
Total shareholders’ equity	155,595	154,512
	$ 240,602	$ 242,176

The accompanying notes are an integral part of these Condensed Consolidated Balance Sheets.

STRATTEC SECURITY CORPORATION AND SUBSIDIARIES

Condensed Consolidated Statements of Cash Flows

(In Thousands)

(Unaudited)

	Six Months Ended	
	January 1, 2017	December 27, 2015
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$4,042	$9,045
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	5,647	5,075
Foreign currency transaction gain	(2,497)	(1,321)
Unrealized loss on peso forward contracts	1,563	867
Stock based compensation expense	792	870
Equity (earnings) loss of joint ventures	(291)	315
Change in operating assets and liabilities:		
Receivables	4,085	(2,132)
Inventories	(403)	(10,434)
Other assets	(2,541)	(226)
Accounts payable and accrued liabilities	(248)	1,161
Other, net	(148)	—
Net cash provided by operating activities	10,001	3,220
CASH FLOWS FROM INVESTING ACTIVITIES:		
Investment in joint ventures	(100)	(220)
Loan to joint ventures	(1,400)	(150)
Repayment from loan to joint ventures	75	—
Purchase of property, plant and equipment	(16,329)	(8,095)
Net cash used in investing activities	(17,754)	(8,465)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Borrowings under credit facility	21,000	5,500
Repayments of borrowings under credit facility	(21,000)	(5,500)
Contribution from non-controlling interest of subsidiaries	2,940	—
Dividends paid to non-controlling interests of subsidiaries	(1,764)	(1,568)
Dividends paid	(1,006)	(932)
Exercise of stock options and employee stock purchases	160	584
Net cash provided by (used in) financing activities	330	(1,916)
Foreign currency impact on cash	136	(611)
NET DECREASE IN CASH AND CASH EQUIVALENTS	(7,287)	(7,772)
CASH AND CASH EQUIVALENTS		
Beginning of period	15,477	25,695

End of period	$8,190	$17,923
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:		
Cash paid during the period for:		
Income taxes	$1,026	$2,395
Interest	$167	$43
Non-cash investing activities:		
Change in capital expenditures in accounts payable	$(2,051)	$456
Guarantee of joint venture revolving credit facility	$—	$105

The accompanying notes are an integral part of these Condensed Consolidated Statements of Cash Flows.

STRATTEC SECURITY CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

(Unaudited)

Basis of Financial Statements

STRATTEC SECURITY CORPORATION designs, develops, manufactures and markets automotive access control products including mechanical locks and keys, electronically enhanced locks and keys, steering column and instrument panel ignition lock housings, latches, power sliding door systems, power lift gate systems, power deck lid systems, door handles and related products for primarily North American automotive customers. We also supply global automotive manufacturers through a unique strategic relationship with WITTE Automotive ("WITTE") of Velbert, Germany, and ADAC Automotive ("ADAC") of Grand Rapids, Michigan. Under this relationship, STRATTEC, WITTE and ADAC market the products of each company to global customers under the "VAST" brand name (as more fully described herein). STRATTEC products are shipped to customer locations in the United States, Canada, Mexico, Europe, South America, Korea, China and India, and we provide full service and aftermarket support for each partner's company's products. We also maintain a 51 percent interest in a joint venture, STRATTEC Advanced Logic, LLC ("SAL LLC"), which exists to introduce a new generation of biometric security products based on the designs of Actuator Systems, our partner and the owner of the remaining ownership interest.

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

In the opinion of management, the accompanying condensed consolidated balance sheets as of January 1, 2017 and July 3, 2016, which have been derived from our audited financial statements, and the related unaudited interim condensed consolidated financial statements included herein contain all adjustments, consisting only of normal recurring items, necessary for their fair presentation in conformity with accounting principles generally accepted in the United States of America ("U.S. GAAP") and in accordance with Rule 10-01 of Regulation S-X. All significant intercompany transactions have been eliminated.

Interim financial results are not necessarily indicative of operating results for an entire year. The information included in this Form 10-Q should be read in conjunction with the financial statements and notes thereto included in the STRATTEC SECURITY CORPORATION 2016 Annual Report, which was filed with the Securities and Exchange Commission as an exhibit to our Form 10-K on September 8, 2016.

New Accounting Standards

In May 2014, the FASB issued an update to the accounting guidance for the recognition of revenue arising from contracts with customers. The update supersedes most current revenue recognition guidance and outlines a single comprehensive model for revenue recognition based on the principle that an entity should recognize revenue in an amount that reflects the expected consideration to be received in the exchange of goods and services. The guidance update also requires additional disclosure about the nature, amount, timing and uncertainty of revenue and cash flows arising from customer contracts. The guidance permits two methods of adoption: the full retrospective method, which requires retrospective restatement of each prior reporting period presented, or the cumulative catch-up transition method, which requires the cumulative effect of initially applying the guidance be recognized at the date of initial application. We currently anticipate adopting the standard using the full retrospective method. The guidance update is effective for annual reporting periods beginning after December 15, 2017 and becomes effective for us at the beginning of our 2019 fiscal year. We do not anticipate early adoption. Our ability to adopt using the full retrospective method is dependent on system readiness and the completion of our analysis of information necessary to restate prior period financial statements. While we are continuing to assess all potential impacts of the standard, we currently anticipate changes to revenue recognition of customer owned tooling and engineering recoveries. We expect revenue related to parts shipped under our production contracts to remain unchanged.

In August 2014, the FASB issued an update to the accounting guidance on determining when and how to disclose going-concern uncertainties in the financial statements. The new guidance requires management to perform interim and annual assessments of an entity's ability to continue as a going concern within one year of the date the financial statements are issued. An entity must provide certain disclosures if conditions or events raise substantial doubt about the entity's ability to continue as a going concern. This accounting update is effective for annual and interim periods beginning on or after December 15, 2016, with early adoption permitted. We do not expect that the adoption of this pronouncement will have a material impact on our consolidated financial statements.

In July 2015, the FASB issued an accounting standard to simplify the measurement of inventory by changing the subsequent measurement guidance from the lower of cost or market to the lower of cost and net realizable value for inventory. The standard update is effective for fiscal years beginning after December 15, 2016 and interim periods within those years, and early adoption is permitted. The standard is to be applied prospectively. We do not expect that the adoption of this pronouncement will have a material impact on our consolidated financial statements.

In February 2016, the FASB issued an update to the accounting guidance for leases. The update increases the transparency and comparability among organizations by requiring lessees to recognize lease assets and lease liabilities on the balance sheet and to disclose key information about leasing arrangements. The guidance is effective for fiscal years beginning after December 15, 2018 and interim periods within those years. We are currently assessing the impact that this guidance will have on our consolidated financial statements.

In March 2016, the FASB issued an update to the accounting guidance for share-based payments. The update simplifies several aspects of the accounting for employee share-based payment transactions including the accounting for income taxes, forfeitures and statutory tax withholding requirements, as well as classification of such items in the statement of cash flows. The guidance is effective for fiscal years beginning after December 15, 2016 and interim periods within those years. We do not expect that the adoption of this pronouncement will have a material impact on our consolidated financial statements.

In August 2016, the FASB issued an update to the accounting guidance on the classification of certain cash receipts and cash payments. The update aims to eliminate diversity in practice in how certain cash receipts and cash payments are presented and classified in the statement of cash flows. The guidance is effective for fiscal years beginning after December 15, 2017 and interim periods within those years. We are currently assessing the impact that this guidance will have on our consolidated financial statements.

Derivative Instruments

We own and operate manufacturing operations in Mexico. As a result, a portion of our manufacturing costs are incurred in Mexican pesos, which causes our earnings and cash flows to fluctuate due to changes in the U.S.

dollar/Mexican peso exchange rate. We executed contracts with Bank of Montreal that provide for bi-weekly and monthly Mexican peso currency forward contracts for a portion of our estimated peso denominated operating costs. The peso currency forward contracts include settlement dates that began on October 16, 2015 and end on June 15, 2018. Our objective in entering into these currency forward contracts is to minimize our earnings volatility resulting from changes in exchange rates affecting the U.S. dollar cost of our Mexican operations. The Mexican peso forward contracts are not used for speculative purposes and are not designated as hedges. As a result, all currency forward contracts are recognized in our accompanying condensed consolidated financial statements at fair value and changes in the fair value are reported in current earnings as part of Other Income, net.

The following table quantifies the outstanding Mexican peso forward contracts as of January 1, 2017 (thousands of dollars, except average forward contractual exchange rates):

	Effective Dates	Notional Amount	Average Forward Contractual Exchange Rate	Fair Value
Buy MXP/Sell USD	January 13, 2017 - June 15, 2017	$12,000	17.95	$1,686
Buy MXP/Sell USD	July 14, 2017 - June 15, 2018	$12,000	20.37	$766

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The fair market value of all outstanding Mexican peso forward contracts in the accompanying Condensed Consolidated Balance Sheets was as follows (thousands of dollars):

	January 1, 2017	July 3, 2016
Not Designated as Hedging Instruments:		
Other Current Liabilities:		
Mexican Peso Forward Contracts	$1,992	$107
Other Long-term Liabilities:		
Mexican Peso Forward Contracts	$460	$996

The pre-tax effects of the Mexican peso forward contracts are included in Other Income, net on the accompanying Condensed Consolidated Statements of Income and Comprehensive (Loss) Income and consisted of the following (thousands of dollars):

	Three Months Ended		Six Months Ended	
	January 1, 2017	December 27, 2015	January 1, 2017	December 27, 2015
Not Designated as Hedging Instruments:				
Realized Loss	$(576)	$ (178)	$(806)	$ (178)
Unrealized (Loss) Gain	$(664)	$ 29	$(1,563)	$ (867)

Fair Value of Financial Instruments

The fair value of our cash and cash equivalents, accounts receivable, accounts payable and borrowings under our credit facility approximated book value as of January 1, 2017 and July 3, 2016. Fair value is defined as the exchange price that would be received for an asset or paid for a liability (an exit price) in the principal or most advantageous market in an orderly transaction between market participants on the measurement date.

The following table summarizes our financial assets and liabilities measured at fair value on a recurring basis as of January 1, 2017 (in thousands):

	Fair Value Inputs		
	Level 1 Assets: Quoted Prices In Active Markets	Level 2 Assets: Observable Inputs Other Than Market Prices	Level 3 Assets: Unobservable Inputs
Assets:			
Rabbi Trust Assets:			
Stock Index Funds:			
Small Cap	$399	$ —	$ —
Mid Cap	382	—	—
Large Cap	536	—	—
International	406	—	—
Fixed Income Funds	694	—	—
Cash and Cash Equivalents	—	1	—
Total Assets at Fair Value	$2,417	$ 1	$ —
Liabilities:			
Mexican Peso Forward Contracts	$—	$ 2,452	$ —

The Rabbi Trust assets fund our amended and restated supplemental executive retirement plan and are included in Other Long-term Assets in the accompanying Condensed Consolidated Balance Sheets. Refer to discussion of Mexican peso forward contracts under Derivative Instruments above. The fair value of the Mexican peso forward contracts considers the remaining term, current exchange rate, and interest rate differentials between the two currencies. There were no transfers between Level 1 and Level 2 assets during the six month period ended January 1, 2017.

Equity Earnings (Loss) of Joint Ventures

We hold a one-third interest in a joint venture company, VAST LLC, with WITTE and ADAC. VAST LLC exists to seek opportunities to manufacture and sell all three companies' products in areas of the world outside of North America and Europe. Our investment in VAST LLC, for which we exercise significant influence but do not control and are not the primary beneficiary, is accounted for using the equity method.

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

	Three Months Ended		Six Months Ended	
	January 1, 2017	December 27, 2015	January 1, 2017	December 27, 2015
Net Sales	$34,007	$31,402	$59,016	$57,750
Cost of Goods Sold	27,124	25,497	47,217	47,411
Gross Profit	6,883	5,905	11,799	10,339
Engineering, Selling and Administrative Expenses	5,212	4,491	9,227	8,116
Income From Operations	1,671	1,414	2,572	2,223
Other Income (Expense), net	730	(150)	1,171	(462)
Income before Provision for Income Taxes	2,401	1,264	3,743	1,761
Provision for Income Taxes	405	217	577	311
Net Income	$1,996	$1,047	$3,166	$1,450
STRATTEC's Share of VAST LLC Net Income	$665	$349	$1,055	$483
Intercompany Profit Elimination	(23)	(4)	(22)	(5)
STRATTEC's Equity Earnings of VAST LLC	$642	$345	$1,033	$478

We hold a 51% ownership interest in a joint venture company, SAL LLC, which exists to introduce a new generation of biometric security products based upon the designs of Actuator Systems LLC, our partner. SAL LLC had a $1.5 million revolving credit facility (the "SAL Credit Facility") with BMO Harris Bank N.A., which was fully guaranteed by STRATTEC. The SAL Credit Facility had a maturity date of February 16, 2016. Outstanding borrowings under the SAL Credit Facility as of February 16, 2016 totaled $1.5 million. SAL LLC did not have cash available to pay the outstanding debt balance as of the maturity date. Therefore, STRATTEC made a payment of $1.5 million on its guarantee on February 16, 2016. SAL LLC is considered a variable interest entity based on the STRATTEC guarantee and additional loans from STRATTEC as discussed below. STRATTEC is not the primary beneficiary and does not control the entity. Accordingly, our investment in SAL LLC is accounted for using the equity method.

SAL LLC maintains a license agreement with Westinghouse allowing SAL LLC to do business as Westinghouse Security. Payments due Westinghouse under the license agreement were guaranteed by STRATTEC. As of January 1, 2017 and July 3, 2016, STRATTEC has a recorded liability equal to the estimated fair value of the future payments due under this guarantee of $250,000. The liability is included in Other Long-term Liabilities in the accompanying Condensed Consolidated Balance Sheets.

Loans were made from STRATTEC to SAL LLC in support of operating expenses and working capital needs. The outstanding loan amounts totaled $1.7 million and $325,000 as of January 1, 2017 and July 3, 2016, respectively. As of January 1, 2017, the outstanding loan amount was eliminated against STRATTEC's Investment in SAL LLC in the preparation of the consolidated financial statements.

Even though we maintain a 51 percent ownership interest in SAL LLC, effective with our fiscal 2015 fourth quarter, 100 percent of the funding for SAL LLC was being made by loans from STRATTEC to SAL LLC. Therefore, STRATTEC recognized 100 percent of the losses of SAL LLC up to our committed financial support through Equity (Loss) Earnings of Joint Ventures in the accompanying Condensed Consolidated Statements of Income and Comprehensive Income (Loss) for all periods presented in this report.

The following are summarized statements of operations for SAL, LLC (in thousands):

	Three Months Ended		Six Months Ended	
	January 1, 2017	December 27, 2015	January 1, 2017	December 27, 2015
Net Sales	$96	$ 65	$196	$ 125
Cost of Goods Sold	97	40	184	95
Gross Profit	(1)	25	12	30
Engineering, Selling and Administrative Expenses	369	358	706	604
Loss From Operations	(370)	(333)	(694)	(574)
Other Expense, net	(35)	(10)	(47)	(18)
Net Loss	$(405)	$ (343)	$(741)	$ (592)
STRATTEC's Share of Equity Loss of SAL LLC	$(413)	$ (343)	$(741)	$ (592)
Loss on Loan to SAL LLC	—	—	—	(150)
Loss on SAL LLC Credit Facility Guarantee	—	(24)	—	(51)
STRATTEC's Equity Loss of SAL LLC	$(413)	$ (367)	$(741)	$ (793)

We have sales of component parts to VAST LLC and SAL LLC, purchases of component parts from VAST LLC, expenses charged to VAST LLC for engineering and accounting services and expenses charged to us from VAST LLC for general headquarters expenses. The following table summarizes these related party transactions with VAST LLC and SAL LLC for the periods indicated below (in thousands):

	Three Months Ended		Six Months Ended	
	January 1, 2017	December 27, 2015	January 1, 2017	December 27, 2015
Sales to VAST LLC	$50	$ 72	$103	$ 210
Sales to SAL, LLC	$52	$ 27	$127	$ 44
Purchases from VAST LLC	$71	$ 38	$102	$ 63
Expenses Charged to VAST LLC	$226	$ 176	$454	$ 411
Expenses Charged from VAST LLC	$349	$ 405	$758	$ 797

Credit Facilities and Guarantees

STRATTEC has a $30 million secured revolving credit facility (the "STRATTEC Credit Facility") with BMO Harris Bank N.A. ADAC-STRATTEC LLC has a $20 million secured revolving credit facility (the "ADAC-STRATTEC

Credit Facility") with BMO Harris Bank N.A., which is guaranteed by STRATTEC. The credit facilities both expire August 1, 2019. Borrowings under either credit facility are secured by our cash balances, accounts receivable, inventory and fixed assets located in the U.S. Interest on borrowings under both credit facilities is at varying rates based, at our option, on the London Interbank Offering Rate ("LIBOR") plus 1.0 percent or the bank's prime rate. Both credit facilities contain a restrictive financial covenant that requires the applicable borrower to maintain a minimum net worth level. The ADAC-STRATTEC Credit Facility includes an additional restrictive financial covenant that requires the maintenance of a minimum fixed charge coverage ratio. The ADAC-STRATTEC Credit Facility also required that a capital contribution to ADAC-STRATTEC LLC of $6 million collectively from STRATTEC and ADAC be completed by September 30, 2016. This capital contribution was completed as required. STRATTEC's portion of the capital contribution totaled $3.06 million. As of January 1, 2017, we were in compliance with all financial covenants required by these credit facilities.

Outstanding borrowings under the credit facilities were as follows (in thousands):

	January 1, 2017	July 3, 2016
STRATTEC Credit Facility	$9,000	$11,500
ADAC-STRATTEC Credit Facility	$11,000	$8,500

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Average outstanding borrowings and the weighted average interest rate under each credit facility referenced above were as follows for each period presented (in thousands):

	Six Months Ended			
	Average Outstanding Borrowings		Weighted Average Interest Rate	
	January 1, 2017	December 27, 2015	January 1, 2017	December 27, 2015
STRATTEC Credit Facility	$ 13,673	$ 3,646	1.5 %	1.2 %
ADAC-STRATTEC Credit Facility	$ 8,703	$ 3,054	1.6 %	1.3 %

Commitments and Contingencies

We are from time to time subject to various legal actions and claims incidental to our business, including those arising out of alleged defects, alleged breaches of contracts, product warranties, intellectual property matters and employment related matters. It is our opinion that the outcome of such matters will not have a material adverse impact on our consolidated financial position, results of operations or cash flows. With respect to warranty matters, although we cannot ensure that future costs of warranty claims by customers will not be material, we believe our established reserves are adequate to cover potential warranty settlements.

ADAC STRATTEC de Mexico (ASdM), a wholly owned subsidiary of ADAC-STRATTEC LLC, which is a joint venture between STRATTEC SECURITY CORPORATION and ADAC Automotive, is in the process of constructing a new manufacturing facility in Leon, Mexico. Total capital expenditures required for the land, facility, paint system, and assembly equipment is expected to total approximately $22 million. Capital expenditures made through January 1, 2017 for the land, facility and equipment totaled $15.2 million. We anticipate financing the remaining required capital expenditures through a combination of current cash balances, bank loans, and current operating cash flow.

In 1995, we recorded a provision of $3 million for estimated costs to remediate an environmental contamination site at our Milwaukee facility. The facility was contaminated by a solvent spill, which occurred in 1985, from a former above ground solvent storage tank located on the east side of the facility. The reserve was originally established based on third party estimates to adequately cover the cost for active remediation of the contamination. Due to changing technology and related costs associated with active remediation of the contamination, in fiscal 2010, the reserve was adjusted based on updated third party estimates to adequately cover the cost for active remediation of the contamination. Additionally, in fiscal 2016, we obtained updated third party estimates for adequately covering the cost for active remediation of this contamination. Based upon the updated estimates, no further adjustment to the reserve was required. From 1995 through January 1, 2017, costs of approximately $555,000 have been incurred related to the installation of monitoring wells on the property and ongoing monitoring costs. We monitor and evaluate the site with the use of these groundwater monitoring wells. An environmental consultant samples these wells one or two times a year to determine the status of the contamination and the potential for remediation of the contamination by natural attenuation, the dissipation of the contamination over time to concentrations below applicable standards. If such sampling evidences a sufficient degree of and trend toward natural attenuation of the contamination at the site, we may be able to obtain a closure letter from the regulatory authorities resolving the issue without the need for active remediation. If a sufficient degree and trend toward natural attenuation is not evidenced by sampling, a more active form of remediation beyond natural attenuation may be required. The sampling has not yet satisfied all of the requirements for closure by natural attenuation. As a result, sampling continues and the reserve remains at an amount to reflect the estimated cost of active remediation. The reserve is not measured on a discounted basis. We believe, based on findings-to-date and known environmental regulations, that the remaining environmental reserve of $1.3 million at January 1, 2017 is adequate.

Shareholders' Equity

A summary of activity impacting shareholders' equity for the six month period ended January 1, 2017 was as follows (in thousands):

	Total Shareholders' Equity	Equity Attributable to STRATTEC	Equity Attributable to Non-Controlling Interest
Balance, July 3, 2016	$ 154,512	$ 139,332	$ 15,180
Net Income	4,042	1,940	2,102
Dividend Declared	(1,005)	(1,005)	—
Dividend Declared – Non-controlling Interests of Subsidiaries	(1,764)	—	(1,764)
Contributions from Non-controlling Interests of Subsidiaries	2,940	—	2,940
Translation adjustments	(5,031)	(4,028)	(1,003)
Stock Based Compensation	792	792	—
Pension and Postretirement Adjustment, Net of tax	949	949	—
Employee Stock Purchases and Stock Option Exercises	160	160	—
Balance, January 1, 2017	$ 155,595	$ 138,140	$ 17,455

Other Income, net

Net other income included in the accompanying Condensed Consolidated Statements of Income and Comprehensive (Loss) Income primarily included foreign currency transaction gains and losses, realized and unrealized losses on our Mexican peso currency forward contracts and Rabbi Trust gains and losses. Foreign currency transaction gains and losses resulted from activity associated with foreign denominated assets held by our Mexican subsidiaries. We entered into the Mexican Peso currency forward contracts to minimize earnings volatility resulting from changes in exchange rates affecting the U.S. dollar cost of our Mexican operations. The Rabbi Trust assets fund our amended and restated supplemental executive retirement plan. The investments held in this Trust are considered trading securities.

The impact of these items for each of the periods presented was as follows (in thousands):

Six Months Ended

	Three Months Ended			
	January 1,	December 27,	January 1,	December 27,
	2017	2015	2017	2015
Foreign Currency Transaction Gain	$1,808	$ 364	$2,497	$ 1,321
Unrealized (Loss) Gain on Peso Forward Contracts	(664)	29	(1,563)	(867)
Realized Loss on Peso Forward Contracts	(576)	(178)	(806)	(178)
Rabbi Trust Gain (Loss)	32	60	115	(104)
Other	111	75	511	146
	$711	$ 350	$754	$ 318

Income Taxes

The income tax provisions for the three and six months periods ended January 1, 2017 and December 27, 2015 were affected by the non-controlling interest portion of our pre-tax income. The reduction in our effective tax rate in the current year periods as compared to the prior year periods was due to the increased impact of the non-controlling interest in certain of our subsidiaries. The non-controlling interest impacts the effective tax rate as ADAC-STRATTEC LLC and STRATTEC POWER ACCESS LLC entities are taxed as partnerships for U.S. tax purposes. Additionally, the income tax provision for the three and six month periods ended January 1, 2017 included $424,000 related to the recognition of a deferred tax liability resulting from a change in assertion regarding the permanent reinvestment of earnings from two of our Mexican subsidiaries. Prior to our fiscal 2017 second quarter, the accumulated undistributed earnings from such subsidiaries were considered to be permanently reinvested in Mexico. Accordingly, we did not previously record deferred income taxes on these earnings in our financial statements. During our fiscal 2017 second quarter, the strength of the U.S. dollar to the Mexican peso significantly decreased the U.S. tax cost associated with a distribution from the Mexican entities as compared to the U.S. tax cost associated with such a distribution in prior periods. Consequently, we changed our assertion regarding the permanent reinvestment of earnings from these Mexican subsidiaries. Such earnings are no longer considered permanently reinvested. We repatriated $15 million from Mexico to the U.S. during the quarter ended January 1, 2017, recognized the deferred tax liability resulting from the change in assertion, and concluded that, with some restrictions and tax implications, the remaining current and future accumulated undistributed earnings of these subsidiaries will be available for repatriation as deemed necessary.

Earnings Per Share (EPS)

Basic earnings per share is computed on the basis of the weighted average number of shares of common stock outstanding during the applicable period. Diluted earnings per share is computed on the basis of the weighted average number of shares of common stock plus the potential dilutive common shares outstanding during the applicable period using the treasury stock method. Potential dilutive common shares include outstanding stock options and unvested restricted stock awards.

A reconciliation of the components of the basic and diluted per-share computations follows (in thousands, except per share amounts):

	Three Months Ended		Six Months Ended	
	January 1, 2017	December 27, 2015	January 1, 2017	December 27, 2015
Net Income Attributable to STRATTEC SECURITY CORPORATION	$398	$ 3,403	$1,940	$ 6,676
Less: Income Attributable to Participating	—	21	1	42

Securities				
Net Income Attributable to Common Shareholders	$398	$ 3,382	$1,939	$ 6,634
Basic Weighted Average Shares of Common Stock Outstanding	3,589	3,563	3,583	3,553
Incremental Shares – Stock based Compensation	78	61	81	68
Diluted Weighted Average Shares of Common Stock Outstanding	3,667	3,624	3,664	3,621
Basic Earnings Per Share	$0.11	$ 0.95	$0.54	$ 1.87
Diluted Earnings Per Share	$0.11	$ 0.93	$0.53	$ 1.83

We consider unvested restricted stock that provides the holder with a non-forfeitable right to receive dividends to be a participating security.

The calculation of earnings per share excluded 14,010 and 10,000 share-based payment awards as of January 1, 2017 and December 27, 2015, respectively, because their inclusion would have been anti-dilutive.

Stock-based Compensation

We maintain an omnibus stock incentive plan. This plan provides for the granting of stock options, shares of restricted stock and stock appreciation rights. As of January 1, 2017, the Board of Directors had designated 1,850,000 shares of common stock available for the grant of awards under the plan. Remaining shares available to be granted under the plan as of January 1, 2017 were 204,939. Awards that expire or are canceled without delivery of shares become available for re-issuance under the plan. We issue new shares of common stock to satisfy stock option exercises.

Nonqualified and incentive stock options and shares of restricted stock have been granted to our officers, outside directors and specified associates under our stock incentive plan. Stock options granted under the plan may not be issued with an exercise price less than the fair market value of the common stock on the date the option is granted. Stock options become exercisable as determined at the date of grant by the Compensation Committee of the Board of Directors. The options expire 10 years after the grant date unless an earlier expiration date is set at the time of grant. The options vest 1 to 4 years after the date of grant as determined by the Compensation Committee of the Board of Directors. Shares of restricted stock granted under the plan are subject to vesting criteria determined by the Compensation Committee of the Board of Directors at the time the shares are granted and have a minimum vesting period of three years from the date of grant. Restricted shares granted prior to August 2014 have voting and dividend rights, regardless of whether the shares are vested or unvested. Restricted shares granted during August 2014 and thereafter have voting rights, regardless of whether the shares are vested or unvested, but only have the right to receive cash dividends after such shares become vested. Prior to August 2016, the restricted stock grants issued vest 3 to 5 years after the date of grant. As of August 2016, restricted stock grants issued vest 1 to 5 years after the date of grant as determined by the Compensation Committee of the Board of Directors.

The fair value of each stock option grant was estimated as of the date of grant using the Black-Scholes pricing model. The fair value of each restricted stock grant was based on the market price of the underlying common stock as of the date of grant. The resulting compensation cost for fixed awards with graded vesting schedules is amortized on a straight line basis over the vesting period for the entire award.

A summary of stock option activity under our stock incentive plan for the six months ended January 1, 2017 was as follows:

	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (years)	Aggregate Intrinsic Value (in thousands)
Outstanding, July 3, 2016	144,998	$ 28.86		
Exercised	(4,490)	$ 18.88		
Outstanding, January 1, 2017	140,508	$ 29.18	4.9	$ 1,918
Exercisable, January 1, 2017	131,498	$ 25.71	4.7	$ 1,918

The intrinsic value of stock options exercised and the fair value of stock options that vested during the three and six month periods presented below are as follows (in thousands):

	Three Months Ended		Six Months Ended	
	January 1, 2017	December 27, 2015	January 1, 2017	December 27, 2015
Intrinsic Value of Options Exercised	$26	$ 115	$97	$ 529
Fair Value of Stock Options Vesting	$—	—	$566	$ 331

No options were granted during the six month period ended January 1, 2017 or December 27, 2015.

A summary of restricted stock activity under our omnibus stock incentive plan for the six months ended January 1, 2017 was as follows:

	Shares	Weighted Average Grant Date Fair Value
Nonvested Balance, July 3, 2016	71,750	$ 60.05
Granted	27,150	$ 43.87
Vested	(19,500)	$ 35.96
Forfeited	(1,800)	$ 58.24
Nonvested Balance, January 1, 2017	77,600	$ 60.48

As of January 1, 2017, there was $66,000 of total unrecognized compensation cost related to outstanding stock options granted under our omnibus stock incentive plan. This cost is expected to be recognized over a remaining weighted average period of 0.4 years. As of January 1, 2017, there was approximately $2.1 million of total unrecognized compensation cost related to unvested restricted stock grants outstanding under the plan. This cost is expected to be recognized over a remaining weighted average period of 1.1 years. Total unrecognized compensation cost will be adjusted for any future changes in estimated and actual forfeitures of awards granted under our omnibus stock incentive plan.

Pension and Postretirement Benefits

We have a qualified, noncontributory defined benefit pension plan ("Qualified Pension Plan") covering substantially all U.S. associates. Benefits under the Qualified Pension Plan are based on years of service and final average compensation. Our policy is to fund the Qualified Pension Plan with at least the minimum actuarially computed annual contribution required under the Employee Retirement Income Security Act of 1974 (ERISA). Plan assets consist primarily of listed equity and fixed income securities. Effective December 31, 2009, an amendment to the Qualified Pension Plan discontinued the benefit accruals for salary increases and credited service rendered after that date. On April 2, 2014, our Board of Directors approved a resolution to terminate the Qualified Pension Plan. The termination of the Qualified Pension Plan is subject to the Internal Revenue Service's ("IRS") determination that the Qualified Pension Plan is qualified on termination. We believe it will take 18 to 24 months to finalize the complete termination of the Qualified Pension Plan after obtaining IRS approval. We have not yet received IRS approval that the Qualified Pension Plan is qualified on termination. Additionally, we have amended the Qualified Pension Plan to provide that participants are 100 percent vested in their accrued benefits as of the effective date of the plan termination, to adopt a new standard for disability benefits that will apply when the plan's assets are distributed due to the termination, to add a lump sum distribution for employees and terminated vested participants who are not in payment status when Qualified Pension Plan assets are distributed due to the termination and to make certain other conforming amendments to the Qualified Pension Plan to comply with applicable laws that may be required by the IRS or may be deemed necessary or advisable to improve the administration of the Qualified Pension Plan or facilitate its termination and liquidation. We also intend to make contributions to the Trust Fund for the Qualified Pension Plan to ensure that there are sufficient assets to provide all Qualified Pension Plan benefits as of the anticipated distribution date. The financial impact of the plan termination will be recognized as a settlement of the Qualified Pension Plan liabilities. The settlement date and related financial impact have not yet been determined.

We have historically had in place a noncontributory supplemental executive retirement plan ("SERP"), which prior to January 1, 2014 was a nonqualified defined benefit plan that essentially mirrored the Qualified Pension Plan, but provided benefits in excess of certain limits placed on our Qualified Pension Plan by the Internal Revenue Code. As noted above, we froze our Qualified Pension Plan effective as of December 31, 2009 and the SERP provided benefits to participants as if the Qualified Pension Plan had not been frozen. Because the Qualified Pension Plan was frozen and because new employees were not eligible to participate in the Qualified Pension Plan, our Board of Directors adopted amendments to the SERP on October 8, 2013 that were effective as of December 31, 2013 to simplify the SERP calculation. The SERP is funded through a Rabbi Trust with BMO Harris Bank N.A. Under the amended SERP, participants received an accrued lump-sum benefit as of December 31, 2013 which was credited to each participant's account. Subsequent to December 31, 2013, each eligible participant receives a supplemental retirement benefit equal to the foregoing lump sum benefit, plus an annual benefit accrual equal to 8 percent of the participant's base salary and cash bonus, plus annual credited interest on the participant's account balance. All then current participants as of December 31, 2013 are fully vested in their account balances with any new individuals participating in the SERP effective on or after January 1, 2014 being subject to a five year vesting period. The SERP, which is considered a defined benefit plan under applicable rules and regulations of the Internal Revenue Code, will continue to be funded through use of a Rabbi Trust to hold investment assets to be used in part to fund any future required lump sum benefit payments to participants. The Rabbi Trust assets had a value of $2.4 million at January 1, 2017 and $2.3 million at July 3, 2016, respectively, and are included in Other Long-Term Assets in the accompanying Condensed Consolidated Balance Sheets.

We also sponsor a postretirement health care plan for all U.S. associates hired prior to June 1, 2001. The expected cost of retiree health care benefits is recognized during the years the associates who are covered under the plan render service. Effective January 1, 2010, an amendment to the postretirement health care plan limited the benefit for future eligible retirees to $4,000 per plan year and the benefit is further subject to a maximum five year coverage period based on the associate’s retirement date and age. The postretirement health care plan is unfunded.

Net periodic benefit costs under these plans are allocated between Cost of Goods Sold and Engineering, Selling and Administrative Expenses in the accompanying Condensed Consolidated Statements of Income and Comprehensive (Loss) Income.

The following table summarizes the net periodic benefit cost recognized for each of the periods indicated under these plans (in thousands):

	Pension Benefits Three Months Ended		Postretirement Benefits Three Months Ended	
	January 1, 2017	December 27, 2015	January 1, 2017	December 27, 2015
Service cost	$13	$ 13	$4	$ 3
Interest cost	981	1,076	13	22
Expected return on plan assets	(1,463)	(1,352)	—	—
Amortization of prior service cost (credit)	3	3	(191)	(188)
Amortization of unrecognized net loss	807	599	134	151
Net periodic benefit cost (credit)	$341	$ 339	$(40)	$ (12)

	Pension Benefits Six Months Ended		Postretirement Benefits Six Months Ended	
	January 1, 2017	December 27, 2015	January 1, 2017	December 27, 2015
Service cost	$27	$ 25	$7	$ 6
Interest cost	1,962	2,152	27	43
Expected return on plan assets	(2,927)	(2,703)	—	—
Amortization of prior service cost (credit)	6	6	(382)	(375)
Amortization of unrecognized net loss	1,614	1,198	269	302
Net periodic benefit cost (credit)	$682	$ 678	$(79)	$ (24)

Voluntary contributions of $5 million were made to the Qualified Pension Plan during the six month period ended January 1, 2017. No contributions were made to the Qualified Pension Plan during the six month periods ended December 27, 2015. No additional contributions are anticipated to be made during the remainder of fiscal 2017.

Accumulated Other Comprehensive Loss

The following tables summarize the changes in accumulated other comprehensive loss ("AOCL") for each period presented (in thousands):

	Six Months Ended January 1, 2017		
	Foreign Currency Translation Adjustments	Retirement and Postretirement Benefit Plans	Total
Balance, July 3, 2016	$13,155	$ 24,518	$37,673
Other comprehensive loss before reclassifications	5,031	—	5,031
Income tax	—	—	