

STRATTEC SECURITY CORP
Form 10-Q
February 04, 2016

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 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 27, 2015

or

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

For the transition period from to

Commission File Number 0-25150

STRATTEC SECURITY CORPORATION

(Exact Name of Registrant as Specified in Its Charter)

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

3333 West Good Hope Road, Milwaukee, WI 53209

(Address of Principal Executive Offices)

(414) 247-3333

(Registrant's Telephone Number, Including Area Code)

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Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

YES NO

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

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

Large Accelerated filer

Accelerated filer

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

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

YES NO

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

Common stock, par value \$0.01 per share: 3,637,339 shares outstanding as of December 28, 2015 (which number includes all restricted shares previously awarded that have not vested as of such date).

STRATTEC SECURITY CORPORATION

FORM 10-Q

December 27, 2015

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

The Company's business, operations and financial performance are subject to certain risks and uncertainties, which could result in material differences in actual results from the Company's current expectations. These risks and uncertainties include, but are not limited to, general economic conditions, in particular relating to the automotive industry, consumer demand for the Company's and its customers' products, competitive and technological developments, customer purchasing actions, changes in warranty provisions and customers' product recall policies, foreign currency fluctuations, costs of operations, the volume and scope of product returns and warranty claims and other matters described in the section titled "Risk Factors" in the Company's Form 10-K report filed on September 4, 2015 with the Securities and Exchange Commission for the year ended June 28, 2015.

Shareholders, potential investors and other readers are urged to consider these factors carefully in evaluating the forward-looking statements and are cautioned not to place undue reliance on such forward-looking statements. The

forward-looking statements made herein are only made as of the date of this Form 10-Q and the Company undertakes no obligation to publicly update such forward-looking statements to reflect subsequent events or circumstances occurring after the date of this Form 10-Q.

Item 1 Financial Statements

STRATTEC SECURITY CORPORATION AND SUBSIDIARIES

Condensed Consolidated Statements of Income and Comprehensive Income

(In Thousands, Except Per Share Amounts)

(Unaudited)

	Three Months Ended		Six Months Ended	
	December	December	December	December
	27,	28,	27,	28,
	2015	2014	2015	2014
Net sales	\$102,511	\$101,990	\$199,024	\$224,232
Cost of goods sold	83,901	83,538	163,915	177,723
Gross profit	18,610	18,452	35,109	46,509
Engineering, selling and administrative expenses	11,196	10,490	21,770	23,677
Income from operations	7,414	7,962	13,339	22,832
Interest income	8	43	15	65
Equity (loss) earnings of joint ventures	(22)	(121)	(315)	69
Interest expense	(23)	(11)	(44)	(22)
Other income, net	350	1,823	318	2,611
Income before provision for income taxes and non-controlling				
interest	7,727	9,696	13,313	25,555
Provision for income taxes	2,514	2,795	4,268	8,314
Net income	5,213	6,901	9,045	17,241
Net income attributable to non-controlling interest	1,810	1,123	2,369	2,163
Net income attributable to STRATTEC SECURITY				
CORPORATION	\$3,403	\$5,778	\$6,676	\$15,078
Comprehensive Income:				
Net income	\$5,213	\$6,901	\$9,045	\$17,241
Pension and postretirement plans, net of tax	364	428	728	856
Currency translation adjustments	(488)	(2,590)	(3,355)	(3,442)
Other comprehensive loss, net of tax	(124)	(2,162)	(2,627)	(2,586)
Comprehensive income	5,089	4,739	6,418	14,655
Comprehensive income attributable to non-controlling interest	1,779	965	2,179	1,941
Comprehensive income attributable to STRATTEC SECURITY				
CORPORATION	\$3,310	\$3,774	\$4,239	\$12,714
Earnings per share attributable to STRATTEC SECURITY				

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CORPORATION:

Basic	\$0.95	\$1.62	\$1.87	\$4.25
Diluted	\$0.93	\$1.58	\$1.83	\$4.13
Average shares outstanding:				
Basic	3,563	3,518	3,553	3,507
Diluted	3,624	3,612	3,621	3,603
Cash dividends declared per share	\$0.13	\$0.12	\$0.26	\$0.24

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

STRATTEC SECURITY CORPORATION AND SUBSIDIARIES

Condensed Consolidated Balance Sheets

(In Thousands, Except Share Amounts)

	December 27, 2015 (Unaudited)	June 28, 2015
ASSETS		
Current Assets:		
Cash and cash equivalents	\$ 17,923	\$25,695
Receivables, net	60,802	58,807
Inventories		
Finished products	13,576	11,358
Work in process	8,574	7,746
Purchased materials	25,842	17,982
Excess and obsolete reserve	(2,772)	(2,300)
Inventories, net	45,220	34,786
Other current assets	19,507	18,873
Total current assets	143,452	138,161
Investment in joint ventures	15,464	15,326
Other long-term assets	11,269	10,816
Property, plant and equipment	201,674	194,567
Less: accumulated depreciation	(128,142)	(123,441)
Net property, plant and equipment	73,532	71,126
	\$ 243,717	\$235,429
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current Liabilities:		
Accounts payable	\$ 35,136	\$27,838
Accrued Liabilities:		
Payroll and benefits	12,222	16,107
Environmental	1,376	1,383
Warranty	9,431	11,835
Other	9,573	7,572
Total current liabilities	67,738	64,735
Deferred income taxes	4,581	4,595
Borrowings under credit facility	10,000	10,000
Accrued pension obligations	1,382	1,331
Accrued postretirement obligations	1,477	1,657
Other long-term liabilities	764	710
Shareholders' Equity:		
Common stock, authorized 12,000,000 shares, \$.01 par value, issued 7,188,363		
shares at December 27, 2015 and 7,151,154 shares at June 28, 2015	71	71

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Capital in excess of par value	91,003	89,560
Retained earnings	219,187	213,442
Accumulated other comprehensive loss	(29,296)	(26,859)
Less: treasury stock, at cost (3,623,724 shares at December 27, 2015 and 3,624,454 shares at June 28, 2015)	(135,890)	(135,902)
Total STRATTEC SECURITY CORPORATION shareholders' equity	145,075	140,312
Non-controlling interest	12,700	12,089
Total shareholders' equity	157,775	152,401
	\$ 243,717	\$ 235,429

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

STRATTEC SECURITY CORPORATION AND SUBSIDIARIES

Condensed Consolidated Statements of Cash Flows

(In Thousands)

(Unaudited)

	Six Months Ended	
	December 27,	December 28,
	2015	2014
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	\$9,045	\$ 17,241
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	5,075	4,261
Foreign currency transaction gain	(1,321)	(2,421)
Unrealized loss on peso forward contracts	867	—
Stock based compensation expense	870	700
Equity loss (earnings) of joint ventures	315	(69)
Change in operating assets and liabilities:		
Receivables	(2,132)	6,780
Inventories	(10,434)	(8,391)
Other assets	(226)	207
Accounts payable and accrued liabilities	1,161	(781)
Other, net	—	157
Net cash provided by operating activities	3,220	17,684
CASH FLOWS FROM INVESTING ACTIVITIES:		
Investment in joint ventures	(220)	(384)
Loan to joint ventures	(150)	(215)
Purchase of property, plant and equipment	(8,095)	(16,955)
Net cash used in investing activities	(8,465)	(17,554)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Borrowings under credit facility	5,500	1,500
Repayments of borrowings under credit facility	(5,500)	(500)
Dividends paid to non-controlling interests of subsidiaries	(1,568)	(882)
Dividends paid	(932)	(854)
Exercise of stock options and employee stock purchases	584	714
Net cash used in financing activities	(1,916)	(22)
Foreign currency impact on cash	(611)	(21)
NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	(7,772)	87
CASH AND CASH EQUIVALENTS		
Beginning of period	25,695	19,756
End of period	\$17,923	\$ 19,843
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:		

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Cash paid during the period for:		
Income taxes	\$2,395	\$ 10,207
Interest	\$43	\$ 17
Non-cash investing activities:		
Change in capital expenditures in accounts payable	\$456	\$ 274
Guarantee of joint venture revolving credit facility	\$105	\$—

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

STRATTEC SECURITY CORPORATION AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

(Unaudited)

Basis of Financial Statements

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

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

In the opinion of management, the accompanying condensed consolidated balance sheets as of December 27, 2015 and June 28, 2015, which has been derived from our audited financial statements, and the related unaudited interim condensed consolidated financial statements included herein contain all adjustments, consisting only of normal recurring items, necessary for their fair presentation in conformity with accounting principles generally accepted in the United States of America (“U.S. GAAP”) and in accordance with Rule 10-01 of Regulation S-X. All significant intercompany transactions have been eliminated.

Interim financial results are not necessarily indicative of operating results for an entire year. The information included in this Form 10-Q should be read in conjunction with Management’s Discussion and Analysis and the financial statements and notes thereto included in the STRATTEC SECURITY CORPORATION 2015 Annual Report, which was filed with the Securities and Exchange Commission as an exhibit to our Form 10-K on September 4, 2015.

New Accounting Standards

In May 2014, the FASB issued an update to the accounting guidance for the recognition of revenue arising from contracts with customers. The update supersedes most current revenue recognition guidance and outlines a single comprehensive model for revenue recognition based on the principle that an entity should recognize revenue in an amount that reflects the expected consideration to be received in the exchange of goods and services. The guidance update also requires additional disclosure about the nature, amount, timing and uncertainty of revenue and cash flows arising from customer contracts. The guidance update is effective for annual reporting periods beginning after December 15, 2017 and becomes effective for us at the beginning of our 2019 fiscal year. We are currently assessing the impact that this guidance will have on our condensed consolidated financial statements.

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

In February 2015, the FASB issued an update to the accounting guidance that amends current consolidation guidance by modifying the evaluation of whether limited partnerships and similar legal entities are variable interest entities or voting interest entities, eliminating the presumption that a general partner should consolidate a limited partnership, and affects the consolidation analysis of reporting entities that are involved with variable interest entities. The update is effective for interim and annual reporting periods beginning after December 15, 2015, with early adoption permitted. We do not expect that the adoption of this pronouncement will have a material impact on our condensed consolidated financial statements.

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

In November 2015, the FASB issued an update to an accounting standard to simplify the presentation of deferred income taxes by requiring that deferred tax assets and liabilities be classified as non-current in a classified statement of financial position, which would be a change from our historical presentation whereby certain of our deferred tax assets and liabilities were classified as current and the remainder were classified as non-current. The standard update is effective for fiscal years beginning after December 15, 2016 and interim periods within those years, and early adoption is permitted. The standard is to be applied either prospectively to all deferred tax assets and liabilities or retrospectively to all periods presented. We are currently assessing the impact that this guidance will have on our condensed consolidated financial statements.

Subsequent Event

In January 2016, we entered into additional contracts with Bank of Montreal that provide for monthly Mexican peso currency forward contracts covering the period July 15, 2016 through June 15, 2017. The currently effective Mexican peso currency forward contracts continue through June 21, 2016. The contracts provide for the purchase of Mexican pesos at an average U.S. dollar / Mexican peso exchange rate of \$18.38. The notional amount over the contract period totals \$12 million. See further discussion below under Derivative instruments included in these Notes to Condensed Consolidated Financial Statements.

On January 20, 2016, ADAC STRATTEC de Mexico (ASdM), a wholly owned subsidiary of ADAC-STRATTEC LLC which is a joint venture between STRATTEC SECURITY CORPORATION and ADAC Automotive, signed a "Letter of Intent" to purchase land in Leon, Mexico. ASdM intends to construct a new manufacturing facility on this land in the mid-Mexico area. This facility is expected to be used primarily to paint and assemble door handle products. Currently, the ADAC-STRATTEC LLC joint venture has net sales of approximately \$60 million. With newly awarded customer business, we anticipate net sales will increase to approximately \$120 million within the next two years. Total capital expenditures required for the land, facility, paint system, and assembly equipment is expected to total approximately \$20 million. We anticipate financing the required capital expenditures through a combination of partner capital contributions, bank loans, and current operating cash flow.

Derivative Instruments

We own and operate manufacturing operations in Mexico. As a result, a portion of our manufacturing costs are incurred in Mexican pesos, which causes our earnings and cash flows to fluctuate due to changes in the U.S. dollar/Mexican peso exchange rate. As of December 27, 2015, we have executed contracts with Bank of Montreal that provide for bi-weekly and monthly Mexican peso currency forward contracts for a portion of our estimated peso denominated operating costs. The current peso currency forward contracts include settlement dates that began on October 16, 2015 and end on June 15, 2017. No forward contracts were in place during fiscal 2015 or outstanding as of June 28, 2015. Additional contracts were executed subsequent to December 27, 2015. Refer to Subsequent Event included in these Notes to Condensed Consolidated Financial Statements. Our objective in entering into these currency forward contracts is to minimize our earnings volatility resulting from changes in exchange rates affecting the U.S. dollar cost of our Mexican operations. The Mexican peso forward contracts are not used for speculative purposes and are not designated as hedges. As a result, all currency forward contracts are recognized in our accompanying condensed consolidated financial statements at fair value and changes in the fair value are reported in current earnings as part of Other Income, net.

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The following table quantifies the outstanding Mexican peso forward contracts as of December 27, 2015 (thousands of dollars, except average forward contractual exchange rates):

	Effective Dates	Notional Amount	Average Forward Contractual Exchange Rate	Fair Value
Buy MXP/Sell USD	January 5, 2016 - June 21, 2016	\$9,000	16.00	\$(714)
Buy MXP/Sell USD	July 15, 2016 - June 15, 2017	\$12,000	17.51	\$(153)

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

	December 27, 2015	June 28, 2015
Not Designated as Hedging Instruments:		
Other Current Liabilities:		
Mexican Peso Forward Contracts	\$ 867	\$ —

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

	Three Months Ended December 27, 2015		Six Months Ended December 28, 2015	
	2015	2014	2015	2014
Not Designated as Hedging Instruments:				
Realized Loss	\$(178)	\$ —	\$(178)	\$ —
Unrealized Gain (Loss)	\$29	\$ —	\$(867)	\$ —

Fair Value of Financial Instruments

The fair value of our cash and cash equivalents, accounts receivable, accounts payable and borrowings under our credit facility approximated book value as of December 27, 2015 and June 28, 2015. Fair value is defined as the

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exchange price that would be received for an asset or paid for a liability in the principal or most advantageous market in an orderly transaction between market participants on the measurement date.

The following table summarizes our financial assets and liabilities measured at fair value on a recurring basis as of December 27, 2015 (in thousands):

	Fair Value Inputs			
	Level 2		Level 3	
	Assets:		Assets:	
	Observable			
	Level 1	Inputs	Level 3	
	Assets:	Other	Assets:	
	Quoted	Than	Unobservable	
	Prices	Market		
	In Active	Markets	Inputs	
Assets:				
Rabbi Trust Assets:				
Stock Index Funds:				
Small Cap	\$ 341	\$ —	\$	—
Mid Cap	346	—		—
Large Cap	483	—		—
International	391	—		—
Fixed Income Funds	678	—		—
Cash and Cash Equivalents	—	1		—
Total Assets at Fair Value	\$2,239	\$ 1	\$	—
Liabilities:				
Mexican Peso Forward Contracts	\$—	\$ 867	\$	—

The Rabbi Trust assets fund our amended and restated supplemental executive retirement plan and are included in Other Long-term Assets in the accompanying Condensed Consolidated Balance Sheets. Refer to discussion of Mexican peso forward contracts under Derivative Instruments above. The fair value of the Mexican peso forward contracts considers the remaining term, current exchange rate, and interest rate differentials between the two currencies. There were no transfers between Level 1 and Level 2 assets during the six month period ended December 27, 2015.

Equity (Loss) Earnings of Joint Ventures

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

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

	Three Months		Six Months Ended	
	Ended December 27,	December 28,	December 27,	December 28,
	2015	2014	2015	2014
Net Sales	\$31,402	\$35,663	\$57,750	\$66,661
Cost of Goods Sold	25,497	30,469	47,411	56,552
Gross Profit	5,905	5,194	10,339	10,109
Engineering, Selling and Administrative Expenses	4,491	4,590	8,116	8,788
Income From Operations	1,414	604	2,223	1,321
Other (Expense) Income, net	(150)	183	(462)	656
Income before Provision for Income taxes	1,264	787	1,761	1,977
Provision for Income Taxes	217	376	311	435
Net Income	\$1,047	\$411	\$1,450	\$1,542
STRATTEC's Share of VAST LLC Net Income	\$349	\$137	\$483	\$514
Intercompany Profit Elimination	(4)	5	(5)	4
STRATTEC's Equity Earnings of VAST LLC	\$345	\$142	\$478	\$518

During 2013, we acquired a 51% ownership interest in a newly formed joint venture company, SAL LLC, which was formed to introduce a new generation of biometric security products based upon designs of Actuator Systems LLC, our partner. SAL LLC has a \$1.5 million revolving credit facility (the "SAL Credit Facility") with BMO Harris Bank N.A., which is fully guaranteed by STRATTEC. The SAL Credit Facility has a maturity date of February 16, 2016. Outstanding borrowings under the SAL Credit Facility as of December 27, 2015 and June 28, 2015 totaled \$1.1 million and \$995,000, respectively. SAL LLC is considered a variable interest entity based on the STRATTEC guarantee. STRATTEC is not the primary beneficiary and does not control the entity. Accordingly, our investment in

SAL LLC is accounted for using the equity method. STRATTEC had a recorded liability related to the guarantee of \$1.1 million and \$995,000 at December 27, 2015 and June 28, 2015, respectively, which amounts were equal to the estimated fair value of the guarantee as of these balance sheet dates. The guarantee liability is included in Other Current Liabilities in the accompanying Condensed Consolidated Balance Sheets. STRATTEC's proportionate share of the guarantee based on our ownership percentage in SAL LLC totaled \$561,000 and \$507,000, respectively, as of December 27, 2015 and June 28, 2015, and accordingly, our investment in SAL LLC included these amounts at these balance sheet dates. Our joint venture partner did not guarantee their proportionate share of the SAL Credit Facility. As a result, we recorded a loss equal to our partner's proportionate share of the fair value of the STRATTEC guarantee based upon their ownership interest in the joint venture of \$488,000 during the fourth quarter of fiscal 2015 and \$51,000 during the six months ended December 27, 2015.

SAL LLC maintains a license agreement with Westinghouse allowing SAL LLC to do business as Westinghouse Security. Payments under the license agreement were guaranteed by STRATTEC. As of December 27, 2015 and June 28, 2015, STRATTEC has a recorded liability equal to the estimated fair value of the future payments due under this guarantee of \$250,000. The liability is included in Other Long-term Liabilities in the accompanying Condensed Consolidated Balance Sheets. STRATTEC's proportionate share of the guarantee of these payments based on our ownership percentage in SAL LLC totals \$127,000, and accordingly, our investment in SAL LLC as of December 27, 2015 and June 28, 2015 included this amount. Our joint venture partner did not guarantee their proportionate share of the payments required under the license agreement. As a result, we recorded a loss of \$123,000 during the fourth quarter of fiscal 2015 which was equal to our partner's proportionate share, based upon their ownership interest in the joint venture, of the fair value of the STRATTEC guarantee.

During fiscal 2015 and during the six months ended December 27, 2015, loans were made from STRATTEC to SAL LLC in support of operating expenses and working capital needs. The outstanding loan amounts totaled \$250,000 and \$100,000 as of December 27, 2015 and June 28, 2015, respectively. A valuation reserve of \$250,000 and \$100,000 was recorded as of December 27, 2015 and June 28, 2015, respectively, in connection with these loans. The corresponding loss related to this valuation reserve was included in Equity (Loss) Earnings of Joint Ventures in the accompanying Condensed Consolidated Statements of Income and Comprehensive Income in each respective period.

Notwithstanding the existence of the SAL Credit Facility described herein, as a result of STRATTEC's guarantee of such credit facility and as a result of borrowing limitations imposed by the bank under such credit facility, effective with our fiscal 2015 fourth quarter, 100 percent of the funding for SAL LLC was being made by STRATTEC through loans and guarantees. Therefore, effective with our fiscal 2015 fourth quarter, STRATTEC began recognizing 100 percent of the losses of SAL LLC through Equity (Loss) Earnings of Joint Ventures in the accompanying Condensed Consolidated Statements of Income and Comprehensive Income.

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

	Three Months Ended December 27, 28,		Six Months Ended December 27, 28,	
	2015	2014	2015	2014
Net Sales	\$65	\$ —	\$125	\$ —
Cost of Goods Sold	40	—	95	—
Gross Profit	25	—	30	—
Engineering, Selling and Administrative Expenses	358	516	604	880
Loss From Operations	(333)	(516)	(574)	(880)
Other Expense, net	(10)	—	(18)	—
Net Loss	\$(343)	\$(516)	\$(592)	\$(880)
STRATTEC's Share of Equity Loss of SAL LLC	\$(343)	\$(263)	\$(592)	\$(449)
Loss on Loan to SAL LLC	—	—	(150)	—
Loss on SAL LLC Credit Facility Guarantee	(24)	—	(51)	—
STRATTEC's Equity Loss of SAL LLC	\$(367)	\$(263)	\$(793)	\$(449)

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

	Three Months Ended December 27, 28,		Six Months Ended December 27, 28,	
	2015	2014	2015	2014

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	2015	2014	2015	2014
Sales to VAST LLC	\$72	\$ 657	\$210	\$ 771
Sales to SAL, LLC	\$27	\$ 27	\$44	\$ 32
Purchases from VAST LLC	\$38	\$ 41	\$63	\$ 80
Expenses Charged to VAST LLC	\$176	\$ 245	\$411	\$ 404
Expenses Charged from VAST LLC	\$405	\$ 457	\$797	\$ 940

Warranty

We have a warranty liability recorded related to our known and potential exposure to warranty claims in the event our products fail to perform as expected, and in the event we may be required to participate in the repair costs incurred by our customers for such products. During the six month period ended December 27, 2015, the warranty liability was reduced by approximately \$2.05 million as a result of the settlement of a previously accrued customer warranty issue.

Credit Facilities and Guarantees

STRATTEC has a \$30 million secured revolving credit facility (the “STRATTEC Credit Facility”) with BMO Harris Bank N.A. ADAC-STRATTEC LLC has a \$10 million secured revolving credit facility (the “ADAC-STRATTEC Credit Facility”) with BMO Harris Bank N.A, which is guaranteed by STRATTEC. The credit facilities both expire August 1, 2018. Borrowings under either credit facility are secured by our cash balances, accounts receivable, inventory and fixed assets located in the U.S. Interest on borrowings under both credit facilities is at varying rates based, at our option, on the London Interbank Offering Rate (“LIBOR”) plus 1.0 percent or the bank’s prime rate. Both credit facilities contain a restrictive financial covenant that requires the applicable borrower to maintain a minimum net worth level. The ADAC-STRATTEC Credit Facility includes an additional restrictive financial covenant that requires the maintenance of a minimum fixed charge coverage ratio. As of December 27, 2015, we were in compliance with all financial covenants.

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

	December 27, 2015	June 28, 2015
STRATTEC Credit Facility	\$ 7,500	\$7,000
ADAC-STRATTEC Credit Facility	\$ 2,500	\$3,000

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

	Six Months Ended					
	Average Outstanding December 27, 2015	December 28, 2014	Weighted Average Borrowings December 27, 2015		Average Interest Rate December 28, 2014	
STRATTEC Credit Facility	\$ 3,646	\$ —	1.2	%	—	%
ADAC-STRATTEC Credit Facility	\$ 3,054	\$ 3,819	1.3	%	1.2	%

SAL LLC has a \$1.5 million revolving credit facility (the “SAL Credit Facility”) with BMO Harris Bank N.A., which is fully guaranteed by STRATTEC. Interest on borrowings under the SAL Credit Facility is at varying rates based, at SAL LLC’s option, on LIBOR plus 1.0 percent or the bank’s prime rate. The SAL Credit Facility has a maturity date of February 16, 2016. Outstanding borrowings under the SAL Credit Facility as of December 27, 2015 totaled \$1.1 million. As of December 27, 2015, STRATTEC had a recorded liability related to its guarantee of this credit facility of \$1.1 million, which amount is equal to the estimated fair value of the guarantee as of December 27, 2015.

SAL LLC maintains a license agreement with Westinghouse allowing SAL LLC to do business as Westinghouse Security. STRATTEC guaranteed all payments due under the Westinghouse agreement. As of December 27, 2015,

STRATTEC has a recorded liability related to this guarantee of \$250,000, which amount is equal to the amount of future payments required under the agreement and the estimated fair value of the guarantee as of December 27, 2015. See further discussion under Equity (Loss) Earnings of Joint Ventures included herein.

Commitments and Contingencies

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

In 1995, we recorded a provision of \$3 million for estimated costs to remediate an environmental contamination site at our Milwaukee facility. The facility was contaminated by a solvent spill, which occurred in 1985, from a former above ground solvent storage tank located on the east side of the facility. The reserve was originally established based on third party estimates to adequately cover the cost for active remediation of the contamination. Due to changing technology and related costs associated with active remediation of the contamination, an updated analysis and estimate was obtained during fiscal 2010. As a result of this analysis, the reserve was reduced by approximately \$1.1 million, to \$1.5 million in 2010, to reflect the revised monitoring and remediation cost estimate. From 1995 through December 27, 2015, costs of approximately \$500,000 have been incurred related to the installation of monitoring wells on the property and ongoing monitoring costs. We continue to monitor and evaluate the site with the use of these groundwater monitoring wells. An environmental consultant samples these wells one or two times a year to determine the status of the contamination and the potential for remediation of the contamination by natural attenuation, the dissipation of the contamination over time to concentrations below applicable standards. If such sampling evidences a sufficient degree of and trend toward natural attenuation of the contamination at the site, we may be able to obtain a closure letter from the regulatory authorities resolving the issue without the need for active remediation. If a sufficient degree and trend toward natural attenuation is not evidenced by sampling, a more active form of remediation beyond natural attenuation may be required. The sampling has not yet satisfied all of the requirements for closure by natural attenuation. As a result, sampling continues and the reserve remains at an amount to reflect the estimated cost of active remediation. The reserve is not measured on a discounted basis. We believe, based on findings-to-date and known environmental regulations, that the remaining environmental reserve of \$1.4 million at December 27, 2015 is adequate.

Shareholders' Equity

A summary of activity impacting shareholders' equity for the six month period ended December 27, 2015 was as follows (in thousands):

	Equity		
	Total	Equity	Attributable to Non-
	Shareholders' Equity	Attributable to	Controlling
	Equity	STRATTEC	Interest
Balance, June 28, 2015	\$ 152,401	\$ 140,312	\$ 12,089
Net Income	9,045	6,676	2,369
Dividend Declared	(932)	(932)	—
Dividend Declared – Non-controlling Interests of			
Subsidiaries	(1,568)	—	(1,568)
Translation adjustments	(3,355)	(3,165)	(190)
Stock Based Compensation	870	870	—
Tax Benefit – Dividend Paid on Restricted Shares	2	2	—
Pension and Postretirement Adjustment, Net of tax	728	728	—

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Employee Stock Purchases and Stock Option Exercises	584	584	—
Balance, December 27, 2015	\$ 157,775	\$ 145,075	\$ 12,700

Other Income, net

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

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

	Three Months		Six Months Ended	
	Ended December 27,	December 28,	December 27,	December 28,
	2015	2014	2015	2014
Foreign Currency Transaction Gain	\$364	\$ 1,635	\$1,321	\$ 2,421
Unrealized Gain (Loss) on Peso Forward Contracts	29	—	(867)	—
Realized Loss on Peso Forward Contracts	(178)	—	(178)	—
Rabbi Trust Gain (Loss)	60	45	(104)	18
Other	75	143	146	172
	\$350	\$ 1,823	\$318	\$ 2,611

Income Taxes

The income tax provisions for the three and six month periods ended December 27, 2015 and December 28, 2014 were affected by the non-controlling interest portion of our pre-tax income and a lower statutory tax rate for income subject to tax in Mexico as compared to the statutory tax rate for income subject to tax in the U.S.

Earnings Per Share (EPS)

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

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

	Three Months Ended		Six Months Ended	
	December 27,	December 28,	December 27,	December 28,
	2015	2014	2015	2014
Net Income Attributable to STRATTEC SECURITY CORPORATION	\$3,403	\$ 5,778	\$6,676	\$ 15,078
Less: Income Attributable to Participating Securities	21	71	42	191
Net Income Attributable to Common Shareholders	\$3,382	\$ 5,707	\$6,634	\$ 14,887
Basic Weighted Average Shares of Common Stock				
Outstanding	3,563	3,518	3,553	3,507
Incremental Shares – Stock based Compensation	61	94	68	96
Diluted Weighted Average Shares of Common Stock				
Outstanding	3,624	3,612	3,621	3,603
Basic Earnings Per Share	\$0.95	\$ 1.62	\$1.87	\$ 4.25
Diluted Earnings Per Share	\$0.93	\$ 1.58	\$1.83	\$ 4.13

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

As of December 27, 2015 and as of December 28, 2014, options to purchase 9,010 shares of common stock were excluded from the calculation of diluted earnings per share because their inclusion would have been anti-dilutive.

Stock-based Compensation

We maintain an omnibus stock incentive plan. This plan provides for the granting of stock options, shares of restricted stock and stock appreciation rights. As of December 27, 2015, the Board of Directors had designated 1,850,000 shares of common stock available for the grant of awards under the plan. Remaining shares available to be granted under the plan as of December 27, 2015 were 229,339. Awards that expire or are canceled without delivery of shares become available for re-issuance under the plan. We issue new shares of common stock to satisfy stock option exercises.

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

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

A summary of stock option activity under our stock incentive plan for the six months ended December 27, 2015 was as follows:

		Weighted		
		Average	Remaining	Aggregate
		Weighted	Contractual	Intrinsic
		Average	Value	
	Shares	Exercise Price	Term (years)	(in thousands)
Outstanding, June 28, 2015	163,907	\$ 27.97		
Exercised	(16,909)	\$ 21.55		
Forfeited	(2,000)	\$ 17.59		
Outstanding, December 27, 2015	144,998	\$ 28.86	5.9	\$ 4,253
Exercisable, December 27, 2015	103,798	\$ 21.39	5.1	\$ 3,672

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

	Three Months Ended December 27, 2015		Six Months Ended December 27, 2015	
	2015	2014	2015	2014
Intrinsic Value of Options Exercised	\$ 115	\$ 290	\$ 529	\$ 990
Fair Value of Stock Options Vesting	\$ —	\$ —	\$ 331	\$ 382

No options were granted during the six month period ended December 27, 2015. The grant date fair value and assumptions used to determine compensation expense for the options granted during the six month period ended December 28, 2014 were as follows:

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Weighted Average Grant Date Fair Value:	
Options Issued at Grant Date Market Value	n/a
Options Issued Above Grant Date Market Value	\$34.93
Assumptions:	
Risk Free Interest Rate	1.90 %
Expected Volatility	57.83 %
Expected Dividend Yield	0.62 %
Expected Term (in years)	6.0

A summary of restricted stock activity under our omnibus stock incentive plan for the six months ended December 27, 2015 was as follows:

	Weighted	
	Average	
	Grant	
	Date	
	Fair	
	Value	
Nonvested Balance, June 28, 2015	66,350	\$ 45.03
Granted	28,750	\$ 69.02
Vested	(20,300)	\$ 23.69
Forfeited	(2,100)	\$ 60.27
Nonvested Balance, December 27, 2015	72,700	\$ 60.03

As of December 27, 2015, there was \$295,000 of total unrecognized compensation cost related to outstanding stock options granted under our omnibus stock incentive plan. This cost is expected to be recognized over a remaining weighted average period of 0.6 years. As of December 27, 2015, there was approximately \$2.4 million of total unrecognized compensation cost related to unvested restricted stock grants outstanding under the plan. This cost is expected to be recognized over a remaining weighted average period of 1.3 years. Total unrecognized compensation cost will be adjusted for any future changes in estimated and actual forfeitures of awards granted under our omnibus stock incentive plan.

Pension and Postretirement Benefits

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

We have historically had in place a noncontributory supplemental executive retirement plan (“SERP”), which prior to January 1, 2014 was a nonqualified defined benefit plan that essentially mirrored the Qualified Pension Plan, but provided benefits in excess of certain limits placed on our Qualified Pension Plan by the Internal Revenue Code. We froze our Qualified Pension Plan effective as of December 31, 2009 and the SERP provided benefits to participants as if the Qualified Pension Plan had not been frozen. Because the Qualified Pension Plan was frozen and because new employees were not eligible to participate in the Qualified Pension Plan, our Board of Directors adopted amendments to the SERP on October 8, 2013 that were effective as of December 31, 2013 to simplify the SERP calculation. The SERP is funded through a Rabbi Trust with BMO Harris Bank N.A. Under the amended SERP, participants received an accrued lump-sum benefit as of December 31, 2013 which was credited to each participant’s account. Subsequent to December 31, 2013, each eligible participant receives a supplemental retirement benefit equal to the foregoing lump sum benefit, plus an annual benefit accrual equal to 8 percent of the participant’s base salary and cash bonus, plus annual credited interest on the participant’s account balance. All then current participants as of December 31, 2013 are fully vested in their account balances with any new individuals participating in the SERP effective on or after January 1, 2014 being subject to a five year vesting period. The SERP, which is considered a defined benefit plan under applicable rules and regulations of the Internal Revenue Code, will continue to be funded through use of a Rabbi Trust to hold investment assets to be used in part to fund any future required lump sum benefit payments to participants. The foregoing amendments to the SERP did not have a material effect on our financial statements. The Rabbi Trust assets had a value of \$2.2 million at December 27, 2015 and \$2.3 million at June 28, 2015, respectively, and are included in Other Long-Term Assets in the accompanying Condensed Consolidated Balance Sheets.

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

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

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

	Pension Benefits		Postretirement	
	Three Months		Benefits	
	Ended		Three Months	
	December	December	December	December
	27,	28,	27,	28,
	2015	2014	2015	2014
Service cost	\$13	\$16	\$3	\$3
Interest cost	1,076	1,043	22	29
Expected return on plan assets	(1,352)	(1,544)	—	—
Amortization of prior service cost (credit)	3	3	(188)	(191)
Amortization of unrecognized net loss	599	694	151	174
Net periodic benefit cost	\$339	\$212	\$(12)	\$15

	Pension Benefits		Postretirement	
	Six Months		Benefits	
	Ended		Six Months	
	December	December	December	December
	27,	28,	27,	28,
	2015	2014	2015	2014
Service cost	\$25	\$32	\$6	\$7
Interest cost	2,152	2,086	43	57
Expected return on plan assets	(2,703)	(3,087)	—	—
Amortization of prior service cost (credit)	6	6	(375)	(382)
Amortization of unrecognized net loss	1,198	1,387	302	347
Net periodic benefit cost	\$678	\$424	\$(24)	\$29

No contributions were made to the Qualified Pension Plan during the six month periods ended December 27, 2015 or December 28, 2014. Voluntary contributions of \$3.0 million are anticipated to be made during the remainder of fiscal 2016.

Accumulated Other Comprehensive Loss

The following table summarizes the changes in accumulated other comprehensive loss (“AOCL”) for each period presented (in thousands):

	Six Months Ended December 27, 2015		
	Foreign	Retirement	
	Currency and		
	Translation	Postretirement	
	Adjustment	Benefit Plans	Total
Balance, June 28, 2015	\$8,221	\$ 18,638	\$26,859
Other comprehensive loss before reclassifications	3,355	—	3,355
Income tax	—	—	—
Net other comprehensive loss before reclassifications	3,355	—	3,355
Reclassifications:			
Prior service credits (A)	—	376	376
Actuarial gains (A)	—	(1,530)	(1,530)
Total reclassifications before tax	—	(1,154)	(1,154)
Income tax	—	426	426
Net reclassifications	—	(728)	(728)
Other comprehensive loss (income)	3,355	(728)	2,627
Other comprehensive loss attributable to non-controlling			
interest	190	—	190
Balance, December 27, 2015	\$11,386	\$ 17,910	\$29,296

	Six Months Ended December 28, 2014		
	Foreign Retirement		
	Currency and		
	Translation Postretirement		
	Adjustments	Benefit Plans	Total
Balance, June 29, 2014	\$3,411	\$ 16,787	\$20,198
Other comprehensive loss before reclassifications	3,442	—	3,442
Income tax	—	—	—
Net other comprehensive loss before reclassifications	3,442	—	3,442
Reclassifications:			
Prior service credits (A)	—	376	376
Unrecognized net loss (A)	—	(1,734)	(1,734)
Total reclassifications before tax	—	(1,358)	(1,358)
Income tax	—	502	502
Net reclassifications	—	(856)	(856)
Other comprehensive loss (income)	3,442	(856)	2,586
Other comprehensive loss attributable to non-controlling			
interest	222	—	222
Balance, December 28, 2014	\$6,631	\$ 15,931	\$22,562

(A) Amounts reclassified are included in the computation of net periodic benefit cost, which is included in Cost of Goods Sold and Engineering, Selling and Administrative expenses in the accompanying Condensed Consolidated Statements of Income and Comprehensive Income. See Pension and Postretirement Benefits note to these Notes to Condensed Consolidated Financial Statements above.

Item 2

STRATTEC SECURITY CORPORATION AND SUBSIDIARIES

MANAGEMENT'S DISCUSSION AND ANALYSIS

OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following Management's Discussion and Analysis should be read in conjunction with STRATTEC SECURITY CORPORATION's accompanying Condensed Consolidated Financial Statements and Notes thereto and its 2015 Annual Report which was filed with the Securities and Exchange Commission as an exhibit to its Form 10-K on September 4, 2015. Unless otherwise indicated, all references to years refer to fiscal years.

Outlook

During the first six months of fiscal year 2016, we experienced stronger sales demand for our components from our major North American automotive customers, Fiat Chrysler Automobiles, General Motors Company and Ford Motor Company, as it relates to light trucks and both sport and car based utility vehicles in comparison to passenger cars, which was likely influenced by lower gas prices. If gas prices continue to remain low over the next six months, we anticipate this consumer buying trend to continue through the remainder of the 2016 fiscal year.

Analysis of Results of Operations

Three months ended December 27, 2015 compared to the three months ended December 28, 2014

	Three Months Ended December	
	27, 2015	28, 2014
Net Sales (in millions)	\$ 102.5	\$ 102.0

Net sales to each of our customers or customer groups in the current year quarter and prior year quarter were as follows (in millions):

	Three Months Ended December	
	27, 2015	28, 2014
Fiat Chrysler Automobiles	\$ 31.8	\$ 32.8
General Motors Company	20.7	23.7

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Ford Motor Company	14.1	11.6
Tier 1 Customers	15.7	17.1
Commercial and Other OEM Customers	11.5	8.9
Hyundai / Kia	8.7	7.9
	\$102.5	\$ 102.0

The sales to Fiat Chrysler Automobiles in the current year quarter decreased slightly due to lower customer vehicle production volume and content on vehicles for which we supply components. The decrease in sales to General Motors Company in the current year quarter was attributed to incremental service parts sales of \$6 million shipped in the prior year quarter, which incremental sales did not continue during the current year quarter ended December 27, 2015. Increased sales to Ford Motor Company in the current year quarter were attributed to increased product content on locksets and latches, in particular related to the new F-150 pick-up truck for which we supply components. Sales to Tier 1 Customers during the current year quarter decreased in comparison to the prior year quarter. These customers primarily represent purchasers of vehicle access control products, such as latches, fobs, and driver controls, that we have developed in recent years to complement our historic core business of locks and keys. The increase in sales to Hyundai / Kia in the current year quarter was principally due to higher levels of sales on the Kia Sedona minivan for which we supply components.

	Three Months	
	Ended	
	December	December
	27,	28,
	2015	2014
Cost of Goods Sold (in millions)	\$83.9	\$ 83.5

Direct material costs are the most significant component of our cost of goods sold and comprised \$57.0 million or 67.9 percent of cost of goods sold in the current year quarter compared to \$55.7 million or 66.7 percent of cost of goods sold in the prior year quarter. The increase in material costs of \$1.3 million or 2.3 percent and the increase in material costs as a percentage of cost of goods sold between these quarterly periods was due to a less favorable product mix in the current year quarter as compared to the prior year quarter. The prior year quarter included increased sales of service parts to General Motors Company, as discussed above, which typically have lower material cost percentages as compared to parts sold for new vehicle programs.

The remaining components of cost of goods sold consist of labor and overhead costs which decreased \$900,000 or 3.2 percent in the current year quarter as compared to the prior year quarter. Reductions in current quarter labor and overhead costs, including a decrease of \$680,000 in expense provisions for the accrual of bonuses under our incentive bonus plans, a reduction of approximately \$2.4 million in the U.S. dollar value of our Mexican operations due to a favorable Mexican peso to U.S. dollar exchange rate, and a lump sum bonus totaling \$311,000 paid to our Milwaukee represented hourly workers during the prior year quarter resulting from the ratification of a new 4-year labor contract, which impacts were mostly offset by higher depreciation expense, higher repair and maintenance expense, and increased labor costs associated with a less favorable product sales mix in the current year quarter. The average U.S. dollar / Mexican peso exchange rate increased to approximately 16.73 pesos to the dollar in the current year quarter from approximately 13.82 pesos to the dollar in the prior year quarter.

	Three Months Ended December 27, 28,	
	2015	2014
Gross Profit (in millions)	\$ 18.6	\$ 18.5
Gross Profit as a percentage of net sales	18.2%	18.1 %

Gross profit and gross profit as a percentage of net sales in the current year quarter were consistent with the prior year quarter as a result of overall sales and cost of goods sold being consistent between periods as discussed above.

Engineering, selling and administrative expenses in the current year quarter and prior year quarter were as follows:

	Three Months Ended December 27, 28,	
	2015	2014
Expenses (in millions)	\$ 11.2	\$ 10.5
Expenses as a percentage of net sales	10.9%	10.3 %

Engineering, selling and administrative expenses increased approximately \$700,000 between periods. The increase in these costs in the current year quarter as compared to the prior year quarter was due to higher selling and engineering costs associated with current product programs as well as new product programs under development, which increased costs were partially offset by reduced expense provisions for the accrual of bonuses under our incentive bonus plans during the current year period over the prior year period.

Income from operations in the current year quarter was \$7.4 million compared to \$8.0 million in the prior year quarter. This reduction was the result of an increase in engineering, selling and administrative expenses in the current year quarter as compared to the prior year quarter as discussed above.

The equity (loss) income of joint ventures was comprised of the following in the current year quarter and prior year quarter (in thousands):

	Three Months Ended December	
	2015	2014
Vehicle Access Systems Technology LLC	\$ 345	\$ 142
STRATTEC Advanced Logic, LLC	(367)	(263)
	\$(22)	\$ (121)

VAST LLC's operations in both China and Brazil were negatively impacted during the current year quarter by both a slow-down in automotive sales and impacts of foreign currency as it relates to purchases of components outside of their local markets. We anticipate VAST do Brasil will require a capital contribution of approximately \$600,000 collectively by all VAST partners to fund operations during the remainder of fiscal 2016. STRATTEC's portion of the capital contributions is anticipated to be \$200,000.

STRATTEC is not the primary beneficiary and does not control STRATTEC Advanced Logic, LLC (“SAL LLC”). Accordingly, our investment in SAL LLC is accounted for using the equity method. Notwithstanding the existence of the SAL Credit Facility described herein, as a result of STRATTEC’s guaranty of such credit facility and as a result of borrowing limitations imposed by the bank under such credit facility, even though we maintain a 51 percent ownership interest in SAL LLC, effective with our fiscal 2015 fourth quarter, 100 percent of the funding for SAL LLC was being made through loans from STRATTEC to SAL LLC and the guaranty of the SAL Credit Facility. Therefore, effective with our fiscal 2015 fourth quarter, STRATTEC began recognizing 100 percent of the losses of SAL LLC. In addition, the following loss was included in our current quarter equity loss of joint ventures for SAL LLC (thousands of dollars):

Loss on Guaranty of SAL LLC Credit Facility \$24

SAL LLC has a \$1.5 million revolving credit facility with BMO Harris Bank N.A., which is fully guaranteed by STRATTEC. As of December 27, 2015, STRATTEC had a recorded liability equal to the estimated fair value of the guarantee of \$1.1 million, which amount is equal to outstanding borrowings on the SAL LLC credit facility as of December 27, 2015. STRATTEC’s proportionate share of the guarantee, based on our ownership percentage in SAL LLC, totals \$561,000, and accordingly we have increased our investment in SAL LLC as of December 27, 2015 by this amount. Our joint venture partner did not guarantee their proportionate share of the SAL LLC credit facility. As a result, STRATTEC recorded a loss equal to our partner’s proportionate share of the guarantee based on their ownership interest in the joint venture of \$24,000 in the current quarter, \$27,000 in our fiscal quarter ended September 27, 2015, and \$488,000 in our fiscal quarter ended June 28, 2015.

Included in other income, net in the current year quarter and prior year quarter were the following items (in thousands):