

LSI INDUSTRIES INC  
Form 10-Q  
February 07, 2018

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 DECEMBER 31, 2017.

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," "smaller reporting company" and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer [  ]      Accelerated filer [  ]      Emerging growth company [  ]  
Non-accelerated filer [  ]      Smaller reporting company [  ]

If an emerging growth company, indicate by check mark if the Registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

As of January 27, 2018 there were 25,574,457 shares of the Registrant's common stock, no par value per share, outstanding.

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LSI INDUSTRIES INC.

FORM 10-Q

FOR THE QUARTER ENDED DECEMBER 31, 2017

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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		Six Months Ended	
	December 31		December 31	
	2017	2016	2017	2016
<i>(In thousands, except per share data)</i>				
Net sales	\$92,305	\$85,658	\$179,771	\$169,817
Cost of products and services sold	66,998	63,611	130,761	126,432
Restructuring costs	--	640	--	1,143
Gross profit	25,307	21,407	49,010	42,242
Restructuring costs	--	57	--	210
Impairment of goodwill	--	--	28,000	--
Selling and administrative expenses	20,760	18,532	41,277	38,148
Operating income (loss)	4,547	2,818	(20,267)	3,884
Interest (income)	(8 )	(28 )	(16 )	(55 )
Interest expense	425	8	836	21
Income (loss) before income taxes	4,130	2,838	(21,087)	3,918

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Income tax expense (benefit)	5,598	832	(3,990 )	1,083
Net (loss) income	\$(1,468 )	\$2,006	\$(17,097 )	\$2,835
(Loss) Earnings per common share (see Note 4)				
Basic	\$(0.06 )	\$0.08	\$(0.66 )	\$0.11
Diluted	\$(0.06 )	\$0.08	\$(0.66 )	\$0.11
Weighted average common shares outstanding				
Basic	25,858	25,314	25,824	25,294
Diluted	25,858	25,803	25,824	25,859

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

## LSI INDUSTRIES INC.

## CONDENSED CONSOLIDATED BALANCE SHEETS

(Unaudited)

<i>(In thousands, except shares)</i>	December 31, 2017	June 30, 2017
<b>ASSETS</b>		
Current Assets		
Cash and cash equivalents	\$ 3,177	\$ 3,039
Accounts receivable, less allowance for doubtful accounts of \$475 and \$506, respectively	59,740	48,880
Inventories	48,662	50,008
Refundable income tax	--	775
Assets held for sale	--	1,463
Other current assets	3,712	2,964
Total current assets	115,291	107,129
Property, Plant and Equipment, at cost		
Land	6,469	6,429
Buildings	35,855	35,463
Machinery and equipment	82,152	78,804
Construction in progress	796	3,805
	125,272	124,501
Less accumulated depreciation	(80,409 )	(77,147 )
Net property, plant and equipment	44,863	47,354
Goodwill	30,538	58,538
Other Intangible Assets, net	36,789	38,169

Other Long-Term Assets, net	10,893	5,490
Total assets	\$238,374	\$256,680

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



LSI INDUSTRIES INC.

## CONDENSED CONSOLIDATED BALANCE SHEETS

(Unaudited)

<i>(In thousands, except shares)</i>	December 31, 2017	June 30, 2017
<b>LIABILITIES &amp; SHAREHOLDERS' EQUITY</b>		
Current Liabilities		
Accounts payable	\$16,828	\$19,356
Accrued expenses	25,713	26,069
Total current liabilities	42,541	45,425
Long-Term Debt	52,149	49,698
Other Long-Term Liabilities	1,356	1,479
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 25,562,003 and 24,429,223 shares, respectively	122,170	120,259
Retained earnings	20,158	39,819
Total shareholders' equity	142,328	160,078
Total liabilities & shareholders' equity	\$238,374	\$256,680

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)

*(In thousands)*

	Six Months Ended December 31	
	2017	2016
Cash Flows from Operating Activities		
Net (loss) income	\$(17,097)	\$2,835
Non-cash items included in net income		
Depreciation and amortization	5,124	3,605
Deferred income taxes	(5,667 )	(962 )
Impairment of goodwill	28,000	--
Deferred compensation plan	(413 )	237
Stock compensation expense	1,463	1,688
Issuance of common shares as compensation	156	228
Loss (gain) on disposition of fixed assets	(29 )	53
Fixed asset impairment and accelerated depreciation	--	354
Allowance for doubtful accounts	115	205
Inventory obsolescence reserve	1,033	758
Changes in certain assets and liabilities:		
Accounts receivable	(10,975)	(2,771 )
Inventories	313	979
Refundable income taxes	775	--
Accounts payable	(2,626 )	(176 )
Accrued expenses and other	(742 )	(2,630 )
Customer prepayments	(221 )	216
Net cash flows (used in) provided by operating activities	(791 )	4,619
Cash Flows from Investing Activities		
Purchases of property, plant and equipment	(1,190 )	(2,744 )
Proceeds from sale of fixed assets	1,527	1
Net cash flows provided by (used in) investing activities	337	(2,743 )
Cash Flows from Financing Activities		
Payments of long-term debt	(48,553)	--
Borrowings of long-term debt	51,004	--
Cash dividends paid	(2,564 )	(2,513 )

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Exercise of stock options	175	171
Purchase of treasury shares	(107 )	(390 )
Acquisition of common stock for tax withholding related to share based compensation	183	--
Issuance of treasury shares	454	44
Net cash flows provided by (used in) financing activities	592	(2,688 )
Increase (decrease) in cash and cash equivalents	138	(812 )
Cash and cash equivalents at beginning of period	3,039	33,835
Cash and cash equivalents at end of period	\$3,177	\$33,023

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 *December 31, 2017*, the results of its operations for the *three* and *six* month periods ended *December 31, 2017* and *2016*, and its cash flows for the *six* month periods ended *December 31, 2017* and *2016*. These statements should be read in conjunction with the financial statements and footnotes included in the fiscal 2017 Annual Report on Form 10-K. Financial information as of *June 30, 2017* 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:**

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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. 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 multiple 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. 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. 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 a 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>	December 31, 2017	June 30, 2017
Accounts receivable	\$ 60,215	\$49,386
Less: Allowance for doubtful accounts	(475 )	(506 )
Accounts receivable, net	\$ 59,740	\$48,880

### 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 *December 31, 2017* and *June 30, 2017*, the Company had bank balances of \$4,827,512 and \$4,488,000, 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 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. A combination of financial modeling and qualitative input factors are 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 \$1,862,000 and \$1,669,000 of depreciation expense in the *second* quarter of fiscal 2018 and 2017, respectively, and \$3,744,000 and \$3,397,000 of depreciation expense in the *first* half of fiscal 2018 and 2017, respectively.

**Goodwill and 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 possible 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 receivable, 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 analyses, and in the purchase price of acquired companies (if any). 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 *ten* 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 based upon historical claims as a percentage of sales 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:

<i>(In thousands)</i>	Six Months Ended December 31, 2017	Six Months Ended December 31, 2016	Fiscal Year Ended June 30, 2017
Balance at beginning of the period	\$ 7,560	\$ 5,069	\$5,069
Additions charged to expense	2,394	2,243	4,956
Addition from acquired company	--	--	907
Deductions for repairs and replacements	(3,266 )	(1,351 )	(3,372 )
Balance at end of the period	\$ 6,688	\$ 5,961	\$7,560

#### **Research and Development Costs:**

Research and development costs are 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 \$1,379,000 and \$1,269,00 for the *three* months ended *December 31, 2017* and *2016*, respectively, and \$2,941,000 and \$2,670,000 for the *six* months ended *December 31, 2017* and *2016*, 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 756,000 and 787,000 shares for the *three* month ended *December 31, 2017* and *2016*, respectively, and 686,000 shares and 852,000 shares for the *six* months ended *December 31, 2017* and *2016*, 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 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.

The Tax Cuts and Jobs Act was signed into law on *December 22nd, 2017* and makes numerous changes to the Internal Revenue Code. Among other changes, the Act reduces the US corporate income tax rate to *21%* effective *January 1, 2018*. Because the Act became effective mid-way through the Company's tax year, the Company will have a US statutory income tax rate of *27.7%* for the fiscal *2018*, and will have a *21%* US statutory income tax rate for fiscal years thereafter. During the quarter ended *December 31, 2017*, the Company re-valued the deferred tax balances because of the change in US tax rate resulting in a *one-time* deferred tax expense of *\$4,676,578*.

**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." In *December 2016*, the FASB issued ASU 2016-20, "Technical Corrections and Improvements to Topic 606, Revenue from Contracts with Customers." These *three* standards clarify or improve guidance from ASU 2014-09 and are effective for fiscal and interim periods within those years, beginning after *December 15, 2017*, or the Company's fiscal 2019. The Company currently plans to adopt the new revenue guidance for the fiscal year beginning *July 1, 2018* using the modified retrospective approach. The Company is reviewing accounting policies and evaluating disclosures in the financial statements related to the new standard. The Company is also assessing potential changes to the business processes, internal controls, and information systems related to the adoption of the new standard. While the Company is currently assessing the impact of the new standard, the Company's revenue is primarily generated from the sale of finished products to customers. Those sales predominantly contain a single delivery element and revenue is recognized at a single point in time when ownership, risks, and rewards transfer. The recognition of revenue from most product sales is largely unaffected by the new standard. However, with respect to certain product sales requiring installation, revenue is currently *not* recognized until the installation is complete. While the Company does *not* expect this new guidance to have a material impact on the amount of overall sales recognized, the timing of recognition of revenues from sales on certain projects *may* be affected. Our initial conclusions *may* change as we finalize our assessment and select a transition method during the next *six* months.

In *February 2016*, the Financial Accounting Standards Board issued ASU 2016-02, "Leases." The amended guidance requires an entity to recognize assets and liabilities that arise from leases. The amended guidance is effective for financial statements issued for fiscal and interim periods within those years, beginning after *December 15, 2018*, or the Company's fiscal 2020, with early adoption permitted. The Company has *not* yet determined the impact the amended guidance will have on its financial statements.

In *March 2016*, the Financial Accounting Standards Board issued ASU 2016-09, "Improvements to Employee Share-Based Payment Accounting." This amended guidance simplifies several aspects of the accounting for share-based payment award transactions. The amended guidance is effective for financial statements issued for fiscal and interim periods within those years, beginning after *December 15, 2016*, or the Company's fiscal 2018. We adopted this standard on *July 1, 2017* and recognized excess tax benefits of \$87,354 in income tax expense during the *six* months ended *December 31, 2017*. The amount *may not* necessarily be indicative of future amounts that *may* be recognized as any excess tax benefits recognized would be dependent on future stock price, employee exercise behavior and applicable tax rates. Prior to *July 1, 2017*, excess tax benefits were recognized in additional paid-in capital. Additionally, excess tax benefits are now included in net cash flows provided by operating activities rather

than net cash flows provided by financing activities in the Company's Consolidated Statement of Cash Flows. The treatment of forfeitures has *not* changed, as the Company is electing to continue the current process of estimating forfeiture at the time of grant. The Company had *no* unrecognized excess tax benefits from prior periods to record upon the adoption of this ASU.

In *January 2017*, the Financial Accounting Standards Board issued ASU 2017-04, "Simplifying the Test for Goodwill Impairment", which simplifies the testing for goodwill impairment by eliminating a previously required step. The standard is effective for financial statements issued for fiscal years beginning after *December 15, 2019*, or the Company's fiscal 2021. Early adoption of the accounting standard is permitted, and the Company elected to adopt this standard early. (See Footnote 7)

### **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 consolidated financial statements.

**Use of Estimates:**

The preparation of 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 consolidated 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. In the *first* quarter of fiscal 2018, the Company merged its Technology Segment with the Lighting Segment to be in alignment with the financial information received by the Chief Executive Officer and how the business is managed. The Company's *two* operating segments are Lighting and Graphics, 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, is also 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 Lighting Segment also includes the design, engineering, and manufacturing of electronic circuit boards, assemblies and sub-assemblies used to manufacture certain LED light fixtures and sold directly to customers.

The Graphics Segment designs, manufactures and installs exterior and interior visual image elements such as traditional graphics, interior branding, electrical and architectural signage, 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, but *not* limited to 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.

The Company's corporate administration activities are reported in the Corporate and Eliminations line item. These activities primarily include 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 taxes.

There was *no* concentration of consolidated net sales in the *three* and *six* months ended *December 31, 2017* or *2016*. There was *no* concentration of accounts receivable at *December 31, 2017* or *June 30, 2017*.

Summarized financial information for the Company's operating segments is provided for the indicated periods and as of *December 31, 2017* and *December 31, 2016*:

<i>(In thousands)</i>	Three Months Ended		Six Months Ended	
	December 31		December 31	
	2017	2016	2017	2016
<b>Net Sales:</b>				
Lighting Segment	\$69,174	\$65,076	\$137,602	\$130,341
Graphics Segment	23,131	20,582	42,169	39,476
	\$92,305	\$85,658	\$179,771	\$169,817
<b>Operating Income (Loss):</b>				
Lighting Segment	\$5,275	\$3,761	\$(17,655)	\$6,852
Graphics Segment	2,255	1,174	3,731	2,191
Corporate and Eliminations	(2,983)	(2,117)	(6,343)	(5,159)
	\$4,547	\$2,818	\$(20,267)	\$3,884
<b>Capital Expenditures:</b>				
Lighting Segment	\$499	\$205	\$760	\$1,301
Graphics Segment	157	459	339	825
Corporate and Eliminations	36	120	91	618
	\$692	\$784	\$1,190	\$2,744
<b>Depreciation and Amortization:</b>				
Lighting Segment	\$1,885	\$1,115	\$3,786	\$2,307
Graphics Segment	384	376	763	736
Corporate and Eliminations	283	279	575	562
	\$2,552	\$1,770	\$5,124	\$3,605

	December 31,	June 30,
	2017	2017

<b>Identifiable Assets:</b>	December 31,	June 30,
	2017	2017
Lighting Segment	\$182,680	\$214,070
Graphics Segment	39,394	33,144
Corporate and Eliminations	16,300	9,466
	\$238,374	\$256,680

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.

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 December 31 2017		Six Months Ended December 31 2017	
<i>(In thousands)</i>	2016	2017	2016	2017
Lighting Segment inter-segment net sales	\$992	\$700	\$1,707	\$1,453
Graphics Segment inter-segment net sales	\$1,040	\$680	\$1,071	\$812

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 December 31		Six Months Ended December 31	
	2017	2016	2017	2016
<b><u>BASIC EARNINGS PER SHARE</u></b>				
Net (loss) income	\$(1,468)	\$2,006	\$(17,097)	\$2,835
Weighted average shares outstanding during the period, net of treasury shares (a)	25,551	25,016	25,528	25,007
Weighted average vested restricted stock units outstanding	63	37	52	37
Weighted average shares outstanding in the Deferred Compensation Plan during the period	244	261	244	250
Weighted average shares outstanding	25,858	25,314	25,824	25,294
Basic (loss) earnings per share	\$(0.06)	\$0.08	\$(0.66)	\$0.11
<b><u>DILUTED EARNINGS PER SHARE</u></b>				
Net (loss) income	\$(1,468)	\$2,006	\$(17,097)	\$2,835
Weighted average shares outstanding				
Basic	25,858	25,314	25,824	25,294
Effect of dilutive securities (b):				
Impact of common shares to be issued under stock option plans, and contingently issuable shares, if any	--	489	--	565
Weighted average shares outstanding (c)	25,858	25,803	25,824	25,859
Diluted (loss) earnings per share	\$(0.06)	\$0.08	\$(0.66)	\$0.11

(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 3,569,762 common shares and 1,682,270 common shares for the *three* months ended *December 31, 2017* and *2016*, respectively, and options to purchase 3,549,705 common shares and 1,626,770 common shares for the *six* months ended *December 31, 2017* and *2016*, respectively were *not* included in the (c) computation of the *three* month and *six* month period for diluted earnings per share, respectively, because the exercise price was greater than the average fair market value of the common shares. For the *three* and *six* months ended *December 31, 2017*, the effect of dilutive securities was *not* included in the calculation of diluted earnings (loss) per share because there was a net operating loss for the period.

**NOTE 5 - INVENTORIES**

The following information is provided as of the dates indicated:

<i>(In thousands)</i>	December 31, 2017	June 30, 2017
Inventories:		
Raw materials	\$ 31,156	\$32,421
Work-in-process	2,772	3,527
Finished goods	14,734	14,060
Total Inventories	\$ 48,662	\$50,008

**NOTE 6 - ACCRUED EXPENSES**

The following information is provided as of the dates indicated:

<i>(In thousands)</i>	December 31, 2017	June 30, 2017
Accrued Expenses:		
Compensation and benefits	\$ 8,667	\$9,759
Customer prepayments	840	1,061
Accrued sales commissions	2,214	2,314
Accrued warranty	6,688	7,560
Other accrued expenses	7,304	5,375
Total Accrued Expenses	\$ 25,713	\$26,069

**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. The estimation of the fair value of goodwill and intangible assets 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 has a total of *three* reporting units that contain goodwill. There are *two* reporting units within the Lighting Segment and *one* reporting unit within the Graphics Segment. One reporting unit previously reported in the Technology Segment has been transferred to the Lighting Segment as a result of the merge of the Technology Segment with the Lighting Segment (See Note 3). The Company relies upon a number of factors, judgments and estimates when conducting its impairment testing including, but *not* limited to, the Company's stock price, operating results, forecasts, anticipated future cash flows and marketplace data. There are inherent uncertainties related to these factors and judgments in applying them to the analysis of goodwill impairment.

A sustained and significant decline in the Company's stock price in the *first* quarter of fiscal *2018* led management to believe that a triggering event occurred and that an interim goodwill impairment test was required for *one* of the reporting units in the Lighting Segment that contains goodwill, as of *September 30, 2017*. Because the Company elected to early adopt ASU *2017-04*, "Simplifying the Test for Goodwill Impairment", the requirement to perform step 2 in the impairment test was *not* required. The result of the impairment test on the reporting unit in the Lighting Segment indicated that goodwill was impaired by *\$28,000,000*.

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

Goodwill (In thousands)	Lighting	Graphics	Total
	Segment	Segment	
Balance as of June 30, 2017			
Goodwill	\$94,564	\$28,690	\$123,254
Accumulated impairment losses	(37,191)	(27,525)	(64,716)
Goodwill, net as of June 30, 2017	\$57,373	\$1,165	\$58,538
Goodwill Impairment	(28,000)	--	(28,000)
Balance as of December 31, 2017			
Goodwill	\$94,564	28,690	123,254
Accumulated impairment losses	(65,191)	(27,525)	(92,716)
Goodwill, net as of December 31, 2017	\$29,373	\$1,165	\$30,538

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

Other Intangible Assets (In thousands)	December 31, 2017		
	Gross Carrying Amount	Accumulated Amortization	Net Amount
Amortized Intangible Assets			
Customer relationships	\$35,563	\$ 8,982	\$26,581
Patents	338	201	137
LED technology firmware, software	16,066	11,521	4,545
Trade name	2,658	554	2,104
Non-compete agreements	710	710	--
Total Amortized Intangible Assets	55,335	21,968	33,367
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	\$58,757	\$ 21,968	\$36,789
	June 30, 2017		
Other Intangible Assets	Gross		
(In thousands)	Carrying Amount	Accumulated Amortization	Net Amount
Amortized Intangible Assets			
Customer relationships	\$35,563	\$ 7,956	\$27,607



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Patents	338	186	152
LED technology firmware, software	16,066	11,237	4,829
Trade name	2,658	499	2,159
Non-compete agreements	710	710	-
Total Amortized Intangible Assets	55,335	20,588	34,747
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	\$58,757	\$ 20,588	\$38,169

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	Amortization Expense of	
<i>(In thousands)</i>	Other Intangible Assets	
	December 31, 2017	December 31, 2016
Three Months Ended	\$ 690	\$ 101
Six Months Ended	\$ 1,380	\$ 208

The Company expects to record annual amortization expense as follows:

*(In thousands)*

2018	\$2,760
2019	\$2,760
2020	\$2,687
2021	\$2,682
2022	\$2,461
After 2022	\$21,397

#### **NOTE 8 - REVOLVING LINE OF CREDIT**

In *February 2017* the Company amended its secured line of credit to a \$100 million facility. The line of credit expires in the *third* quarter of fiscal 2022. 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 125 and 250 basis points depending upon the ratio of indebtedness to earnings before interest, taxes, depreciation and amortization ("EBITDA"), as defined in the line of credit agreement. The increment over LIBOR borrowing rate will remain at 175 basis points for the next *twelve* months. The fee on the unused balance of the \$100 million committed line of credit is 15 basis points. Under the terms of this line of credit, the Company has agreed to a negative pledge of real estate assets and is required to comply with financial covenants that limit the ratio of indebtedness to EBITDA and require a minimum fixed charge coverage ratio. As of *December 31, 2017*, there was \$52.1 million borrowed against the line of credit, and \$47.9 million was available as of that date. Based on the terms of the line of credit and the maturity date, the debt has been classified as long term.

The Company is in compliance with all of its loan covenants as of *December 31, 2017*.

## **NOTE 9 - CASH DIVIDENDS**

The Company paid cash dividends of \$2,564,000 and \$2,513,000 in the *six months ended December 31, 2017 and 2016*, respectively. Dividends on restricted stock units in the amount of \$38,463 and \$19,826 were accrued as of *December 31, 2017 and 2016*, respectively. These dividends will be paid upon the vesting of the restricted stock units when shares are issued to the award recipients. In *January 2018*, the Board of Directors declared a regular quarterly cash dividend of \$0.05 per share payable *February 13, 2018* to shareholders of record as of *February 5, 2018*. The indicated annual cash dividend rate is \$0.20 per share.

## **NOTE 10 - EQUITY COMPENSATION**

### **Stock Based Compensation**

The Company's equity compensation plan, the 2012 Stock Incentive Plan ("the 2012 Plan"), was approved by shareholders in *November 2012*. The 2012 Plan covers all of its full-time employees, outside directors and certain advisors and replaced all previous equity compensation plans. In *November 2016*, the Company's shareholders approved an amendment to the 2012 Plan that added 1,600,000 shares to the plan and implemented the use of a fungible share ratio that consumes 2.5 available shares for every 1 full value share awarded by the Company as stock compensation. The 2012 Plan allows for the grant of incentive stock options, non-qualified stock options, stock appreciation rights, restricted and unrestricted stock awards, and other stock awards. Stock option grants or stock awards made pursuant to the 2012 Plan are granted at fair market value at the date of option grant or stock award.

Stock option grants *may* be service-based or performance-based. Service-based options granted during fiscal 2017 and prior fiscal years generally have a *four* year ratable vesting period beginning *one* year after the date of grant. Service-based options granted during fiscal 2018 have a *three* year ratable vesting period beginning *one* year after the date of grant. Performance-based options have a *three* year ratable vesting period beginning *one* year after the date of grant. The maximum exercise period of stock options granted under the 2012 Plan 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 under the 2012 Plan is 1,453,356 shares, all of which were available for future grant or award as of *December 31, 2017*. Service-based and performance-based stock options were granted and restricted stock units ("RSUs") were awarded during the *six* months ended *December 31, 2017*. As of *December 31, 2017*, a total of 3,448,677 stock options were outstanding under the 2012 Plan (as well as *one* previous stock option plan which was also approved by shareholders), of which, a total of 1,527,651 stock options were vested and exercisable. As of *December 31, 2017*, the approximate unvested stock option expense that will be recorded as expense in future periods is \$2,563,987. The weighted average time over which this expense will be recorded is approximately 24 months. Additionally, as of *December 31, 2017*, a total of 187,150 RSUs were outstanding. The approximate unvested stock compensation expense that will be recorded as expense in future periods for the RSUs is \$775,144. The weighted average time over which this expense will be recorded is approximately 30 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 December 31 2017		Six Months Ended December 31 2016	
Dividend yield	3.06%	2.07%	3.35%	1.81%
Expected volatility	41 %	41 %	41 %	43 %
Risk-free interest rate	1.94%	2.06%	1.77%	1.00%
Expected life (in years)	6.0	6.0	6.0	6.0

At *December 31, 2017*, the 794,537 options granted during the *first six* months of fiscal 2018 to employees had exercise prices ranging from \$5.92 to \$6.54 per share, fair values ranging from of \$1.71 to \$1.96 per share, and remaining contractual lives of between 9.5 and 10 years.

At *December 31, 2016*, the 834,320 options granted during the *first six* months of fiscal 2017 to employees had exercise prices ranging from \$9.65 to \$11.06 per share, fair values ranging from of \$3.29 to \$3.83 per share, and remaining contractual lives of between 9.5 and 10 years.

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 8.54% forfeiture rate effective *October 1, 2017*. Previous estimated forfeiture rates were between 2.0% and 8.3% between the periods *January 1, 2013* through *September 30, 2017*. 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 \$367,920 of expense in the *three* months ended *December 31, 2017* and recorded a reduction of expense of \$142,434 in the *three* months ended *December 31, 2016*, related to stock options. The reduction of stock option expense in the *three* months ended *December 31, 2016* was the result of expectations that the performance criteria related to incentive based options will *not* be met. The Company recorded \$1,125,728 and \$1,296,009 of expense related to stock options in the *six* months ended *December 31, 2017* and 2016, respectively. As of *December 31, 2017*, the Company had 3,344,138 stock options that were vested and that were expected to vest, with a weighted average exercise price of \$8.13 per share, an aggregate intrinsic value of \$905,309 and weighted average remaining contractual terms of 7.4 years.

Information related to all stock options for the six months ended *December 31, 2017* and *2016* is shown in the following tables:

Six Months Ended December 31, 2017				
	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value
Outstanding at 6/30/17	3,119,688	\$ 9.12	7.4	\$2,332,224
Granted	794,537	\$ 5.98		
Forfeitures	(438,609 )	\$ 11.62		
Exercised	(26,939 )	\$ 6.49		
Outstanding at 12/31/17	3,448,677	\$ 8.10	7.4	\$971,344
Exercisable at 12/31/17	1,527,651	\$ 8.14	5.7	\$218,246

Six Months Ended December 31, 2016				
	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value
Outstanding at 6/30/16	2,976,490	\$ 8.97	6.6	\$8,338,974
Granted	834,320	\$ 11.05		
Forfeitures	(147,375 )	\$ 16.03		
Exercised	(38,063 )	\$ 7.75		
Outstanding at 12/31/16	3,625,372	\$ 9.18	7.1	\$4,648,729
Exercisable at 12/31/16	1,700,025	\$ 8.73	5.1	\$3,216,899

The following table presents information related to unvested stock options:

## Weighted-Average

	Shares	Grant Date	Fair Value
Unvested at June 30, 2017	1,842,127	\$	3.52
Granted	794,537	\$	1.73
Vested	(513,504 )	\$	3.49
Forfeited	(202,134 )	\$	3.46
Unvested at December 31, 2017	1,921,026	\$	2.79

The weighted average grant date fair value of options granted during the *six* month periods ended *December 31, 2017* and *2016* was *\$1.73* and *\$3.83*, respectively. The aggregate intrinsic value of options exercised during the *six* months ended *December 31, 2017* and *2016* was *\$22,079* and *\$99,883*, respectively. The aggregate grant date fair value of options that vested during the *six* months ended *December 31, 2017* and *2016* was *\$1,793,086* and *\$1,779,490*, respectively. The Company received *\$174,965* and *\$295,030* of cash from employees who exercised options in the *six* month periods ended *December 31, 2017* and *2016*, respectively. In the *first six* months of fiscal *2018* the Company recorded a *\$83,608* reduction of the federal income tax payable, *\$559,474* as an increase in common stock, *\$87,354* as a reduction of income tax expense, and *\$170,462* as a reduction of the deferred tax assets. In the *first six* months of fiscal *2017* the Company recorded *\$95,443* as a reduction of federal income taxes payable, *\$124,056* as a decrease in common stock, *\$22,073* as a reduction of income tax expense, and *\$197,427* as a reduction of the deferred tax asset related to the issuance of RSUs 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.

*Restricted Stock Units*

A total of 91,490 RSUs with a fair value of \$5.92 per share were awarded to employees during the six months ended December 31, 2017. The service-based RSUs awarded during fiscal 2018 have a three year ratable vesting period beginning one year after the date of award. A total of 71,700 RSUs with a fair value of \$11.06 per share were awarded to employees during the six months ended December 31, 2016. The service-based RSUs awarded during fiscal 2017 and in prior fiscal years have a four year ratable vesting period beginning one year after the date of award. The Company determined the fair value of the awards based on the closing price of the Company stock on the date the RSUs were awarded. The RSUs have a four year ratable vesting period. The RSUs 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 RSUs in the amount of \$38,463 and \$19,826 were accrued as of December 31, 2017 and 2016, respectively. Accrued dividends are paid to the holder upon vesting of the RSUs and issuance of shares.

The following table presents information related to RSUs:

	Shares	Weighted-Average Grant Date Fair Value
Unvested at June 30, 2017	133,335	\$ 10.38
Awarded	91,490	\$ 5.92
Shares Issued	(30,675 )	\$ 10.30
Shares Forfeited	(7,000 )	\$ 10.46
Unvested at December 31, 2017	187,150	\$ 8.21

As of December 31, 2017, the 187,150 RSUs had a remaining contractual life of between 2.5 and 3.5 years. Of the 187,150 RSUs outstanding as of December 31, 2017, 176,073 RSUs are vested or expected to vest in the future. An estimated forfeiture rate of 8.5% was used in the calculation of expense related to the RSUs. The Company recorded \$81,895 and \$337,310 of expense related to RSUs in the three and six month periods ended December 31, 2017, respectively.

As of December 31, 2016, the 118,575 RSUs had a remaining contractual life of between 2.5 and 3.5 years. Of the 118,575 RSUs outstanding as of December 31, 2016, 114,531 RSUs are vested or expected to vest in the future. An estimated forfeiture rate of 3.4% was used in the calculation of expense related to the RSUs. The Company recorded \$89,896 and \$392,197 of expense related to RSUs in the three and six month periods ended December 31, 2016,



respectively.

**Director and Employee Stock Compensation Awards**

The Company awarded a total of *19,920* and *21,199* common shares in the *six* months ended *December 31, 2017* and *2016*, respectively, as stock compensation awards. These common shares were valued at their approximate *\$155,974* and *\$228,000* 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 *December 31, 2017* there were 38 participants, all with fully vested account balances. A total of 245,732 common shares with a cost of \$2,187,811, and 257,898 common shares with a cost of \$2,456,875 were held in the plan as of *December 31, 2017* and *June 30, 2017*, 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; shares newly issued for compensation deferred into the plan, and for distributions to terminated employees. The Company issued 42,280 new common shares for purposes of the non-qualified deferred compensation plan as of *December 31, 2017* and the company did *not* issue new common shares for plan in fiscal 2017. The Company used approximately \$106,537 and \$390,288 to purchase 15,225 and 39,487 common shares of the Company in the open stock market during the *six* months ended *December 31, 2017* and *2016*, respectively, for either employee salary deferrals or Company contributions into the non-qualified deferred compensation plan.

The Company's non-qualified deferred compensation is *no* longer funded by purchases in the open market of LSI stock as of *September 30, 2017*. This plan is now solely funded by newly issued shares that are authorized from the Company's 2012 Stock Incentive Plan.

**NOTE 11 - SUPPLEMENTAL CASH FLOW INFORMATION**

<i>(In thousands)</i>	Six Months Ended	
	December 31 2017	2016
Cash payments:		
Interest	\$767	\$21
Income taxes	\$1,232	\$2,381
Non-cash investing and finance activities:		
Issuance of common shares as compensation	\$156	\$228
Issuance of common shares to fund deferred compensation plan	\$261	\$--

**NOTE 12 - COMMITMENTS AND CONTINGENCIES**

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 *December 31, 2017*, there were *no* standby letter of credit agreements.

### NOTE 13 – SEVERANCE COSTS

The Company recorded severance expense of \$83,000 and \$173,000 in the *six* months ended *December 31, 2017* and *2016*, 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:

	Six Months Ended December 31, 2017	Six Months Ended December 31, 2016	Fiscal Year Ended June 30, 2017
<i>(In thousands)</i>			
Balance at beginning of the period	\$ 235	\$ 39	\$ 39
Accrual of expense	83	173	523
Payments	(218 )	(205 )	(313 )
Adjustments	(14 )	--	(14 )
Balance at end of the period	\$ 86	\$ 7	\$ 235

### 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 fluorescent light sources as long as these products are commercially viable. All operations at the Kansas City facility ceased prior to *December 31, 2016*. Fiscal 2017 restructuring costs related to the closure of the Kansas City facility were *\$944,000*. There have been *no* restructuring costs in fiscal 2018. These costs primarily included employee-related costs (primarily severance), the impairment of manufacturing equipment, plant shut down costs, costs related to the preparation of the facility for sale, legal costs, and other related costs. In addition, there was also an inventory write-down of *\$485,000* recorded in fiscal 2017. The write-down was related to inventory that was previously realizable until the decision in the *first* quarter of fiscal 2017 to close the Kansas City plant due to the planned curtailment of the manufacturing of fluorescent light fixtures. The Company owned the facility in Kansas City and realized a *\$1,361,000* gain when the facility was sold.

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 administration and engineering functions were moved to the Company's Cincinnati, Ohio facility. This consolidation was completed *September 30, 2016*. As a result of this consolidation, restructuring charges of \$377,000 were recorded in 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. There were *no* restructuring charges in fiscal 2018.

In *November 2016*, the Company announced the consolidation of the Woonsocket, Rhode Island manufacturing operation into its North Canton, Ohio operation. The manufacturing operations in Woonsocket ceased prior to *December 31, 2016*. The Company owned the facility in Woonsocket and realized a small gain when the facility was sold in *September 2017*. Total restructuring costs related to the consolidation of the Woonsocket facility were \$452,000 in fiscal 2017. These costs primarily include employee-related costs (severance), plant shut down costs, costs related to the preparation of the facility for sale, legal costs, and other related costs. There have been *no* restructuring charges in fiscal 2018.

Management does *not* expect any significant restructuring charges for fiscal 2018. All previously announced restructuring projects were completed in fiscal 2017 and all restructuring charges were recorded in fiscal 2017.

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

	Three Months Ended December 31, 2017	Six Months Ended December 31, 2017	Three Months Ended December 31, 2016	Six Months Ended December 31, 2016
<i>(In thousands)</i>				
Severance and other termination benefits	\$ --	\$ --	\$ 526	\$ 691
Lease obligation	--	--	--	213
Impairment of fixed assets and accelerated depreciation	--	--	80	353
Other	--	--	91	96
Total	\$ --	\$ --	\$ 697	\$ 1,353

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 December 31 2016	Six Months Ended December 31 2016
<i>(In thousands)</i>		
Cost of Goods Sold	\$ 640	\$ 1,143
Operating Expenses	57	210
Total	\$ 697	\$ 1,353

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

	Three	Six	Three	Six
	Months	Months	Months	Months
	Ended	Ended	Ended	Ended
	December	December	December	December
	31,	31,	31,	31,
	2017	2017	2016	2016
<i>(In thousands)</i>				
Lighting Segment	\$ --	\$ --	\$ 476	\$ 1,021
Graphics Segment	--	--	221	221
Corporate and Eliminations	--	--	--	111
Total	\$ --	\$ --	\$ 697	\$ 1,353

The above tables exclude the gain on the sale of the Kansas City and Woonsocket facilities. Additionally, the above 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	Restructuring			Balance
	as of		Payments	Adjustments	as of
	June	Expense			December
	30,				31,
	2017				2017
Severance and termination benefits	\$ --	\$ --	\$ --	\$ --	\$ --
Lease obligation	85	--	(85 )	--	--
Other	--	--	--	--	--
Total	\$ 85	\$ --	\$ (85 )	\$ --	\$ --

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 on a periodic basis 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.

The Tax Cuts and Jobs Act was signed into law on *December 22nd, 2017* and makes numerous changes to the Internal Revenue Code. Among other changes, the Act reduces the US corporate income tax rate to *21%* effective *January 1, 2018*. Because the Act became effective mid-way through the Company's tax year, the Company will have a US statutory income tax rate of *27.7%* for the fiscal *2018*, and will have a *21%* US statutory income tax rate for fiscal years thereafter. During the quarter ended *December 31, 2017*, the Company re-valued the deferred tax balances because of the change in US tax rate resulting in a *one-time* deferred tax expense of *\$4,676,578*. The Company revised its full year projected effective tax rate to incorporate the fiscal *2018* statutory rate of *27.7%*. The Company completed its accounting for the income tax effects of the Act during the quarter.



	Three Months Ended December 31 2017		Six Months Ended December 31 2016	
<b>Reconciliation to effective tax rate:</b>				
Provision for income taxes at the anticipated annual tax rate	28.9 %	30.4%	28.9 %	30.8%
Enactment of tax law changes	111.2	--	(22.2)	--
Uncertain tax positions	(4.8 )	(0.6 )	0.5	(0.8 )
Difference between deferred and current tax rate related to the impairment of goodwill	--	--	12.1	--
Other	--	--	--	(1.8 )
Tax impact related to share based compensation	0.3	(0.5 )	(0.4 )	(0.6 )
<b>Effective tax rate</b>	<b>135.6%</b>	<b>29.3%</b>	<b>18.9 %</b>	<b>27.6%</b>

## **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**

<i>(In thousands)</i>	Three Months Ended December 31 2017		Six Months Ended December 31 2016	
	2017	2016	2017	2016
Lighting Segment	\$69,174	\$65,076	\$137,602	\$130,341
Graphics Segment	23,131	20,582	42,169	39,476
	\$92,305	\$85,658	\$179,771	\$169,817

### **Operating Income (Loss) by Business Segment**

<i>(In thousands)</i>	Three Months Ended December 31 2017		Six Months Ended December 31 2016	
	2017	2016	2017	2016

Lighting Segment	\$5,275	\$3,761	\$(17,655)	\$6,852
Graphics Segment	2,255	1,174	3,731	2,191
Corporate and Eliminations	(2,983)	(2,117)	(6,343)	(5,159)
	\$4,547	\$2,818	\$(20,267)	\$3,884

### **Summary Comments**

Fiscal 2018 second quarter net sales of \$92,305,000 increased \$6.6 million or 7.8% as compared to second quarter fiscal 2017 net sales of \$85,658,000. Net sales were favorably influenced by increased net sales of the Lighting Segment (up \$4.1 million or 6.3%) and increased net sales of the Graphics Segment (up \$2.5 million or 12.4%). Comparable fiscal 2018 net sales excluding net sales from Atlas Lighting Products, Inc. ("Atlas") decreased by \$7.3 million or 8.5% compared to fiscal 2017 net sales. The Company acquired Atlas on February 21, 2017.

Fiscal 2018 first half net sales of \$179,771,000 increased \$10 million or 5.9% as compared to first half fiscal 2017 net sales of \$169,817,000. Net sales were favorably influenced by increased net sales of the Lighting Segment (up \$7.3 million or 5.5%) and increased net sales of the Graphics Segment (up \$2.7 million or 6.8%). Comparable fiscal 2018 net sales excluding net sales from Atlas decreased by \$15.0 million or 8.8% compared to fiscal 2017 net sales.

Fiscal 2018 second quarter operating income of \$4,547,000 increased \$1.7 million or 61.4% from operating income of \$2,818,000 in the second quarter of fiscal 2017. The increase in adjusted operating income was the net result of increased net sales, increased gross profit and increased gross profit as a percentage of sales, and an increase in selling and administrative expenses. The Company also recorded restructuring costs of \$697,000 in the second quarter of fiscal 2017 with no corresponding cost in fiscal 2018.

Fiscal 2018 first half operating loss of \$(20,267,000) represents a \$24.2 million change from operating income of \$3,884,000 in the first half of fiscal 2017. The change from operating income in fiscal 2017 to an operating loss in fiscal 2018 is primarily the result of a \$28 million goodwill impairment in the first quarter of fiscal 2018. Also contributing to the year-over-year change in operating income is the net result of increased net sales, increased gross profit and increased gross profit as a percentage of sales, and an increase in selling and administrative expenses. The Company also recorded restructuring costs of \$1,753,000 in the first half of fiscal 2017 with no corresponding cost in fiscal 2018.

### Non-GAAP Financial Measures

The Company believes it is appropriate to evaluate its performance after making adjustments to the as-reported U.S. GAAP operating income, net income, and earnings per share. Adjusted operating income, net income and earnings per share, which exclude the impact of a goodwill impairment, a tax charge related to the revaluation of deferred tax assets, restructuring and plant closure costs, and other severance costs, are non-GAAP financial measures. We believe that these adjusted supplemental measures are useful in assessing the operating performance of our business. These supplemental measures are used by our management, including our chief operating decision maker, to evaluate business results. We exclude these items because they are not representative of the ongoing results of operations of our business. Below is a reconciliation of these non-GAAP measures to operating income, net income, and earnings per share for the periods indicated.

(in thousands, unaudited)	Second Quarter	
	FY 2018	FY 2017
Reconciliation of operating income to adjusted operating income:		
Operating income as reported	\$4,547	\$2,818
Adjustment for restructuring and plant closure costs	--	697
Adjustment for other severance costs	83	28
Adjusted operating income	\$4,630	\$3,543

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(in thousands, except per share data; unaudited)

	Second Quarter			
	FY 2018	Diluted EPS	FY 2017	Diluted EPS
Reconciliation of net income (loss) to adjusted net income:				
Net income (loss) and earnings (loss) per share as reported	\$(1,468)	\$(0.06 )	\$2,006	\$ 0.08
Tax impact from the reduction of the deferred tax assets	4,676	0.18	--	--
Adjustment for restructuring and plant closure costs, inclusive of the income tax effect	--	--	448 (1)	0.02
Adjustment for severance costs, inclusive of the income tax effect	59 (3)	--	23 (2)	--
Adjusted net income and earnings per share	\$3,267	\$ 0.12	\$2,477	\$ 0.10

The income tax effects of the adjustments in the tables above were calculated using the estimated U.S. effective income tax rates re-computed after considering non-GAAP adjustments for the periods indicated. The income tax effects were as follows (in thousands):

(1) 249

(2) 5

(3) 24

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(in thousands, unaudited)	First Half	
	FY 2018	FY 2017
Reconciliation of operating income (loss) to adjusted operating income:		
Operating income (loss) as reported	\$(20,267)	\$3,884
Adjustment for goodwill impairment	28,000	--
Adjustment for restructuring, plant closure costs, and related inventory write-downs	--	1,753
Adjustment for other severance costs	83	173
Adjusted operating income	\$7,816	\$5,810

(in thousands, except per share data; unaudited)	First Half		Diluted	
	FY 2018	Diluted EPS	FY 2017	Diluted EPS
Reconciliation of net income (loss) to adjusted net income:				
Net income (loss) and earnings (loss) per share as reported	\$(17,097)	\$(0.66 )	\$2,835	\$ 0.11
Adjustment for goodwill impairment, inclusive of the income tax effect	17,361 (4)	0.67		
Tax impact from the reduction of the deferred tax assets	4,676	0.18	--	--
Adjustment for restructuring and plant closure costs, inclusive of the income tax effect	--	--	1,143(1)	0.04
Adjustment for other severance costs, inclusive of the income tax effect	59 (3)	--	120 (2)	--
Adjusted net income and earnings per share	\$5,001	\$0.19	\$4,098	\$ 0.16

The income tax effects of the adjustments in the tables above were calculated using the estimated U.S. effective income tax rates re-computed after considering non-GAAP adjustments for the periods indicated. The income tax effects were as follows (in thousands):

(1) 610

(2) 53

(3) 24

(4) 10,639

The reconciliation of reported net income and earnings per share to adjusted net income and earnings per share may not agree due to rounding differences and due to the difference between basic and dilutive weighted average shares outstanding in the computation of earnings per share.

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**Results of Operations****THREE MONTHS ENDED DECEMBER 31, 2017 COMPARED TO THREE MONTHS ENDED DECEMBER 31, 2016****Lighting Segment**

<i>(In thousands)</i>	Three Months Ended	
	December 31 2017	December 31 2016
Net Sales	\$69,174	\$65,076
Gross Profit	\$19,259	\$16,493
Operating Income	\$5,275	\$3,761

Lighting Segment net sales of \$69,174,000 in the second quarter of fiscal 2018 increased 6.3% from fiscal 2017 same period net sales of \$65,076,000. Comparable fiscal 2018 net sales excluding net sales from Atlas decreased by \$9.8 million or 15.1% from fiscal 2017 second quarter sales. The Lighting Segment's net sales of light fixtures having solid-state LED technology totaled \$57.7 million in the second quarter of fiscal 2018, representing an \$11.6 million or 25.1% increase from fiscal 2017 second quarter net sales of solid-state LED light fixtures of \$46.1 million. Light fixtures having solid-state LED technology represent 91.7% of total lighting product net sales in the second quarter of fiscal 2018 compared to 78.2% of total lighting product net sales in the second quarter of fiscal 2017. Total lighting product net sales excludes sales related to installation and shipping and handling. There was a reduction in the Company's traditional lighting sales (metal halide and fluorescent light sources) from fiscal 2017 to fiscal 2018 as customers continue to convert from traditional lighting to light fixtures having solid-state LED technology.

Lighting Segment total net sales of solid-state LED technology in light fixtures have been recorded as indicated in the table below.

<i>(In thousands)</i>	LED Net Sales		% Change	
	FY 2018	FY 2017		
First Quarter	\$52,956	\$43,146	22.7	%
Second Quarter	57,726	46,137	25.1	%
First Half	110,682	89,283	24.0	%
Third Quarter		44,946		
Nine Months		134,229		

Fourth Quarter	52,303
Full Year	\$186,532

Gross profit of \$19,259,000 in the second quarter of fiscal 2018 increased \$2.8 million or 16.8% from the same period of fiscal 2017, and increased from 25.1% to 27.4% as a percentage of Lighting Segment net sales (customer plus inter-segment net sales). The Company incurred restructuring and plant closure costs that were recorded in cost of sales related to the closure of the Kansas City, Kansas manufacturing facility of \$429,000 with no comparable costs in fiscal 2018. The remaining increase in amount of gross profit is due to the net effect of improved product mix, net sales from Atlas for which there were no comparable sales in fiscal 2017, manufacturing efficiencies as a result of the Company's lean initiatives, continued inflationary pressures in certain commodities, competitive pricing pressures, continued softness in the lighting industry, and cost savings related to the closure of the Kansas City manufacturing facility.

Selling and administrative expenses of \$13,984,000 in the second quarter of fiscal 2018 increased \$1.3 million or 9.9% from the same period of fiscal 2017, primarily as the net result of acquiring Atlas. Our comparable selling and administrative expenses excluding Atlas decreased 16.2% in the second quarter of fiscal 2018 from the same period of fiscal 2017. The more notable quarter-over-quarter changes impacting the \$1.3 million increase in selling and administrative expenses are increased employee compensation and benefits expense (\$0.8 million), decreased commission expense (\$1.1 million), and increased amortization expense (\$0.6 million).

The Lighting Segment second quarter fiscal 2018 operating income of \$5,275,000 increased \$1.5 million or 40.3% from operating income of \$3,761,000 in the same period of fiscal 2017. The \$1.5 million increase in operating income was the net result of increased net sales, an increase in gross profit and gross profit as a percentage of sales, increased selling and administrative expenses, and plant closure costs in fiscal 2017 with no comparable expenses in fiscal 2018.



**Graphics Segment**

<i>(In thousands)</i>	Three Months Ended	
	December 31	
	2017	2016
Net Sales	\$23,131	\$20,582
Gross Profit	\$6,046	\$4,918
Operating Income	\$2,255	\$1,174

Graphics Segment net sales of \$23,131,000 in the second quarter of fiscal 2018 increased \$2.5 million or 12.4% from fiscal 2017 same period net sales of \$20,582,000. Sales to the Retail and QSR markets increased in the second quarter of fiscal 2018 compared the second quarter of fiscal 2017, followed by a modest increase in sales to the Petroleum market.

Gross profit of \$6,046,000 in the second quarter of fiscal 2018 increased \$1.1 million or 23.0% from the same period of fiscal 2017. Gross profit as a percentage of segment net sales (customer plus inter-segment net sales) increased from 23.1% in the second quarter of fiscal 2017 to 25.0% in the second quarter of fiscal 2018. The change in amount of gross profit is due to the net effect of increased net sales (customer plus inter-segment net sales), improved gross profit margin on shipping and handling sales, and decreased employee compensation and benefit expense (\$0.1 million). The Company incurred \$211,000 in the second quarter of fiscal 2017 related to the closure of its Woonsocket, Rhode Island facility with no comparable expense in fiscal 2018.

Selling and administrative expenses of \$3,791,000 in the second quarter of fiscal 2018 increased slightly from fiscal 2017 selling and administrative expenses of \$3,744,000. There were only modest increases and offsetting decreases in several cost categories.

The Graphics Segment second quarter fiscal 2018 operating income of \$2,255,000 increased \$1.1 million or 92.1% from operating income of \$1,174,000 in the same period of fiscal 2017. The increase of \$1.1 million was primarily the net result of increased net sales, increased gross profit and increased gross profit margin as a percentage of sales, and a small increase in selling and administrative costs.

**Corporate and Eliminations**

<i>(In thousands)</i>	Three Months Ended
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	December 31	
	2017	2016
Gross Profit (Loss)	\$2	\$(4 )
Operating (Loss)	\$(2,983)	\$(2,117)

The gross profit (loss) relates to the change in the intercompany profit in inventory elimination.

Administrative expenses of \$2,985,000 in the second quarter of fiscal 2018 increased \$0.9 million or 41.0% from the same period of the prior year. The \$0.9 million increase is the result of increased employee compensation and benefit expense (\$1.1 million increase) partially offset by a reduction in the cost of outside services expense such as legal expenses (\$0.2 million decrease). Most of the increase in employee compensation and benefit expense is the result of the reduction of incentive-based compensation in the second quarter of fiscal 2017 which was driven by the operating results of the Company. There was no similar reduction in incentive-based compensation in fiscal 2018.

### Consolidated Results

The Company reported \$417,000 net interest expense in the second quarter of fiscal 2018 compared to net interest income of \$20,000 in the second quarter of fiscal 2017. The change from interest income in fiscal 2017 to interest expense in fiscal 2018 is the result of borrowing against the Company's line of credit. Commitment fees related to the unused portion of the Company's line of credit and interest income on invested cash are included in both fiscal years.

The \$5,598,000 income tax expense in the second quarter of fiscal 2018 was most notably impacted by a \$4.7 million tax adjustment related to the revaluation of the Company's deferred tax assets partially offset by a favorable tax impact related to the re-alignment of the Company's tax expense to a lower effective tax rate, both related to the recently enacted "Tax Cut and Jobs Act" ("TCJA") legislation. The \$832,000 income tax expense in the second quarter of fiscal 2017 represents a consolidated effective tax rate of 29.3%. This is the net result of an income tax rate of 30.8% influenced by certain permanent book-tax differences and by a benefit related to uncertain income tax positions.

The Company reported a net loss of \$(1,468,000) in the second quarter of fiscal 2018 as compared to net income of \$2,006,000 in the same period of the prior year. The change between net income in fiscal 2017 to a net loss in fiscal 2018 is mostly driven by the \$4.7 million charge in fiscal 2018 related to the re-valuation of the Company's deferred tax assets. Also contributing to the quarter-over-quarter net change in net income are increased net sales, increased gross profit and an improvement of gross profit as a percentage of sales, increased selling and administrative expenses, and restructuring and plant closure costs in fiscal 2017 with no comparable costs in fiscal 2018. Diluted loss per share of \$(0.06) was reported in the second quarter of fiscal 2018 as compared to \$0.08 diluted earnings per share in the same period of fiscal 2017. The weighted average common shares outstanding for purposes of computing diluted earnings per share in the second quarter of fiscal 2018 were 25,858,000 shares as compared to 25,803,000 shares in the same period last year.

## SIX MONTHS ENDED DECEMBER 31, 2017 COMPARED TO SIX MONTHS ENDED DECEMBER 31, 2016

### Lighting Segment

<i>(In thousands)</i>	Six Months Ended December 31	
	2017	2016
Net Sales	\$137,602	\$130,341
Gross Profit	\$37,932	\$32,383
Operating (Loss) Income	\$(17,655)	\$6,852

Lighting Segment net sales of \$137,602,000 in the first half of fiscal 2018 increased 5.5% from fiscal 2017 same period net sales of \$130,341,000. Comparable fiscal 2018 net sales excluding net sales from Atlas decreased by \$17.7 million or 13.6% from fiscal 2017 second quarter sales. The Lighting Segment's net sales of light fixtures having solid-state LED technology totaled \$110.7 million in the first half of fiscal 2018, representing a \$21.4 million or 24.0% increase from fiscal 2017 first half net sales of solid-state LED light fixtures of \$89.3 million. Light fixtures having solid-state LED technology represent 88.3% of total lighting product net sales in the first half of fiscal 2018 compared to 75.2% of total lighting product net sales in the first half of fiscal 2017. Total lighting product net sales excludes sales related to installation and shipping and handling. There was a reduction in the Company's traditional lighting sales (metal halide and fluorescent light sources) from fiscal 2017 to fiscal 2018 as customers continue to convert from traditional lighting to light fixtures having solid-state LED technology.

Gross profit of \$37,932,000 in the first half of fiscal 2018 increased \$5.5 million or 17.1% from the same period of fiscal 2017, and increased from 24.6% to 27.2% as a percentage of Lighting Segment net sales (customer plus inter-segment net sales). The Company incurred restructuring and plant closure costs that were recorded in cost of sales related to the closure of the Kansas City, Kansas manufacturing facility and the Beaverton, Oregon facility of \$932,000 and plant closure costs related to an inventory write-down of \$400,000 as the Company exited the

manufacturing of fluorescent lighting fixtures with no comparable costs in fiscal 2018. The remaining increase in amount of gross profit is due to the net effect of improved product mix, net sales from Atlas for which there were no comparable sales in fiscal 2017, manufacturing efficiencies as a result of the Company's lean initiatives, continued inflationary pressures in certain commodities, competitive pricing pressures, continued softness in the lighting industry, and cost savings related to the closure of the Kansas City and Beaverton facilities.

Selling and administrative expenses of \$27,587,000 in the first half of fiscal 2018 excluding the \$28 million goodwill impairment charge, increased \$2.1 million or 8.1% from the same period of fiscal 2017 primarily as the net result of acquiring Atlas. Our comparable selling and administrative expenses excluding Atlas decreased 17.5% in the first half of fiscal 2018 from the same period of fiscal 2017. The more notable year-over-year changes impacting the \$2.1 million increase in selling and administrative expenses are increased employee compensation and benefits expense (\$1.3 million), increased research and development expense (\$0.2 million), decreased commission expense (\$1.6 million), and increased amortization expense (\$1.2 million). The Company recorded a \$28 million goodwill impairment charge in fiscal 2018 with no comparable expense in fiscal 2017. The Company will perform an impairment analysis in the third quarter of fiscal 2018 in conjunction with its annual impairment test.

The Lighting Segment first half fiscal 2018 operating loss of \$(17,655,000) represents a \$24,507,000 change from operating income of \$6,852,000 in the same period of fiscal 2017 primarily due to a \$28 million pre-tax goodwill impairment charge. The year-over-year change was also the net result of increased net sales, an increase in gross profit and gross profit as a percentage of sales, increased selling and administrative expenses, and plant closure costs in fiscal 2017 with no comparable expenses in fiscal 2018.

**Graphics Segment**

<i>(In thousands)</i>	Six Months Ended	
	December 31	
	2017	2016
Net Sales	\$42,169	\$39,476
Gross Profit	\$11,109	\$9,358
Operating Income	\$3,731	\$2,191

Graphics Segment net sales of \$42,169,000 in the first half of fiscal 2018 increased \$2.7 million or 6.8% from fiscal 2017 same period net sales of \$39,476,000. Sales to the Retail and QSR markets increased in the first half of fiscal 2018 compared to fiscal 2017 which more than offset a decline in sales to the Petroleum market over the same period.

Gross profit of \$11,109,000 in the first half of fiscal 2018 increased \$1.8 million or 18.7% from the same period of fiscal 2017. Gross profit as a percentage of segment net sales (customer plus inter-segment net sales) increased from 23.2% in the first half of fiscal 2017 to 25.7% in the first half of fiscal 2018. The change in amount of gross profit is due to the net effect of increased net sales (customer plus inter-segment net sales), an improvement in the gross profit margin of installation and shipping and handling sales, and decreased employee compensation and benefit expense (\$0.5 million). The Company incurred \$211,000 in the first half of fiscal 2017 related to the closure of its Woonsocket, Rhode Island facility with no comparable expense in fiscal 2018.

Selling and administrative expenses of \$7,378,000 in the first half of fiscal 2018 increased 2.9% or \$0.2 million from fiscal 2017 selling and administrative expenses of \$7,167,000. There were only modest increases and offsetting decreases in several cost categories.

The Graphics Segment first half fiscal 2018 operating income of \$3,731,000 increased \$1.5 million or 70.3% from operating income of \$2,191,000 in the same period of fiscal 2017. The increase of \$1.5 million was primarily the net result of increased net sales, increased gross profit and increased gross profit margin as a percentage of sales, and a small increase in selling and administrative costs.

**Corporate and Eliminations**

<i>(In thousands)</i>	Six Months	
	Ended	
	December 31	
	2017	2016

Gross Profit (Loss)	\$(31 ) \$501
Operating (Loss)	\$(6,343) \$(5,159)

The gross profit (loss) relates to the change in the intercompany profit in inventory elimination.

Administrative expenses of \$6,312,000 in the first half of fiscal 2018 increased \$0.7 million or 11.5% from the same period of the prior year. The \$0.7 million increase is the result of increased employee compensation and benefit expense (\$0.5 million increase) and by a net increase in other cost categories. Most of the increase in employee compensation and benefit expense is the result of the reduction of incentive-based compensation in the second quarter of fiscal 2017 which is driven by the operating results of the Company. There was no similar reduction in incentive-based compensation in fiscal 2018. Also contributing to the net change in administrative expenses are restructuring costs of \$0.1 million recorded in fiscal 2017 related to the consolidation of its Beaverton, Oregon facility into other LSI facilities, with no comparable costs in fiscal 2018.

### **Consolidated Results**

The Company reported \$820,000 net interest expense in the first half of fiscal 2018 compared to net interest income of \$34,000 in the first half of fiscal 2017. The change from interest income in fiscal 2017 to interest expense in fiscal 2018 is the result of borrowing against the Company's line of credit. Commitment fees related to the unused portion of the Company's line of credit and interest income on invested cash are included in both fiscal years.

The \$3,990,000 tax benefit in the first half of fiscal 2018 represents a consolidated overall tax rate of 135.6%. This is a result of an effective tax rate of 58.2% influenced most notably by the first quarter goodwill impairment, and by a \$4.7 million tax adjustment related to the revaluation of the Company's deferred tax assets partially offset by a favorable tax impact related to the re-alignment of the Company's tax expense to a lower effective tax rate, both related to the recently enacted TCJA legislation. The \$1,083,000 income tax expense in the first half of fiscal 2017 represents a consolidated effective tax rate of 18.9%. This is the net result of an income tax rate of 28.9% influenced by certain permanent book-tax differences, by a benefit related to uncertain income tax positions, and by a favorable adjustment to a deferred tax asset.

The Company reported a net loss of \$(17,097,000) in the first half of fiscal 2018 as compared to net income of \$2,835,000 in the same period of the prior year. The change between net income in fiscal 2017 to a net loss in fiscal 2018 is mostly driven by the \$4.7 million charge in fiscal 2018 related to the re-valuation of the Company's deferred tax assets and by the first quarter goodwill impairment. Also contributing to the quarter-over-quarter net change in net income are increased net sales, increased gross profit and an improvement of gross profit as a percentage of sales, increased selling and administrative expenses, and restructuring and plant closure costs in fiscal 2017 with no comparable costs in fiscal 2018. Diluted loss per share of \$(0.66) was reported in the first half of fiscal 2018 as compared to \$0.11 diluted earnings per share in the same period of fiscal 2017. The weighted average common shares outstanding for purposes of computing diluted earnings per share in the first half of fiscal 2018 were 25,824,000 shares as compared to 25,859,000 shares in the same period last year.

### **Liquidity and Capital Resources**

The Company considers its level of cash on hand, borrowing capacity, current ratio and working capital levels to be its most important measures of short-term liquidity. For long-term liquidity indicators, the Company believes its ratio of long-term debt to equity and its historical levels of net cash flows from operating activities to be the most important measures.

At December 31, 2017, the Company had working capital of \$72.8 million, compared to \$61.7 million at June 30, 2017. The ratio of current assets to current liabilities was 2.71 to 1 as compared to a ratio of 2.36 to 1 at June 30, 2017. The \$11.1 million increase in working capital from June 30, 2017 to December 31, 2017 was primarily driven by an increase in net accounts receivable (\$10.9 million). The other offsetting changes to working capital are as follow: decreased net inventories (\$1.3 million); a reduction in the asset held for sale (\$1.5 million); a decrease in accounts payable (\$2.6 million); and an increase in accrued expenses (\$0.4 million). The Company has a strategy of aggressively managing working capital, including reduction of the accounts receivable days sales outstanding ("DSO") and reduction of inventory levels, without reducing service to its customers.

The Company used \$0.8 million of cash from operating activities in the first half of fiscal 2018 as compared to a source of cash of \$4.6 million in the same period of the prior year. This \$5.4 million decrease in net cash flows from

operating activities is primarily the net result of a larger increase in accounts receivable (unfavorable change of \$8.2 million), a larger decrease in accounts payable (unfavorable change of \$2.4 million), a decrease rather than an increase in customer prepayments (unfavorable change of \$0.4 million), a smaller decrease in net inventory (unfavorable change of \$0.7 million), a smaller decrease in accrued expenses and other (favorable change of \$1.9 million), a decrease in refundable income taxes (favorable change of \$0.8 million), and a change from net income in fiscal 2017 to a net loss in fiscal 2018 more than offset by an increase in non-cash items (favorable change of \$3.7 million).

Net accounts receivable were \$59.7 million and \$48.9 million at December 31, 2017 and June 30, 2017, respectively. DSO increased to 56 days at December 31, 2017 from 52 days at June 30, 2017. The Company believes that its receivables are ultimately collectible or recoverable, net of certain reserves, and that aggregate allowances for doubtful accounts are adequate.

Net inventories of \$48.7 million at December 31, 2017 decreased \$1.4 million from \$50.0 million at June 30, 2017. The decrease of \$1.4 million is the result of a decrease in gross inventory of \$1.0 million and an increase in obsolescence reserves of \$0.4 million. Based on a strategy of balancing inventory reductions with customer service and the timing of shipments, net inventory increases occurred in the first half of fiscal 2018 in the Graphics Segment of approximately \$0.9 million which was more than offset by a decrease in net inventory in the Lighting Segment of \$2.2 million.

Cash generated from operations and borrowing capacity under the Company's line of credit is the Company's primary source of liquidity. The Company has a secured \$100 million revolving line of credit with its bank, with \$56.8 million of the credit line available as of January 25, 2018. This line of credit is a \$100 million five year credit line expiring in the third quarter of fiscal 2022. The Company believes that its \$100 million line of credit plus cash flows from operating activities are adequate for the Company's fiscal 2018 operational and capital expenditure needs. The Company is in compliance with all of its loan covenants.



The Company generated cash of \$0.3 million related to investing activities in the half of fiscal 2018 as compared to a use of \$2.7 million in the same period from the prior year, resulting in a favorable change of \$3.1 million. Capital expenditures for the first half of fiscal 2018 decreased \$1.6 million to \$1.2 million from the same period in fiscal 2017. The Company sold its Woonsocket manufacturing facility for \$1.5 million which contributed to the change in cash flow from investing activities from fiscal 2017 to fiscal 2018.

The Company generated \$0.6 million of cash related to financing activities in the first half of fiscal 2018 compared to a use of cash of \$2.7 million in the first half of fiscal 2017. The \$3.3 million favorable change in cash flow was the net result of borrowings in excess of payments of long term debt of \$2.5 million, and a decrease in the purchase of treasury shares coupled with an increase in the distribution of treasury shares (favorable change of \$0.7 million).

The Company has, or could have, on its balance sheet financial instruments consisting primarily of cash and cash equivalents, short-term investments, revolving lines of credit, and 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.

### **Off-Balance Sheet Arrangements**

The Company has no financial instruments with off-balance sheet risk and has no off-balance sheet arrangements, except for various operating leases.

### **Cash Dividends**

In January 2018, the Board of Directors declared a regular quarterly cash dividend of \$0.05 per share payable February 13, 2018 to shareholders of record as of February 5, 2018. The indicated annual cash dividend rate for fiscal 2018 is \$0.20 per share. The Board of Directors has adopted a policy regarding dividends which indicates that dividends will be determined by the Board of Directors in its discretion based upon its evaluation of earnings, cash flow requirements, financial condition, debt levels, stock repurchases, future business developments and opportunities, and other factors deemed relevant.

### **Critical Accounting Policies and Estimates**

The Company is required to make estimates and judgments in the preparation of its financial statements that affect the reported amounts of assets, liabilities, revenues and expenses, and related footnote disclosures. The Company bases its estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities. The Company continually reviews these estimates and their underlying assumptions to ensure they remain appropriate. The Company believes the items discussed below are among its most significant accounting policies because they utilize estimates about the effect of matters that are inherently uncertain and therefore are based on management's judgment. Significant changes in the estimates or assumptions related to any of the following critical accounting policies could possibly have a material impact on the financial statements.

### ***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. 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 multiple 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. In certain arrangements with customers, as is the case with the sale of some of our solid-state LED video screens, revenue is recognized upon customer acceptance of the video screen at the job site. 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 and billboards.

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 a 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 1 month to 1 year.

Shipping and handling revenue coincides with the recognition of revenue from the 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 standard on software revenue recognition. Our solid-state LED video screens, billboards and active digital signage contain software elements which the Company has determined are incidental.

### ***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. The Company has adopted ASU 2015-17, "Balance Sheet Classification of Deferred Taxes." As a

result of early adoption of this accounting guidance, prior periods have been re-classified, which only affected the financial statement presentation and not the measurement of deferred tax liabilities and assets.

The Company operates in multiple taxing jurisdictions and is subject to audit in these jurisdictions. The Internal Revenue Service and other tax authorities routinely review the Company's tax returns. These audits can involve complex issues which may require an extended period of time to resolve. In management's opinion, adequate provision has been made for potential adjustments arising from these audits.

The Company is recording estimated interest and penalties related to potential underpayment of income taxes as a component of tax expense in the Condensed Consolidated Statements of Operations. The reserve for uncertain tax positions is not expected to change significantly in the next twelve months.

The Tax Cuts and Jobs Act was signed into law on December 22nd, 2017 and makes numerous changes to the Internal Revenue Code. Among other changes, the Act reduces the US corporate income tax rate to 21% effective January 1, 2018. Because the Act became effective mid-way through the Company's tax year, the Company will have a US statutory income tax rate of 27.7% for the fiscal 2018, and will have a 21% US statutory income tax rate for fiscal years thereafter. During the quarter ended December 31, 2017, the Company re-valued the deferred tax balances because of the change in US tax rate resulting in a one-time deferred tax expense of \$4,676,578.

### ***Asset Impairment***

Carrying values of goodwill and other intangible assets with indefinite lives are reviewed at least annually for possible impairment in accordance with the accounting guidance on goodwill and intangible assets. The Company may first assess qualitative factors in order to determine if goodwill is impaired. If through the qualitative assessment it is determined that it is more likely than not that goodwill is not impaired, no further testing is required. If it is determined that it is more likely than not that goodwill is impaired, or if the Company elects not to first assess qualitative factors, the Company's impairment testing continues at the reporting unit level 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. The estimation of the fair value of goodwill and indefinite-lived intangible assets 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, a sustained drop in the Company's stock price, economic factors and technological change or competitive activities may signal that an asset has become impaired.



Carrying values for long-lived tangible assets and definite-lived intangible assets, excluding goodwill and indefinite-lived intangible assets, are reviewed for possible impairment as circumstances warrant. Impairment reviews are conducted at the judgment of Company management when it believes that a change in circumstances in the business or external factors warrants a review. Circumstances such as the discontinuation of a product or product line, a sudden or consistent decline in the forecast for a product, changes in technology or in the way an asset is being used, a history of negative operating cash flow, or an adverse change in legal factors or in the business climate, among others, may trigger an impairment review. The Company's initial impairment review to determine if a potential impairment charge is required is based on an undiscounted cash flow analysis at the lowest level for which identifiable cash flows exist. The analysis requires judgment with respect to changes in technology, the continued success of product lines and future volume, revenue and expense growth rates, and discount rates.

### ***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. The amount ultimately not collected may differ from the reserve established, particularly in the case where percentages are applied against aging categories. In all cases, it is management's goal to carry a reserve against the Company's accounts receivable which is adequate based upon the information available at that time so that net accounts receivable is properly stated. The Company also establishes allowances, at the time revenue is recognized, for returns and allowances, discounts, pricing and other possible customer deductions. These allowances are based upon contractual terms and historical trends.

### ***Warranty Reserves***

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 ten 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 based upon historical claims as a percentage of sales 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.

*Inventory Reserves*

The Company maintains an inventory reserve for probable 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. A combination of financial modeling and qualitative input factors are 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. Management values inventory at lower of cost or market.

The Company is required to make estimates and judgments in the preparation of its financial statements that affect the reported amounts of assets, liabilities, revenues and expenses, and related footnote disclosures. The Company bases its estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities. The Company continually reviews these estimates and their underlying assumptions to ensure they remain appropriate. The Company believes the items discussed below are among its most significant accounting policies because they utilize estimates about the effect of matters that are inherently uncertain and therefore are based on management's judgment. Significant changes in the estimates or assumptions related to any of the following critical accounting policies could possibly have a material impact on the financial statements.

### **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." In December 2016, the FASB issued ASU 2016-20, "Technical Corrections and Improvements to Topic 606, Revenue from Contracts with Customers." These three standards clarify or improve guidance from ASU 2014-09 and are effective for fiscal and interim periods within those years, beginning after December 15, 2017, or the Company's fiscal 2019. The Company will adopt these standards no later than July 1, 2018, using the modified retrospective transition method. The Company is reviewing accounting policies and evaluating disclosures in the financial statements related to the new standard. The Company is also assessing potential changes to the business processes, internal controls, and information systems related to the adoption of the new standard. While the Company is currently assessing the impact of the new standard, the Company's revenue is primarily generated from the sale of finished products to customers. Those sales predominantly contain a single delivery element and revenue is recognized at a single point in time when ownership, risks, and rewards transfer. The recognition of revenue from most product sales is largely unaffected by the new standard. However, with respect to certain product sales requiring installation, revenue is currently not recognized until the installation is complete. While the Company does not expect this new guidance to have a material impact on the amount of overall sales recognized, the timing of recognition of revenues from sales on certain projects may be affected. Our initial conclusions may change as we finalize our assessment and select a transition method during the next six months.

In July 2015, the Financial Accounting Standards Board issued ASU 2015-11, "Simplifying the Measurement of Inventory." The amended guidance requires an entity to measure in scope inventory at lower of cost and net realizable value. The amended guidance is effective for fiscal years beginning after December 15, 2016, or the Company's fiscal 2018. We adopted the new accounting standard in the first quarter of fiscal 2018 and there was no material impact on the Company's consolidated financial statements.

In February 2016, the Financial Accounting Standards Board issued ASU 2016-02, "Leases." The amended guidance requires an entity to recognize assets and liabilities that arise from leases. The amended guidance is effective for financial statements issued for fiscal and interim periods within those years, beginning after December 15, 2018, or the Company's fiscal 2020, with early adoption permitted. The Company has not yet determined the impact the amended guidance will have on its financial statements.

In March 2016, the Financial Accounting Standards Board issued ASU 2016-08, "Principal versus Agent Considerations." The amendment is intended to improve the operability and understandability of the implementation guidance on principal versus agent considerations. The amended guidance is effective for financial statements issued



for fiscal and interim periods within those years, beginning after December 15, 2017, or the Company's fiscal 2019, with early adoption permitted in fiscal years beginning after December 15, 2016. The Company has determined the amended guidance will have an immaterial impact on its financial statements.

In March 2016, the Financial Accounting Standards Board issued ASU 2016-09, "Improvements to Employee Share-Based Payment Accounting." This amended guidance simplifies several aspects of the accounting for share-based payment award transactions. The amended guidance is effective for financial statements issued for fiscal and interim periods within those years, beginning after December 15, 2016, or the Company's fiscal 2018. We adopted this standard on July 1, 2017 and recognized excess tax benefits of \$81,010 in income tax expense during the three months ended September 30, 2017. The amount may not necessarily be indicative of future amounts that may be recognized as any excess tax benefits recognized would be dependent on future stock price, employee exercise behavior and applicable tax rates. Prior to July 1, 2017, excess tax benefits were recognized in additional paid-in capital. Additionally, excess tax benefits are now included in net cash flows provided by operating activities rather than net cash flows provided by financing activities in the Company's Consolidated Statement of Cash Flows. The treatment of forfeitures has not changed, as the Company is electing to continue the current process of estimating forfeiture at the time of grant. The Company had no unrecognized excess tax benefits from prior periods to record upon the adoption of this ASU.

In June 2016, the Financial Accounting Standards Board issued ASU 2016-13, “Measurement of Credit Losses on Financial Instruments.” This amendment provides additional guidance on the measurement of expected credit losses for financial assets based on historical experience, current conditions, and supportable forecasts. The amended guidance is effective for financial statements issued for fiscal and interim periods within those years, beginning after December 15, 2019, or the Company’s fiscal 2021. The Company is evaluating the impact of the amended guidance and the anticipated impact to the financial statements is not material.

In August 2016, the Financial Accounting Standards Board issued ASU 2016-15, “Statement of Cash Flows: Classification of Certain Cash Receipts and Cash Payments,” which provides cash flow classification guidance for certain cash receipts and cash payments. This standard is effective for financial statements issued for fiscal years beginning after December 15, 2017, or the Company’s fiscal 2019. The Company is evaluating the impact the amended guidance will have on its financial statements.

### **ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

There have been no material changes in the Company’s exposure to market risk since June 30, 2017. Additional information can be found in Item 7A, Quantitative and Qualitative Disclosures About Market Risk, which appears on page 13 of the Annual Report on Form 10-K for the fiscal year ended June 30, 2017.

### **ITEM 4. CONTROLS AND PROCEDURES**

#### **Disclosure Controls and Procedures**

The Company maintains disclosure controls and procedures (as such term is defined Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934, as amended (the “Exchange Act”)), that are designed to ensure that information required to be disclosed by a company in the reports that it files under the Exchange Act is recorded, processed, summarized and reported within required time periods specified in the SEC’s rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed is accumulated and communicated to management, including the Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

We conducted, under the supervision of our management, including the Chief Executive Officer and Chief Financial Officer, an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures as defined in Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934. Based upon our evaluation, our Chief Executive Officer and Chief Financial Officer concluded that, as of December 31, 2017, our disclosure controls and procedures were effective. Management believes that the condensed consolidated financial statements included in this Quarterly Report on Form 10-Q are fairly presented in all material respects in accordance with GAAP for interim financial statements, and the Company's Chief Executive Officer and Chief Financial Officer have certified that, based on their knowledge, the condensed consolidated financial statements included in this report fairly present in all material respects the Company's financial condition, results of operations and cash flows for each of the periods presented in this report.

The Company acquired Atlas Lighting Products, Inc. ("Atlas") on February 21, 2017. Management excluded Atlas from its evaluation of the effectiveness of the internal control over financial reporting as of December 31, 2017. Atlas represented 31% of the Company's total consolidated assets as of December 31, 2017, and 14% of the Company's total consolidated sales for the fiscal year ended December 31, 2017.

### **Changes in Internal Control**

There have been no changes in the Company's internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the fiscal quarter ended December 31, 2017, that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

## **PART II. OTHER INFORMATION**

### **ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

The Company does not purchase into treasury its own common shares for general purposes. However, the  
(c) Company does purchase its own common shares, through a Rabbi Trust, in connection with investments of employee/participants of the LSI Industries Inc. Non-Qualified Deferred Compensation Plan. Purchases of Company common shares for this Plan in the second quarter of fiscal 2018 were as follows:

ISSUER PURCHASES OF EQUITY SECURITIES

Period	(a) Total Number of Shares Purchased	(b) Average Price Paid per Share	(c) Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	(d) Maximum Number (or Approximate Dollar Value) of Shares that May Yet Be Purchased Under the Plans or Programs
10/1/17 to 10/31/17	--	--	--	(1)
11/1/17 to 11/30/17	--	--	--	(1)
12/1/17 to 12/31/17	--	--	--	(1)
Total	--	--	--	(1)

In the first half of fiscal 2018, all 575,000 shares authorized for the Company's Non-Qualified Deferred Compensation Plan have been extinguished by purchase in the open market. Newly issued shares from the Company's 2012 Stock Incentive Plan will replace shares purchased in the open market to fulfill the obligation the plan has to its participants.

**ITEM 6. EXHIBITS**

Exhibits:

31.1 Certification of Principal Executive Officer required by Rule 13a-14(a)

31.2 Certification of Principal Financial Officer required by Rule 13a-14(a)

32.1 Section 1350 Certification of Principal Executive Officer

32.2 Section 1350 Certification of Principal Financial Officer

101.INS XBRL Instance Document

101.SCH XBRL Taxonomy Extension Schema Document

101.CAL XBRL Taxonomy Extension Calculation Linkbase Document

101.DEF XBRL Taxonomy Extension Definition Linkbase Document

101.LAB XBRL Taxonomy Extension Label Linkbase Document

101.PRE XBRL Taxonomy Extension Presentation Linkbase Document

**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

**LSI Industries Inc.**

By: /s/ Dennis W. Wells  
Dennis W. Wells  
Chief Executive Officer and President  
(Principal Executive Officer)

By: /s/ James E. Galeese  
James E. Galeese  
Executive President and Chief Financial Officer  
(Principal Financial Officer)

February 7, 2018