

STARRETT L S CO  
Form 10-K  
August 25, 2015

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**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

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**FORM 10-K**

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(check one)

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

**For the fiscal year ended June 30, 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 No. 1-367**

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**THE L.S. STARRETT COMPANY**

**(Exact name of registrant as specified in its charter)**

**MASSACHUSETTS**                    **04-1866480**  
 (State or other jurisdiction of (I.R.S. Employer  
 incorporation or organization) Identification No.)

**121 CRESCENT STREET, ATHOL, MASSACHUSETTS 01331**  
 (Address of principal executive offices)     (Zip Code)

**Registrant's telephone number, including area code 978-249-3551**

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**Securities registered pursuant to Section 12(b) of the Act:**

<b>Title of each class</b>	<b>Name of each exchange on which registered</b>
Class A Common - \$1.00 Per Share Par Value	New York Stock Exchange
Class B Common - \$1.00 Per Share Par Value	Not applicable

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Indicate by check mark if the Registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.  
 Yes     No

Indicate by check mark if the Registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes     No



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 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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or amendment to this Form 10-K.

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 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 Act).    Yes      No

The Registrant had 6,198,381 and 790,683 shares, respectively, of its \$1.00 par value Class A and B common stock outstanding on December 31, 2014. On December 31, 2014, the last business day of the Registrant's second fiscal quarter, the aggregate market value of the common stock held by nonaffiliates was approximately \$122,614,044.

There were 6,230,772 and 782,169 shares, respectively, of the Registrant's \$1.00 par value Class A and Class B common stock outstanding as of August 24, 2015.

The exhibit index is located on pages 53-54.

DOCUMENTS INCORPORATED BY REFERENCE

The Registrant intends to file a definitive Proxy Statement for the Company's 2015 Annual Meeting of Stockholders within 120 days of the end of the fiscal year ended June 30, 2015. Portions of such Proxy Statement are incorporated by reference in Part III.

**THE L.S. STARRETT COMPANY**

**FORM 10-K**

**FOR THE YEAR ENDED JUNE 30, 2015**

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All references in this Annual Report to “Starrett”, the “Company”, “we”, “our” and “us” mean The L.S. Starrett Company and subsidiaries.

## **PART I**

### **Item 1 - Business**

#### **General**

Founded in 1880 by Laroy S. Starrett and incorporated in 1929, The L.S. Starrett Company (the “Company”) is engaged in the business of manufacturing over 5,000 different products for industrial, professional and consumer markets. The Company has a long history of global manufacturing experience and currently operates 5 major global manufacturing plants. Domestic locations are Athol, Massachusetts (1880) and Mt. Airy, North Carolina (1985) with international operations located in Itu, Brazil (1956) Jedburgh, Scotland (1958) and Suzhou, China (1997). All subsidiaries principally serve the global manufacturing industrial base with concentration in the metalworking, construction, machinery, equipment, aerospace and automotive markets.

The Company offers its broad array of measuring and cutting products to the market through multiple channels of distribution throughout the world. The Company’s products include precision tools, electronic gages, gage blocks, optical vision and laser measuring equipment, custom engineered granite solutions, tape measures, levels, chalk products, squares, band saw blades, hole saws, hacksaw blades, jig saw blades, reciprocating saw blades, M1® lubricant and precision ground flat stock. The Company primarily distributes its precision hand tools, saw and construction products through distributors or resellers both domestically and internationally. The Company’s financial reporting is based on one business segment. Starrett® is brand recognized around the world for precision, quality and innovation.

#### **Products**

The Company’s tools and instruments are sold throughout North America and in over 100 other countries. By far the largest consumer of these products is the manufacturing industry including metalworking, aerospace, medical, and automotive but other important consumers are marine and farm equipment shops, do-it-yourselfers and tradesmen such as builders, carpenters, plumbers and electricians.

For 135 years the Company has been a recognized leader in providing measurement and cutting solutions to industry. Measurement tools consist of precision instruments such as micrometers, vernier calipers, height gages, depth gages, electronic gages, dial indicators, steel rules, combination squares, custom, non-contact and in-process gaging such as optical, vision and laser measurement systems. The Company has expanded its product offering in the field of test and measurement equipment, with force measurement and material test equipment. Skilled personnel, superior products, manufacturing expertise, innovation and unmatched service has earned the Company its reputation as the “Best in Class” provider of measuring application solutions for industry. During fiscal 2014, the Company introduced material test systems consisting of hardware and cutting edge software with capacities up to 50KN, in addition to new manual and



automated FOV (Field of View) measurement systems. These systems we believe will be attractive to industry to reduce measurement and inspection time and are ideal for quality assurance, inspection labs, manufacturing and research facilities.

The Company's saw product lines enjoy strong global brand recognition and market share. These products encompass a breadth of uses. The Company introduced several new products in the recent past including a new line of hand tools for measuring, marking and layout that include tapes, levels, chalk lines and other products for the building trades. In fiscal 2015, the Company introduced a new line of drills, knives and tool bags to broaden its hand tool product line. The continued focus on high performance, production band saw applications has resulted in the development of two new ADVANZ carbide tipped products MC5 and MC7 ideal for cutting ferrous materials (MC7) and non-ferrous metals and castings (MC5). These actions are aimed at positioning Starrett for global growth in wide band products for production applications.

As one of the premier industrial brands, the Company continues to be focused on every touch point with its customers. To that end, the Company now offers modern, easy-to-use interfaces for distributors and end-users including interactive catalogs and several online applications.

## **Personnel**

At June 30, 2015, the Company had 1,804 employees, approximately 52% of whom were domestic. This represents a net decrease from June 30, 2014 of 7 employees. The headcount change included an increase of 1 domestically and a decrease of 8 internationally.

None of the Company's operations are subject to collective bargaining agreements. In general, the Company considers relations with its employees to be excellent. Domestic employees hold a large share of Company stock resulting from various stock purchase plans and employee stock ownership plans. The Company believes that this dual role of owner-employee has strengthened employee morale over the years.

## **Competition**

The Company competes on the basis of its reputation as the best in class for quality, precision and innovation combined with its commitment to customer service and strong customer relationships. To that end, Starrett is increasingly focusing on providing customer centric solutions. Although the Company is generally operating in highly competitive markets, the Company's competitive position cannot be determined accurately in the aggregate or by specific market since none of its competitors offer all of the same product lines offered by the Company or serve all of the markets served by the Company.

The Company is one of the largest producers of mechanics' hand measuring tools and precision instruments. In the United States, there are three major foreign competitors and numerous small companies in the field. As a result, the industry is highly competitive. During fiscal 2015, there were no material changes in the Company's competitive position. The Company's products for the building trades, such as tape measures and levels, are under constant margin pressure due to a channel shift to large national home and hardware retailers. The Company is responding to such challenges by expanding its manufacturing operations in China. Certain large customers also offer their own private labels ("own brand") that compete with Starrett branded products. These products are often sourced directly from low cost countries.

Saw products encounter competition from several domestic and international sources. The Company's competitive position varies by market and country. Continued research and development, new patented products and processes, strategic acquisitions and investments and strong customer support have enabled the Company to compete successfully in both general and performance oriented applications.

## **Foreign Operations**

The operations of the Company's foreign subsidiaries are consolidated in its financial statements. The subsidiaries located in Brazil, Scotland and China are actively engaged in the manufacturing and distribution of precision measuring tools, saw blades, optical and vision measuring equipment and hand tools. Subsidiaries in Canada, Australia, New Zealand, Mexico, Germany and Singapore are engaged in distribution of the Company's products. The Company expects its foreign subsidiaries to continue to play a significant role in its overall operations. A summary of the Company's foreign operations is contained in Note 15 to the Company's fiscal 2015 financial statements under the caption "OPERATING DATA" found in Item 8 of this Form 10-K.

## **Orders and Backlog**

The Company generally fills orders from finished goods inventories on hand. Sales order backlog of the Company at any point in time is not significant. Total inventories amounted to \$63.0 million at June 30, 2015 and \$65.6 million at June 30, 2014.

## **Intellectual Property**

When appropriate, the Company applies for patent protection on new inventions and currently owns a number of patents. Its patents are considered important in the operation of the business, but no single patent is of material importance when viewed from the standpoint of its overall business. The Company relies on its continuing product research and development efforts, with less dependence on its current patent position. It has for many years maintained engineers and supporting personnel engaged in research, product development and related activities. The expenditures for these activities during fiscal years 2015, 2014, and 2013 were approximately \$1.7 million, \$1.4 million, and \$1.3 million, respectively.

The Company uses trademarks with respect to its products and considers its trademark portfolio to be one of its most valuable assets. All of the Company's important trademarks are registered and rigorously enforced.

## **Environmental**

Compliance with federal, state, local, and foreign provisions that have been enacted or adopted regulating the discharge of materials into the environment or otherwise relating to protection of the environment is not expected to have a material effect on the capital expenditures, earnings and competitive position of the Company. Specifically, the Company has taken steps to reduce, control and treat water discharges and air emissions. The Company takes seriously its responsibility to the environment, has embraced renewable energy alternatives and received approval from federal and state regulators in fiscal 2013 to begin using its new hydro – generation facility on line at its Athol, MA plant to reduce its carbon footprint and energy costs, an investment in excess of \$1.0 million.

## **Strategic Activities**

Globalization has had a profound impact on product offerings and buying behaviors of industry and consumers in North America and around the world, forcing the Company to adapt to this new, highly competitive business environment. The Company continuously evaluates most aspects of its business, aiming for new world-class ideas to set itself apart from its competition.

Our strategic concentration is on global brand building and providing unique customer value propositions through technically supported application solutions for our customers. Our job is to recommend and produce the best suited standard product or to design and build custom solutions. The combination of the right tool for the job with value added service gives us a competitive advantage. The Company continues its focus on lean manufacturing, plant consolidations, global sourcing, new software and hardware technologies, and improved logistics to optimize its value chain.

The execution of these strategic initiatives has expanded the Company's manufacturing and distribution in developing economies, resulting in international sales revenues totaling 48% of consolidated sales for fiscal 2015.

### **SEC Filings and Certifications**

The Company makes its public filings with the Securities and Exchange Commission ("SEC"), including its Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and all exhibits and amendments to these reports, available free of charge at its website, [www.starrett.com](http://www.starrett.com), as soon as reasonably practicable after the Company files such material with the SEC. Information contained on the Company's website is not part of this Annual Report on Form 10-K.

### **Item 1A – Risk Factors**

#### **SAFE HARBOR STATEMENT UNDER THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995**

This Annual Report on Form 10-K and the Company's 2015 Annual Report to Stockholders, including the President's letter, contain forward-looking statements about the Company's business, competition, sales, gross margins, capital expenditures, foreign operations, plans for reorganization, interest rate sensitivity, debt service, liquidity and capital resources, and other operating and capital requirements. In addition, forward-looking statements may be included in future Company documents and in oral statements by Company representatives to security analysts and investors. The Company is subject to risks that could cause actual events to vary materially from such forward-looking statements, including the following risk factors:

#### **Economic and world events could affect our operating results.**

The Company's results of operations may be materially affected by the conditions in the global economy. These include both world - wide and regional economic conditions and geo-political events. These conditions may affect financial markets, consumer and customer confidence. The recovery from the recession has been slow in North America. Latin America has experienced inflation resulting in weaker local currencies compared to the U. S. dollar. China's growth has slowed and Europe and the Middle – East remain under geo-political threat. The Company can provide no assurance that these economic trends will not continue.

#### **Technological innovation by competitors could adversely affect financial results.**

Although the Company's strategy includes investment in research and development of new and innovative products to meet technology advances, there can be no assurance that the Company will be successful in competing against new technologies developed by competitors.

**International operations and our financial results in those markets may be affected by legal, regulatory, political, currency exchange and other economic risks.**

During 2015, international sales revenues were \$116 million, representing approximately 48% of total net sales. In addition, a significant amount of our manufacturing and production operations are located, or our products are sourced from, outside the United States. As a result, our business is subject to risks associated with international operations. These risks include the burdens of complying with foreign laws and regulations, unexpected changes in tariffs, taxes or regulatory requirements, and political unrest and corruption. Regulatory changes could occur in the countries in which we sell, produce or source our products or significantly increase the cost of operating in or obtaining materials originating from certain countries. Restrictions imposed by such changes can have a particular impact on our business when, after we have moved our operations to a particular location, new unfavorable regulations are enacted in that area or favorable regulations currently in effect are changed.

Countries in which our products are manufactured or sold may from time to time impose additional new regulations, or modify existing regulations, including:

- changes in duties, taxes, tariffs and other charges on imports;
- limitations on the quantity of goods which may be imported into the United States from a particular country;
- requirements as to where products and/or inputs are manufactured or sourced;
- creation of export licensing requirements, imposition of restrictions on export quantities or specification of minimum export pricing and/or export prices or duties;
- limitations on foreign owned businesses; or
- government actions to cancel contracts, re-denominate the official currency, renounce or default on obligations, renegotiate terms unilaterally or expropriate assets.

In addition, political and economic changes or volatility, geopolitical regional conflicts, terrorist activity, political unrest, civil strife, acts of war, public corruption and other economic or political uncertainties could interrupt and negatively affect our business operations. All of these factors could result in increased costs or decreased revenues and could materially and adversely affect our product sales, financial condition and results of operations.

We are also subject to the U.S. Foreign Corrupt Practices Act, in addition to the anti-corruption laws of the foreign countries in which we operate. Although we implement policies and procedures designed to promote compliance with these laws, our employees, contractors and agents, as well as those companies to which we outsource certain of our business operations, may take actions in violation of our policies. Any such violation could result in sanctions or other penalties and have an adverse effect on our business, reputation and operating results.

**Economic weakness in the industrial manufacturing sector could adversely affect the Company's financial results.**

The market for most of the Company's products is subject to economic conditions affecting the industrial manufacturing sector, including the level of capital spending by industrial companies and the general movement of manufacturing to low cost foreign countries where the Company does not have a substantial market presence. Accordingly, economic weakness in the industrial manufacturing sector may, and in some cases has, resulted in decreased demand for certain of the Company's products, which adversely affects sales and performance. Economic weakness in the consumer market will also adversely impact the Company's performance. In the event that demand for any of the Company's products declines significantly, the Company could be required to recognize certain costs as well as asset impairment charges on long-lived assets related to those products.

**Volatility in the price of energy and raw materials could negatively affect our margins.**

Steel is the principal raw material used in the manufacture of the Company's products. The price of steel has historically fluctuated on a cyclical basis and has often depended on a variety of factors over which the Company has no control. The cost of producing the Company's products is also sensitive to the price of energy. The selling prices of the Company's products have not always increased in response to raw material, energy or other cost increases, and the Company is unable to determine to what extent, if any, it will be able to pass future cost increases through to its customers. The Company's inability to pass increased costs through to its customers could materially and adversely affect its financial condition or results of operations.

**The inability to meet expected investment returns and changes to interest rates could have a negative impact on Pension plan assets.**

Currently, the Company's U.S. defined benefit pension plan is underfunded primarily due to lower discount rates. The Company made contributions in fiscal 2015 of \$4.8 million and will be required to make additional contributions in fiscal 2016 of \$3.3 million. The Company could be required to provide more funding to the domestic plan in the future. The Company's UK plan, which is also underfunded, required Company contributions of \$1.2 million, \$1.2 million and \$1.2 million during fiscal 2015, 2014 and 2013 respectively. The Company will be required to make a \$1.1 million contribution to its UK pension plan in fiscal 2016.

**Businesses that we may acquire may fail to perform to expectations.**

Acquisitions involve special risks, including the potential assumption of unanticipated liabilities and contingencies, difficulty in assimilating the operations and personnel of the acquired businesses, disruption of the Company's existing business, dissipation of the Company's limited management resources, and impairment of relationships with employees and customers of the acquired business as a result of changes in ownership and management. While the Company believes that strategic acquisitions can improve its competitiveness and profitability, the failure to successfully integrate and realize the expected benefits of such acquisitions could have an adverse effect on the Company's business, financial condition and operating results.

**We are subject to certain risks as a result of our financial borrowings.** Under the Company's credit facility with TD Bank, N.A., the Company is required to comply with certain financial covenants, including: 1) funded debt to EBITDA, excluding non-cash and retirement benefit expenses ("maximum leverage"), cannot exceed 2.25 to 1; 2) annual capital expenditures cannot exceed \$15.0 million; 3) maintain a Debt Service Coverage Rate of a minimum of 1.25 to 1 and 4) maintain consolidated cash plus liquid investments of not less than \$10.0 million at any time.

The Company believes that it will be able to service its debt and comply with the financial covenants in future periods; however, it can be not be assured of results of operations or future credit and financial markets conditions. An event of default under the credit facility, if not waived, could prevent additional borrowing and could result in the acceleration of the Company's debt. As of June 30, 2015, the Company was in compliance with all the covenants. The credit facility expires in April of 2018.

**Any inadequacy, interruption, integration failure or security failure with respect to our information technology could harm our ability to effectively operate our business.**

The efficient operation of the Company's business is dependent on its information systems, including its ability to operate them effectively and to successfully implement new technologies, systems, controls and adequate disaster recovery systems. In addition, the Company must protect the confidentiality of data of its business, employees, customers and other third parties. The failure of the Company's information systems to perform as designed or its failure to implement and operate them effectively could disrupt the Company's business or subject it to liability and thereby harm its profitability. The Company continues to enhance the applications contained in the Enterprise Resource Planning (ERP) system as well as improvements to other operating systems.

**Failure to comply with laws, rules and regulations could negatively affect our business operations and financial performance.**

Our business is subject to federal, state, local and international laws, rules and regulations, such as state and local wage and hour laws, the U.S. Foreign Corrupt Practices Act, the False Claims Act, the Employee Retirement Income Security Act (“ERISA”), securities laws, import and export laws (including customs regulations) and many others. The complexity of the regulatory environment in which we operate and the related cost of compliance are both increasing due to changes in legal and regulatory requirements, increased enforcement and our ongoing expansion into new markets and new channels. In addition, as a result of operating in multiple countries, we must comply with multiple foreign laws and regulations that may differ substantially from country to country and may conflict with corresponding U.S. laws and regulations. We may also be subject to investigations or audits by governmental authorities and regulatory agencies, which can occur in the ordinary course of business or which can result from increased scrutiny from a particular agency towards an industry, country or practice. If we fail to comply with laws, rules and regulations or the manner in which they are interpreted or applied, we may be subject to government enforcement action, class action litigation or other litigation, damage to our reputation, civil and criminal liability, damages, fines and penalties, and increased cost of regulatory compliance, any of which could adversely affect our results of operations and financial performance.

**Our tax rate is dependent upon a number of factors, a change in any of which could impact our future tax rates and net income.**

Our future tax rates may be adversely affected by a number of factors, including the enactment of certain tax legislation being considered in the U.S.; other changes in tax laws or the interpretation of such tax laws; changes in the estimated realization of our net deferred tax assets; the jurisdictions in which profits are determined to be earned and taxed; the repatriation of non-U.S. earnings for which we have not previously provided for U.S. income and non-U.S. withholding taxes; adjustments to estimated taxes upon finalization of various tax returns; increases in expenses that are not deductible for tax purposes, including impairment of goodwill in connection with acquisitions; changes in available tax credits; and the resolution of issues arising from tax audits with various tax authorities. Losses for which no tax benefits can be recorded could materially impact our tax rate and its volatility from one quarter to another. Any significant change in our jurisdictional earnings mix or in the tax laws in those jurisdictions could impact our future tax rates and net income in those periods.

**Item 1B – Unresolved Staff Comments**

None.



**Item 2 - Properties**

The Company's principal plant and its corporate headquarters are located in Athol, MA on approximately 15 acres of Company-owned land. The plant consists of 25 buildings, mostly of brick construction of varying dates, with approximately 535,000 square feet.

The Company's Webber Gage Division in Cleveland, OH, owns and occupies two buildings totaling approximately 50,000 square feet.

The Company-owned facility in Mt. Airy, NC consists of one building totaling approximately 320,000 square feet. It is occupied by the Company's Saw Division, Ground Flat Stock Division and a distribution center.

The Company's subsidiary in Itu, Brazil owns and occupies several buildings totaling 209,000 square feet.

The Company's subsidiary in Jedburgh, Scotland owns and occupies a 175,000 square foot building.

A wholly owned manufacturing subsidiary in The People's Republic of China leases a 133,000 square foot building in Suzhou and leases a sales office in Shanghai.

The Tru-Stone Division owns and occupies a 106,000 square foot facility in Waite Park, MN.

The Kinematic Engineering Division occupies a 18,000 square foot leased facility in Laguna Hills, CA.

The Bytewise Division occupies a 10,000 square foot leased facility in Columbus, GA.

In addition, the Company operates warehouses and/or sales-support offices in the U.S., Canada, Australia, New Zealand, Mexico, Germany, Singapore and Japan.

In the Company's opinion, all of its property, plant and equipment are in good operating condition, well maintained and adequate for its current and foreseeable needs.



**Item 3 - Legal Proceedings**

In the ordinary course of business the Company is involved from time to time in litigation that is not considered material to its financial condition or operations.

**Item 4 – Mine Safety Disclosures**

Not applicable.

**PART II**

**Item 5 - Market for the Registrant’s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities**

The Company’s Class A common stock is traded on the New York Stock Exchange. Quarterly dividend and high/low closing market price information is presented in the table below. The Company’s Class B common stock is generally nontransferable, except to lineal descendants of stockholders, and thus has no established trading market, but it can be converted into Class A common stock at any time. The Class B common stock was issued on October 5, 1988, and the Company has paid the same dividends thereon as have been paid on the Class A common stock since that date. On June 30, 2015, there were approximately 1,224 registered holders of Class A common stock and approximately 1,015 registered holders of Class B common stock.

<b>Quarter Ended</b>	<b>Dividends</b>	<b>High</b>	<b>Low</b>
September 2013	\$ 0.10	\$11.77	\$10.07
December 2013	0.10	14.57	10.99
March 2014	0.10	19.21	14.41
June 2014	0.10	17.01	13.73
September 2014	0.10	18.23	13.84
December 2014	0.10	19.99	13.15
March 2015	0.10	21.80	18.88
June 2015	0.10	20.30	14.75

The Company’s dividend policy is subject to periodic review by the Board of Directors. Based upon economic conditions, the Board of Directors decided to maintain the quarterly dividend at \$0.10 for all quarters of fiscal 2015.

The Company repurchased 263 shares of class B stock in the fourth quarter of fiscal 2015.

## PERFORMANCE GRAPH

The following graph sets forth information comparing the cumulative total return to holders of the Company's Class A common stock based on the market price of the Company's Class A common stock over the last five fiscal years with (1) the cumulative total return of the Russell 2000 Index ("Russell 2000") and (2) a peer group index (the "Peer Group") reflecting the cumulative total returns of certain small cap manufacturing companies as described below. The peer group is comprised of the following companies: Acme United, Q.E.P. Co. Inc., Badger Meter, Federal Screw Works, National Presto Industries, Regal-Beloit Corp., Tecumseh Products Co., Tennant Company, The Eastern Company and WD-40.

	<b>BASE</b>	<b>FY2011</b>	<b>FY2012</b>	<b>FY2013</b>	<b>FY2014</b>	<b>FY2015</b>
STARRETT	<b>100.00</b>	<b>110.64</b>	<b>129.15</b>	<b>118.35</b>	<b>183.36</b>	<b>183.19</b>
RUSSELL 2000	<b>100.00</b>	<b>137.41</b>	<b>134.55</b>	<b>167.12</b>	<b>206.63</b>	<b>220.03</b>
PEER GROUP	<b>100.00</b>	<b>116.95</b>	<b>114.47</b>	<b>127.51</b>	<b>163.03</b>	<b>163.37</b>

### **Item 6 - Selected Financial Data**

The following selected financial data have been derived from and should be read in conjunction with “Management Discussion and Analysis of Financial Condition and Results of Operations” and our Consolidated Financial Statements and notes thereto, included elsewhere in this Annual Report on Form 10-K.

	<b>Years ended June 30 (in \$000s except per share data)</b>				
	<b>2015</b>	<b>2014</b>	<b>2013</b>	<b>2012</b>	<b>2011</b>
Net sales	\$241,550	\$247,134	\$243,797	\$260,148	\$244,841
Net earnings (loss)	5,244	6,712	(162 )	888	6,845
Basic earnings (loss) per share	0.75	0.97	(0.02 )	0.13	1.02
Diluted earnings (loss) per share	0.75	0.97	(0.02 )	0.13	1.02
Long-term debt	18,552	10,804	24,252	29,387	721
Total assets	212,272	231,443	230,794	252,166	227,179
Dividends per share	0.40	0.40	0.40	0.40	0.32

**Items 7 and 7A- Management's Discussion and Analysis of Financial Condition and Results of Operations and Quantitative and Qualitative Disclosure about Market Risk**

**RESULTS OF OPERATIONS**

**Fiscal 2015 Compared to Fiscal 2014**

**Overview**

L. S. Starrett is a global manufacturing company impacted by economic and geo-political conditions worldwide. North America was the strongest market for the Company in FY 2015. This was driven by a U.S economy that exhibited the most buoyance of any of the major global economies. This was driven by an improved labor market and a steady recovery in overall economic performance coupled with new product introductions and new and enhanced channel partner relationships. This resulted in increased demand for precision hand tools and continued growth in shipments for high-end capital equipment. Internationally, sales declined as result of the strong U.S. dollar. This negatively impacted most all international operating facilities. Other significant factors hurting international performance were accelerating inflation and a deepening recession in Brazil, a European market still suffering with Eurozone financial instability and a Chinese economy experiencing slower expansion. Net sales for fiscal 2015 declined \$5.6 million, or 2%, compared to fiscal 2014, as gains in North America were offset by lower International sales, principally caused by the strong U.S. dollar. Price increases, particularly in Brazil and new products, representing sales gains of \$6.5 million and \$2.7 million respectively, were offset by unfavorable exchange rates of \$14.1 million and volume declines of \$0.77 million. Gross margins declined \$4.4 million from \$81.1 million, or 32.8 % of sales, in fiscal 2014 to \$76.7 million or 31.8% of sales in fiscal 2015 as a \$3.7 million improvement in North America was offset by an \$8.1 million decline in International. Selling, general and administrative expenses decreased \$1.1 million or 2% from \$69.2 million in fiscal 2014 to \$68.1 million in fiscal 2015 principally due to reduced International expenses expressed in U.S. dollars. Operating income declined \$3.3 million, from \$11.9 million in fiscal 2014, to \$8.6 million in fiscal 2015.

**Net Sales**

Net sales in North America increased \$7.9 million, or 6%, from \$129.4 million in fiscal 2014 to \$137.3 million in fiscal 2015 with precision hand tools and capital equipment posting gains of 6% and 13%, respectively. International sales decreased \$13.4 million, or 11%, from \$117.8 million in fiscal 2014 to \$104.4 million in fiscal 2015 with the weak Brazilian Real translated to the strong U.S. dollar representing \$12.1 million, or 90%, of the decline.

### **Gross Margin**

Gross margin in North America increased \$3.8 million, or 10%, from \$39.8 million in fiscal 2014 to \$43.6 million in fiscal 2015 and improved as a percentage of sales from 30.8% in fiscal 2014 to 31.8% in fiscal 2015. The improvement was due to a favorable product mix and increased sales volume. International gross margins decreased \$8.2 million, or 20%, from \$41.3 million in fiscal 2014 to \$33.1 million in fiscal 2015 with unfavorable exchange rates representing \$4.4 million and reduced sales volume \$3.7 million.

### **Selling, General and Administrative Expenses**

North American selling, general and administrative expenses increased \$0.5 million, or 1%, as higher travel and entertainment, professional fees and commissions more than offset savings in salaries and employee benefits. International selling, general and administrative expenses decreased \$1.6 million, or 5%, with a \$4.0 million savings due to the stronger U. S. dollar. Higher spending in local currencies for salaries and benefits, commissions, professional fees and marketing expenses represented the major factors for a \$2.4 million cost increase as measured if currency exchange rate remained constant.

### **Operating Profit**

The operating profit declined \$3.3 million from \$11.9 million in fiscal 2014 to \$8.6 million in fiscal 2015 as a \$3.2 million North American profit improvement was more than offset by \$6.5 million reduction in International.

### **Other Income, Net**

Other income in fiscal 2015 increased \$1.2 million compared to fiscal 2014 principally due to a strong dollar in fiscal 2015 that increased the local currency value of dollar denominated assets, especially export receivables in Brazil, compared to fiscal 2014 when the Brazilian Real was consistent with fiscal 2013 and the strength of the Pound Sterling to the U. S. dollar resulted in foreign exchange losses in Scotland.

## **Income Taxes**

The effective tax rate was 47.2% for fiscal 2015 and 44.3% for fiscal 2014. The rate reflects federal, state and foreign adjustments for permanent book to tax differences. The principal reason for the rate being significantly greater than the US normalized combined federal and state tax rate of approximately 38% was significant losses in foreign operations which could not reduce tax expense based upon the uncertainty of future profits in those entities.

The Company continues to recognize the benefit of most U.S. deferred tax assets as, after weighing the positive and negative evidence, it believes it is more likely than not that those benefits will be recognized. The valuation allowances relating to carryforwards of foreign net operating losses (NOLs) increased by \$0.7 million and to foreign tax credits increased by \$0.5 million. There was no change in the valuation allowance related to certain state NOLs.

## **Fiscal 2014 Compared to Fiscal 2013.**

### **Overview**

L. S. Starrett is a global manufacturing company impacted by economic conditions worldwide. In North America, an improved labor market and a steady recovery in overall economic performance resulted in increased demand for precision hand tools and a resurgence of shipments for high-end capital equipment. Internationally, sales declined as an economic recovery in Europe and strong gains in Asia was offset by a continued weakening of the Brazilian Real against the U. S. dollar.

Net sales for fiscal 2014 increased \$3.3 million, or 1.4%, compared to fiscal 2013, as gains in North America, Europe and Asia more than offset unfavorable foreign currency exchange rates in South America. Price increases, particularly in Brazil, and new products represented sales gains of \$9.6 and \$7.0 million respectively offsetting volume declines of \$6.0 million and unfavorable exchange rates of \$7.3 million. Gross margins increased \$9.3 million from \$71.8 million, or 29.5 %, of sales in fiscal 2013 to \$81.1 million, or 32.8%, of sales in fiscal 2014 as a favorable product mix of increased sales of higher margin products, a successful launch of new products and reduced manufacturing overhead costs all contributed to an improved performance. Selling, general and administrative expenses decreased \$3.9 million, or 5.3%, from \$73.1 million in fiscal 2013 to \$69.2 million in fiscal 2014 principally due to cost reductions implemented in the fourth quarter of fiscal 2013. Operating income improved \$13.2 million, from a loss of \$1.3 million in fiscal 2013, to a profit of \$11.9 million in fiscal 2014.

### **Net Sales**



Net sales in North America increased \$5.9 million, or 4.8%, from \$123.5 million in fiscal 2013 to \$129.4 million in fiscal 2014 with an increase in capital equipment sales representing \$4.3 million, or 73%, of the growth. International sales decreased \$2.6 million, or 2.2%, from \$120.3 million in fiscal 2013 to \$117.7 million in fiscal 2014. Foreign currency exchange rate fluctuations represented an unfavorable impact of \$7.3 million, more than offsetting than revenue increases in Europe and Asia of \$2.1 and \$1.4 million, respectively.

### **Gross Margin**

Gross margin in North America increased \$7.4 million, or 22%, from \$33.1 million in fiscal 2013 to \$40.5 million in fiscal 2014 and improved as a percentage of sales from 26.8% in fiscal 2013 to 31.3% in fiscal 2014. The improvement was due to a favorable product mix, reduced manufacturing overhead and lower LIFO reserves in North America. International gross margins increased \$1.8 million, or 4.7%, from \$38.8 million in fiscal 2013 to \$40.6 million in fiscal 2014 as improved margins in Europe and Asia, of \$0.9 million and \$2.5 million, respectively, more than offset a \$2.7 million negative impact due to foreign exchange rate changes.

### **Selling, General and Administrative Expenses**

North American selling, general and administrative expenses decreased \$1.0 million, or 2.8%, due to lower salaries, travel and professional fees. International selling, general and administrative expenses decreased \$3.0 million, or 8.4%, with a \$1.9 million savings due to the stronger U. S. dollar. Lower salaries and employee benefits, commissions, Information Technology, professional fees and marketing expenses combined for a \$2.7 million savings expressed in U. S. dollars.

### **Operating Profit**

Operating profit improved \$13.2 million from a loss of \$1.3 million in fiscal 2013 to a profit of \$11.9 million in fiscal 2014 as a result of improved gross margins and lower selling, general and administrative expenses.

### **Other Income, Net**

Other income declined \$1.9 million due to \$0.8 million in foreign exchange losses in fiscal 2014 compared to \$1.1 in foreign exchange gains in fiscal 2013.

### **Income Taxes**

The Company recorded \$5.3 million of tax expense (44.3%) on \$12.0 million of pretax income and \$1.0 million of tax expense (120.3%) on \$0.8 million of pretax income for the fiscal years ended June 30, 2014 and June 30, 2013, respectively. The significant items impacting tax expense in fiscal 2014 include the following:

The Company recorded \$0.3 million of deferred income tax expense to reflect a reduction of three percentage points in the tax rate applied to deferred tax assets in the U.K. In addition, as a result of a tax audit in China, the Company's tax loss carryforwards were reduced increasing tax expense by \$0.2 million. Tax benefits include a reduction of the valuation allowance in China as the subsidiary was profitable in fiscal 2014 and fully utilized its tax loss carryforward and the tax benefit of a revised calculation of the U.S. deduction for losses related to receivables and investments in foreign subsidiaries as a return to provision adjustment.

The Company continues to recognize the benefit of most U.S. deferred tax assets as, after weighing the positive and negative evidence, it believes it is more likely than not that those benefits will be recognized. In fiscal 2014, the valuation allowance decreased by \$1.2 million primarily related to profits in China (as noted above) and to the portion of foreign tax credits which expired in 2014 and which were also written off.

### **FINANCIAL INSTRUMENT MARKET RISK**

Market risk is the potential change in a financial instrument's value caused by fluctuations in interest and currency exchange rates, and equity and commodity prices. The Company's operating activities expose it to risks that are continually monitored, evaluated and managed. Proper management of these risks helps reduce the likelihood of earnings volatility.

The Company does not engage in trading, market-making or other speculative activities in derivatives markets. The Company does not enter into long-term supply contracts with either fixed prices or quantities. The Company engages in an immaterial amount of hedging activity to minimize the impact of foreign currency fluctuations and had \$1.3 million in forward currency contracts outstanding at June 30, 2015. Net foreign monetary assets are approximately \$25.7 million as of June 30, 2015.

A 10% change in interest rates would not have a significant impact on the aggregate net fair value of the Company's interest rate sensitive financial instruments or the cash flows or future earnings associated with those financial instruments. A 10% change in interest rates would not have a material impact on our borrowing costs. See Note 12 to the Consolidated Financial Statements for details concerning the Company's long-term debt outstanding of \$18.6 million.

## LIQUIDITY AND CAPITAL RESOURCES

	<b>Years ended June 30</b>		
	<b>(\$000)</b>		
	<b>2015</b>	<b>2014</b>	<b>2013</b>
Cash provided by operating activities	\$6,800	\$11,175	\$20,716
Cash used in investing activities	(5,544)	(8,347)	(9,829)
Cash provided by (used in) financing activities	(3,547)	(6,669)	(7,590)

The Company has a working capital ratio of 5.7 as of June 30, 2015 as compared to 4.1 as of June 30, 2014. The working capital ratio improvement is principally due to the reclassification of our Line of Credit from short-term debt to long-term debt as the credit facility was renewed for three years in April of 2015. Cash, short-term investments, accounts receivable and inventories represent 92% of current assets in both fiscal 2015 and fiscal 2014. The Company had accounts receivable turnover of 5.8 in fiscal 2015 and 6.1 in fiscal 2014, and had an inventory turnover ratio of 2.6 in fiscal 2015 and 2.7 in fiscal 2014.

Net cash provided by operations of \$6.8 million in fiscal 2015 was the result of contributions on earning, depreciation and amortization and an increase in tax liabilities of \$16.4 million partially offset by increased working capital requirements of \$8.5 million. The negative impact of increased working capital on cash flows was primarily the result of a strong U. S. dollar reducing the value of foreign working capital when denominated in U. S. dollars

The Company incurred a \$5.1 million cash flow deficit in fiscal 2015, as the \$6.8 million provided by operations was offset by investments in plant and equipment of \$5.6million, net debt repayments of \$1.2 million, dividends of \$2.8 million and \$2.8 million in currency changes.



Effects of translation rate changes on cash primarily result from the movement of the U.S. dollar against the British Pound, the Euro and the Brazilian Real. The Company uses a limited number of forward contracts to hedge some of this activity and a natural hedge strategy of paying for foreign purchases in local currency when economically advantageous.

## **Liquidity and Credit Arrangements**

The Company believes it maintains sufficient liquidity and has the resources to fund its operations in the near term. In addition to its cash and short-term investments, the Company has maintained a \$23.0 million line of credit, of which, \$0.8 million is reserved for letters of credit and \$9.3 million was outstanding as of June 30, 2015.

On June 30, 2009, The L.S. Starrett Company (the “Company”) and certain subsidiaries of the Company (the “Subsidiaries”) entered into a Loan and Security Agreement (the “Credit Facility”) with TD Bank, N.A.. The amended Credit Facility is scheduled to mature on April 30, 2018 and bears interest at LIBOR plus 1.50%.

The obligations under the Credit Facility are unsecured. However, in the event of certain triggering events, the obligations under the Credit Facility will become secured by the assets of the Company and the subsidiaries party to the Credit Facility. Triggering events are two consecutive quarters of failure to achieve the financial covenants outlined in Note 12.

Availability under the Credit Facility is subject to a borrowing base comprised of accounts receivable and inventory. The Company believes that the borrowing base will consistently produce availability under the Credit Facility in excess of \$23.0 million. As of July 31, 2015, the Company had borrowings of \$9.3 million under the Credit Facility.

The Credit Facility contains financial covenants with respect to leverage, tangible net worth, and interest coverage, and also contains customary affirmative and negative covenants, including limitations on indebtedness, liens, acquisitions, asset dispositions, and fundamental corporate changes, and certain customary events of default. Upon the occurrence and continuation of an event of default, the lender may terminate the revolving credit commitment and require immediate payment of the entire unpaid principal amount of the Credit Facility, accrued interest and all other obligations. As of June 30, 2015, the Company was in compliance with the financial covenants under the Credit Facility.

## OFF-BALANCE SHEET ARRANGEMENTS

The Company does not have any material off-balance sheet arrangements as defined under the Securities and Exchange Commission rules.

## CRITICAL ACCOUNTING POLICIES AND ESTIMATES

The preparation of financial statements and related disclosures in conformity with accounting principles generally accepted in the United States of America requires management to make judgments, assumptions and estimates that affect the amounts reported in the consolidated financial statements and accompanying notes. The second footnote to the Company's Consolidated Financial Statements describes the significant accounting policies and methods used in the preparation of the consolidated financial statements.

Judgments, assumptions, and estimates are used for, but not limited to, the allowance for doubtful accounts receivable and returned goods; inventory allowances; income tax reserves; long lived assets; goodwill; and employee turnover, discount and return rates used to calculate pension obligations.

Future events and their effects cannot be determined with absolute certainty. Therefore, the determination of estimates requires the exercise of judgment. Actual results inevitably will differ from those estimates, and such differences may be material to the Company's Consolidated Financial Statements. The following sections describe the Company's critical accounting policies.

Revenue Recognition and Accounts Receivable: Sales of merchandise and freight billed to customers are recognized when products are shipped, title and risk of loss has passed to the customer, no significant post-delivery obligations remain and collection of the resulting receivable is reasonably assured. Sales are net of provisions for cash discounts, returns, customer discounts (such as volume or trade discounts), and other sales related discounts. Cooperative advertising payments made to customers are included as advertising expense in selling, general and administrative in the Consolidated Statements of Operations. While the Company does allow its customers the right to return in certain circumstances, revenue is not deferred, but rather a reserve for sales returns is provided based on experience, which historically has not been significant.

The allowance for doubtful accounts of \$0.6 million and \$0.7 million at the end of fiscal 2015 and 2014 respectively, is based on our assessment of the collectability of specific customer accounts and the aging of our accounts receivable. While the Company believes that the allowance for doubtful accounts is adequate, if there is a deterioration of a major customer's credit worthiness, actual write-offs are higher than our previous experience, or actual future returns do not reflect historical trends, the estimates of the recoverability of the amounts due the Company and net sales could be adversely affected.



**Inventory Valuation:** The Company values inventories at the lower of the cost of inventory or net realizable value, with cost determined by either the last-in, first-out ("LIFO") method for most U.S. inventories or the first-in, first-out ("FIFO") method for all other inventories. We establish reserves for excess, slow moving, and obsolete inventory based on inventory levels, expected product life, and forecasted sales demand. In assessing the ultimate realization of inventories, we are required to make judgments as to future demand requirements compared with inventory levels. Reserve requirements are developed according to our projected demand requirements based on historical demand, competitive factors, and technological and product life cycle changes. It is possible that an increase in our reserve may be required in the future if there is a significant decline in demand for our products and we do not adjust our production schedule accordingly.

**Property Plant and Equipment:** The Company accounts for property, plant and equipment (PP&E) at historical cost less accumulated depreciation. Impairment losses are recorded when indicators of impairment, such as plant closures, are present and the undiscounted cash flows estimated to be generated by those assets are less than the carrying amount. The Company continually reviews for such impairment and believes that PP&E is being carried at its appropriate value.

The Company groups PP&E for impairment analysis by division and/or product line. PP&E are reviewed for impairment whenever events or changes in circumstances indicate the carrying amount of such an asset may not be recoverable. Such events or circumstances include, but are not limited to, a significant decrease in the fair value of the underlying business or change in utilization of property and equipment.

Recoverability of the net book value of property, plant and equipment is determined by comparison of the carrying amount to estimated future undiscounted net cash flows the assets are expected to generate. Those cash flows include an estimated terminal value based on a hypothetical sale at the end of the assets' depreciation period. Estimating these cash flows and terminal values requires management to make judgments about the growth in demand for our products, sustainability of gross margins, and our ability to achieve economies of scale. If assets are considered to be impaired, the impairment to be recognized is measured as the amount by which the carrying amount of the long-lived asset exceeds its fair value. No events or circumstances arose in fiscal 2015 which required management to perform an impairment analysis.

Depreciation is included in cost of goods sold or selling, general and administrative expenses in the Consolidated Statement of Operations based upon the function or use of the specific asset. Depreciation of equipment used in the manufacturing process is a component of inventory and included in costs of goods sold. Depreciation of equipment used for office and administrative functions is an expense in selling, general and administrative expenses.

**Intangible Assets:** Identifiable intangible assets are recorded at cost and are amortized on a straight-line basis over a 5-15 year period. The estimated useful lives of the intangible assets subject to amortization are: 15 years for patents, 14 years for trademarks and trade names, 10 years for completed technology, 8 years for non-compete agreements, 8



years for customer relationships and 5 years for software development.

Recoverability of the net book value of intangible assets is determined by comparison of the carrying amount to estimated future undiscounted net cash flows the assets are expected to generate. Estimating these cash flows requires management to make judgments about the growth in demand for our products, sustainability of gross margins, and our ability to achieve economies of scale. If assets are considered to be impaired, the impairment to be recognized is measured as the amount by which the carrying amount of the long-lived asset exceeds its fair value. No events or circumstances arose in fiscal 2015 which required management to perform an impairment analysis.

Goodwill: The Company assesses the fair value of its goodwill to determine if the carrying amount of the goodwill is greater than the fair value. An impairment charge would be recognized to the extent the recorded goodwill exceeds the implied fair value of goodwill.

The Company annually tests the goodwill associated with the November 2011 acquisition of Bytewise in October. As of October 1, 2014, the Company performed a two-step impairment assessment analysis. The first step requires a comparison of the implied fair value of the reporting unit to its carrying value. If the carrying value were higher than the fair value, there would have been an indication that impairment may have existed and a second step would have been performed to calculate the potential impairment. The first step of the 2015 goodwill assessment concluded that the fair value of goodwill exceeded the carrying amount by approximately 37.4%. Therefore no goodwill impairment was recorded and the second step was not required. If future results significantly vary from current estimates, related projections, or business assumptions in the future due to changes in industry or market conditions, the Company may be required to record impairment charges.

**Income Taxes:** Accounting for income taxes requires estimates of future benefits and tax liabilities. Due to temporary differences in the timing of recognition of items included in income for accounting and tax purposes, deferred tax assets or liabilities are recorded to reflect the impact arising from these differences on future tax payments. With respect to recorded tax assets, the Company assesses the likelihood that the asset will be realized by evaluating the positive and negative evidence to determine whether realization is more likely than not to occur. Realization of our deferred tax assets is primarily dependent on future taxable income, the timing and amount of which are uncertain, in part, due to the variable profitability of certain subsidiaries. A valuation allowance is recognized if it is “more likely than not” that some or all of a deferred tax asset will not be realized. In the event that we were to determine that we would not be able to realize our deferred tax assets in the future, an increase in the valuation allowance would be required. In the event we were to determine that we are able to use our deferred tax assets and a valuation allowance had been recorded against the deferred tax assets, a decrease in the valuation allowance would be required. Should any significant changes in the tax law or the estimate of the necessary valuation allowance occur, the Company would record the impact of the change, which could have a material effect on our financial position or results of operations. See also Income Taxes (Note 10 to the Consolidated Financial Statements.)

**Defined Benefit Plans:** The Company has two defined benefit pension plans, one for U.S. employees and another for U.K. employees. The Company also has a postretirement medical and life insurance benefit plan for U.S. employees.

Under our current accounting method, both plans use fair value as the market-related value of plan assets and continue to recognize actuarial gains or losses within the corridor in other comprehensive income but instead of amortizing net actuarial gains or losses in excess of the corridor in future periods, excess gains and losses are recognized in net periodic benefit cost as of the plan measurement date, which is the same as the fiscal year end of the Company (*MTM adjustment*). This accounting method is a permitted option which results in immediate recognition of excess net actuarial gains and losses in net periodic benefit cost instead of in other comprehensive income. Immediate recognition in net periodic benefit cost could potentially increase the volatility of net periodic benefit cost. The MTM adjustments to net periodic benefit cost for 2015, 2014 and 2013 were \$0.3, \$0.0, and \$0.0 million, respectively.

Calculation of pension and postretirement medical costs and obligations are dependent on actuarial assumptions. These assumptions include discount rates, healthcare cost trends, inflation, salary growth, long-term return on plan assets, employee turnover rates, retirement rates, mortality and other factors. These assumptions are made based on a combination of external market factors, actual historical experience, long-term trend analysis, and an analysis of the assumptions being used by other companies with similar plans. Significant differences in actual experience or significant changes in assumptions would affect pension and other postretirement benefit costs and obligations. Effective December 31, 2013, the Company terminated eligibility for employees 55-64 years old in the Postretirement Medical Plan. See also Employee Benefit Plans (Note 11 to the Consolidated Financial Statements).

**Cost of Goods Sold:** The Company includes costs of materials, direct and indirect labor and manufacturing overhead in cost of goods sold. Included in these costs are inbound freight, personnel (manufacturing plants only), receiving costs, internal transferring, employee benefits (including pension expense) and inspection costs.

Selling General and Administrative Expenses: The Company includes distribution expenses in selling, general and administrative expenses. Distribution expenses include shipping labor and warehousing costs associated with the storage of finished goods at each manufacturing facility. The Company also includes costs for our dedicated distribution centers as selling expenses. Employee benefits, including pension expense attributable to personnel not involved in the manufacturing process, are also included in selling, general and administrative expenses.

## CONTRACTUAL OBLIGATIONS

The following table summarizes future estimated payment obligations by period.

	<b>Payments due by period (in millions)</b>				
	<b>Total</b>	<b>&lt;1yr.</b>	<b>1-3yrs.</b>	<b>3-5yrs.</b>	<b>&gt;5yrs.</b>
Debt obligations	\$20.1	\$1.5	\$12.5	\$3.5	\$2.6
Estimated interest on debt obligations	2.1	0.6	1.0	0.4	0.1
Capital lease obligations	0.1	0.1	-	-	-
Operating lease obligations	9.3	1.3	2.9	2.6	2.5
Purchase obligations	13.2	13.2	-	-	-
Total	\$44.8	\$16.7	\$16.4	\$6.5	\$5.2

Estimated interest on debt obligations are based on a standard 10 year loan amortization schedule for the \$15.5 million term loan, and the current outstanding balance of the Company's credit line at the current effective interest rate through April 2018 when the current credit line agreement ends. See Note 12 for additional details on these debt instruments.

While our purchase obligations are generally cancellable without penalty, certain vendors charge cancellation fees or minimum restocking charges based on the nature of the product or service.

#### **ANNUAL NYSE CEO CERTIFICATION AND SARBANES-OXLEY SECTION 302 CERTIFICATIONS**

In fiscal 2015, the Company submitted an unqualified “Annual CEO Certification” to the New York Stock Exchange as required by Section 303A.12(a) of the New York Stock Exchange Listed Company Manual. Further, the Company is filing with the Securities and Exchange Commission the certifications required by Section 302 of the Sarbanes-Oxley Act of 2002 as exhibits to the Company’s Annual Report on Form 10-K.

**Item 8 - Financial Statements and Supplementary Data**

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**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

To the Board of Directors and Stockholders

The L.S. Starrett Company

We have audited the accompanying consolidated balance sheets of The L.S. Starrett Company (a Massachusetts corporation) and subsidiaries (the “Company”) as of June 30, 2015 and 2014, and the related consolidated statements of operations, comprehensive income (loss), stockholders’ equity, and cash flows for each of the three years in the period ended June 30, 2015. Our audits of the basic consolidated financial statements included the financial statement schedule listed in the index appearing under Item 15 (2) of this Form 10-K. These financial statements and financial statement schedule are the responsibility of the Company’s management. Our responsibility is to express an opinion on these financial statements and financial statement schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of The L.S. Starrett Company and subsidiaries as of June 30, 2015 and 2014, and the results of their operations and their cash flows for each of the three years in the period ended June 30, 2015 in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, the related financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Company’s internal control over financial reporting as of June 30, 2015, based on criteria established in the 2013 *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated August 25, 2015 expressed an unqualified opinion.

/s/ Grant Thornton LLP

Boston, Massachusetts

August 25, 2015

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## THE L.S. STARRETT COMPANY

## Consolidated Balance Sheets

(in thousands except share data)

	<b>June 30,</b>	<b>June 30,</b>
	<b>2015</b>	<b>2014</b>
<b>ASSETS</b>		
Current assets:		
Cash	\$11,108	\$16,233
Short-term investments	7,855	8,723
Accounts receivable (less allowance for doubtful accounts of \$612 and \$704, respectively)	40,311	43,712
Inventories	63,003	65,582
Current deferred tax asset	4,554	6,037
Prepaid expenses and other current assets	6,582	6,615
Total current assets	133,413	146,902
Property, plant and equipment, net	44,413	51,537
Taxes receivable	3,383	3,775
Deferred tax assets, net	18,803	16,537
Intangible assets, net	7,125	7,760
Goodwill	3,034	3,034
Other assets	2,101	1,898
Total assets	\$212,272	\$231,443
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Notes payable and current maturities of long-term debt	\$1,552	\$10,548
Accounts payable	9,471	9,980
Accrued expenses	7,011	8,516
Accrued compensation	5,565	6,642
Total current liabilities	23,599	35,686
Deferred tax liabilities	1,548	2,037
Other tax obligations	4,607	3,013
Long-term debt, net of current portion	18,552	10,804
Postretirement benefit and pension obligations	49,536	43,589
Total liabilities	97,842	95,129
Stockholders' equity:		
Class A common stock \$1 par (20,000,000 shares authorized; 6,223,558 outstanding at June 30, 2015 and 6,165,838 outstanding at June 30, 2014)	6,224	6,166
Class B common stock \$1 par (10,000,000 shares authorized; 789,069 outstanding at June 30, 2015 and 794,990 outstanding at June 30, 2014)	789	795
Additional paid-in capital	54,869	54,063
Retained earnings	98,164	95,715



Accumulated other comprehensive loss	(45,616 )	(20,425 )
Total stockholders' equity	114,430	136,314
Total liabilities and stockholders' equity	\$212,272	\$231,443

See notes to consolidated financial statements

## THE L.S. STARRETT COMPANY

## Consolidated Statements of Operations

(in thousands except per share data)

	<b>Years Ended</b>					
	<b>6/30/15</b>		<b>6/30/14</b>		<b>6/30/13</b>	
Net sales	\$241,550		\$247,134		\$243,797	
Cost of goods sold	164,855		166,038		171,985	
Gross margin	76,695		81,096		71,812	
% of net sales	31.8	%	32.8	%	29.5	%
Selling, general and administrative expenses	68,092		69,181		73,090	
Operating income (loss)	8,603		11,915		(1,278 )	
Other income, net	1,339		142		2,074	
Earnings before income taxes	9,942		12,057		796	
Income tax expense	4,698		5,345		958	
Net earnings (loss)	\$5,244		\$6,712		\$(162 )	
Basic and diluted earnings (loss) per share	\$0.75		\$0.97		\$(0.02 )	
Average outstanding shares used in per share calculations:						
Basic	6,983		6,926		6,797	
Diluted	7,023		6,955		6,797	
Dividends per share	\$0.40		\$0.40		\$0.40	

See notes to consolidated financial statements

## THE L. S. STARRETT COMPANY

## Consolidated Statements of Comprehensive Income (Loss)

(in thousands)

	<b>Years Ended</b>		
	<b>6/30/15</b>	<b>6/30/14</b>	<b>6/30/13</b>
Net earnings (loss)	\$5,244	\$6,712	\$(162 )
Other comprehensive income (loss):			
Translation gain (loss)	(18,989)	3,323	(5,729)
Pension and postretirement plans, net of tax of \$(3,857), \$1,212 and \$4,037 respectively	(6,202 )	728	6,787
Other comprehensive income (loss)	(25,191)	4,051	1,058
Total comprehensive income (loss)	\$(19,947)	\$10,763	\$896

See notes to consolidated financial statements

## THE L.S. STARRETT COMPANY

## Consolidated Statements of Stockholders' Equity

(in thousands except per share data)

	Common Stock		Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Loss		Total
	Class A Outstanding	Class B Outstanding					
Balance, June 30, 2012	\$6,017	\$753	\$ 51,941	\$ 94,661	\$ (25,534	)	\$127,838
Total comprehensive (loss) income				(162 )	1,058		896
Dividends (\$0.40 per share)				(2,721 )			(2,721 )
Repurchase of shares	(5 )		(57 )				(62 )
Issuance of stock	28		531				593
Stock-based compensation			198				198
Conversion	37	(37 )					-
Balance, June 30, 2013	6,077	750	52,613	91,778	(24,476	)	126,742
Total comprehensive income				6,712	4,051		10,763
Dividends (\$0.40 per share)				(2,775 )			(2,775 )
Issuance of stock	30	104	1,296				1,430
Stock-based compensation			154				154
Conversion	59	(59 )					-
Balance, June 30, 2014	6,166	795	54,063	95,715	(20,425	)	136,314
Total comprehensive income				5,244	(25,191	)	(19,947 )
Dividends (\$0.40 per share)				(2,795 )			(2,795 )
Repurchase of shares	(1 )	(3 )	(64 )				(68 )
Issuance of stock	23	33	632				688
Stock-based compensation			238				238
Conversion	36	(36 )					-
Balance, June 30, 2015	\$6,224	\$789	\$ 54,869	\$ 98,164	\$ (45,616	)	\$114,430
Cumulative balance:							
Translation loss, net of taxes					\$ (37,300	)	
Pension and postretirement plans, net of taxes					(8,316	)	
					\$ (45,616	)	

See notes to consolidated financial statements



## THE L. S. STARRETT COMPANY

## Consolidated Statements of Cash Flows

(in thousands)

	<b>Years Ended</b>		
	<b>6/30/15</b>	<b>6/30/14</b>	<b>6/30/13</b>
Cash flows from operating activities:			
Net earnings (loss)	\$5,244	\$6,712	\$(162 )
Non cash operating activities:			
Depreciation	7,434	8,177	8,529
Amortization	1,283	1,181	1,146
ESOP compensation expense	-	-	773
Stock-based compensation	362	251	231
Net long-term tax obligations	2,414	780	39
Deferred taxes	985	1,329	(303 )
Unrealized transaction gains	(6 )	(4 )	(23 )
Income on equity method investment	(203 )	(257 )	(470 )
Loss on disposal of building	-	89	-
Working capital changes:			
Accounts receivable	(2,615 )	(4,491 )	2,377
Inventories	(6,185 )	(7,526 )	11,994
Other current assets	483	818	60
Other current liabilities	780	1,871	(5,551 )
Postretirement benefit and pension obligations	(3,426 )	2,073	1,752
Other	250	172	324
Net cash provided by operating activities	6,800	11,175	20,716
Cash flows from investing activities:			
Additions to plant and equipment	(5,052 )	(8,464 )	(7,788 )
Software development	(648 )	(372 )	(353 )
Purchase of short-term investments	(45 )	(107 )	(8,116 )
Proceeds from sale of short-term investments	201	-	6,428
Proceeds from sale of building	-	596	-
Net cash used in investing activities	(5,544 )	(8,347 )	(9,829 )
Cash flows from financing activities:			
Proceeds from short-term borrowings	900	-	-
Short-term debt repayments	-	(425 )	(194 )
Proceeds from long-term borrowings	-	500	1,500
Long-term debt repayments	(2,148 )	(4,529 )	(6,673 )
Proceeds from common stock issued	564	560	560
Repurchase of shares	(68 )	-	(62 )
Dividends paid	(2,795 )	(2,775 )	(2,721 )

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Net cash used in financing activities	(3,547 )	(6,669 )	(7,590 )
Effect of translation rate changes on cash	(2,834 )	319	(1,044 )
Net increase (decrease) in cash	(5,125 )	(3,522 )	2,253
Cash beginning of year	16,233	19,755	17,502
Cash end of year	\$11,108	\$16,233	\$19,755
Supplemental cash flow information:			
Interest paid	\$724	\$813	\$935
Taxes paid, net	2,169	3,476	2,573
Supplemental disclosure of non-cash activities:			
Issuance of stock under 2013 ESOP	\$-	\$773	\$-

See notes to consolidated financial statements

THE L.S. STARRETT COMPANY

Notes to Consolidated Financial Statements

June 30, 2015 and 2015

**1. DESCRIPTION OF BUSINESS**

The L. S. Starrett Company (the “Company”) is incorporated in the Commonwealth of Massachusetts and is in the business of manufacturing industrial, professional and consumer measuring and cutting tools and related products. The Company’s manufacturing operations are primarily in North America, Brazil, China and the United Kingdom. The largest consumer of these products is the metalworking industry, but others include automotive, aviation, marine, farm, do-it-yourselfers and tradesmen such as builders, carpenters, plumbers and electricians.

**2. SIGNIFICANT ACCOUNTING POLICIES**

Principles of consolidation: The consolidated financial statements include the accounts of The L. S. Starrett Company and its subsidiaries, all of which are wholly-owned. All significant intercompany items have been eliminated in consolidation.

Financial instruments and derivatives: The Company’s financial instruments include cash, investments and debt and are valued using level 1 inputs. Investments are stated at cost which approximates fair market value. The carrying value of debt, which is at current market interest rates, also approximates its fair value. The Company’s U.K. subsidiary utilizes forward exchange contracts to reduce currency risk. The fair value of contracts outstanding as of June 30, 2015 and June 30, 2014 amounted to \$1.3 million and \$1.1 million, respectively.

Accounts receivable: Accounts receivable consist of trade receivables from customers. The expense for bad debts amounted to \$0.2, \$0.0, and \$0.1 million in fiscal 2015, 2014 and 2013, respectively. In establishing the allowance for doubtful accounts, management considers historical losses, the aging of receivables and existing economic conditions.

Inventories: Inventories are stated at the lower of cost or market. Substantially all United States inventories are valued using the last-in-first-out (“LIFO”) method. All non-U.S. subsidiaries use the first-in-first-out (“FIFO”) method or the



average cost method. LIFO is not a permissible method of inventory costing for tax purposes outside the U.S.

Property Plant and Equipment: The cost of buildings and equipment is depreciated using straight-line and accelerated methods over their estimated useful lives as follows: buildings and building improvements 10 to 50 years, machinery and equipment 3 to 12 years. Leases are capitalized under the criteria set forth in Accounting Standards Codification (ASC) 840, "Leases" which establishes the four criteria of a capital lease. At least one of the four following criteria must be met for a lease to be considered a capital lease: a transfer of ownership of the property to the lessee by the end of the lease term; a bargain purchase option; a lease term that is greater than or equal to 75 percent of the economic life of the leased property; present value of the future minimum lease payments equals or exceeds 90 percent of the fair market value of the leased property. If none of the aforementioned criteria are met, the lease will be treated as an operating lease. Property plant and equipment to be disposed of are reported at the lower of carrying amount or fair value less cost to sell. A gain or loss is recorded on individual fixed assets when retired or disposed of. Included in buildings and building improvements and machinery and equipment at June 30, 2015 and June 30, 2014 were \$1.3 million and \$1.2 million, respectively, of construction in progress. Repairs and maintenance of equipment are expensed as incurred. No events or circumstances arose in fiscal 2015 which required management to perform an impairment analysis.

Intangible assets and goodwill: Identifiable intangibles are recorded at cost and are amortized on a straight-line basis over a 5-15 year period. The estimated useful lives of the intangible assets subject to amortization are: 15 years for patents, 14 years for trademarks and trade names, 10 years for completed technology, 8 years for non-compete agreements, 8 years for customer relationships and 5 years for software development. Goodwill represents costs in excess of fair values assigned to the underlying net assets of acquired businesses. Goodwill is not subject to amortization but is tested for impairment annually and at any time when events suggest impairment may have occurred. The Company annually tests the goodwill associated with the November 2011 acquisition of Bytewise in October. As of October 1, 2014, the Company performed a two-step impairment assessment analysis. The first step requires a comparison of the implied fair value of the reporting unit to its carrying value. If the carrying value were higher than the fair value, there would have been an indication that impairment may have existed and a second step would have been performed to calculate the potential impairment. The first step of the 2015 goodwill assessment concluded that the fair value of goodwill exceeded the carrying amount by approximately 37.4%. Therefore no goodwill impairment was recorded and the second step was not performed. If future results significantly vary from current estimates, related projections, or business assumptions in the future due to changes in industry or market conditions, the Company may be required to record impairment charges. The Company tests identifiable intangible assets for impairment whenever events or circumstances indicate they may be impaired. No such events or circumstances occurred during fiscal 2015.

Revenue recognition: Sales of merchandise and freight billed to customers are recognized when title and risk of loss has passed to the customer, no significant post-delivery obligations remain and collection of the resulting receivable is reasonably assured. Sales are presented net of provisions for cash discounts, returns, customer discounts (such as volume or trade discounts), and other sales related discounts. Cooperative advertising payments made to customers are included in selling, general and administrative expenses in the Consolidated Statements of Operations. While the Company does allow its customers the right to return in certain circumstances, revenue is not deferred, but rather a reserve for sales returns is provided based on experience, which historically has not been significant.

Advertising costs: The Company's policy is to generally expense advertising costs as incurred, except catalogs costs, which are deferred until mailed. Advertising costs were expensed as follows: \$5.7 million in fiscal 2015, \$5.5 million in fiscal 2014 and \$6.0 million in fiscal 2013 and are included in selling, general and administrative expenses.

Freight costs: The cost of outbound freight and the cost for inbound freight included in material purchase costs are both included in cost of sales.

Warranty expense: The Company's warranty obligation is generally one year from shipment to the end user and is affected by product failure rates, material usage, and service delivery costs incurred in correcting a product failure. Historically, the Company has not incurred significant warranty expense and consequently its warranty reserves are not material.

Pension and Other Postretirement Benefits: The Company has two defined benefit pension plans, one for U.S. employees and another for U.K. employees. The Company also has defined contribution plans. The Company amended its Postretirement Medical Plan effective December 31, 2013, whereby the Company terminated eligibility for employees ages 55-64.

The Company sponsors funded U.S. and non-U.S. defined benefit pension plans covering the majority of our U.S. and U.K. employees. The Company also sponsors an unfunded postretirement benefit plan that provides health care benefits and life insurance coverage to eligible U.S. retirees. Under the Company's current accounting method, both pension plans use fair value as the market-related value of plan assets and continue to recognize actuarial gains or losses within the corridor in other comprehensive income (loss) but instead of amortizing net actuarial gains or losses in excess of the corridor in future periods, such excess gains and losses, if any, are recognized in net periodic benefit cost as of the plan measurement date, which is the same as the fiscal year end of the Company (MTM adjustment). This method is a permitted option which results in immediate recognition of excess net actuarial gains and losses in net periodic benefit cost instead of in other comprehensive income (loss). Such immediate recognition in net periodic benefit cost increases the volatility of net periodic benefit cost. The MTM adjustments to net periodic benefit cost for 2015, 2014 and 2013 were \$0.3, \$0.0, and \$0.0 million, respectively.

Income taxes: Deferred tax expense results from differences in the timing of certain transactions for financial reporting and tax purposes. Deferred taxes have not been recorded on approximately \$70 million of undistributed earnings of foreign subsidiaries as of June 30, 2015 and the related unrealized translation adjustments because such amounts are considered permanently invested. In addition, it is possible that remittance taxes, if any, would be reduced by U.S. foreign tax credits to the extent available. Valuation allowances are recognized if, based on the available evidence, it is more likely than not that some portion of the deferred tax assets will not be realized.

Research and development: Research and development costs are expensed, primarily in selling, general and administrative expenses, and were as follows: \$1.7 million in fiscal 2015, \$1.4 million in fiscal 2014, and \$1.3 million in fiscal 2013 and are included in selling general and administrative expenses in the Consolidated Statements of Operations.

Earnings per share (EPS): Basic EPS is computed by dividing earnings (loss) available to common shareholders by the weighted average number of common shares outstanding for the period. Diluted EPS reflects the potential dilution by securities that could share in the earnings. The Company had 40,214, 29,951, and 48,455, of potentially dilutive common shares in fiscal 2015, 2014 and 2013, respectively, resulting from shares issuable under its stock option plans. These shares had no impact on the calculated per share amounts. These additional shares are not used in the diluted EPS calculation in loss years.

Translation of foreign currencies: The financial statements of our foreign subsidiaries, where the local currency is the functional currency, are translated at exchange rates in effect on reporting dates, and income and expense items are translated at average rates or rates in effect on transaction dates as appropriate. The resulting foreign currency translation adjustments are charged or credited directly to the other comprehensive income (loss) as noted in the Consolidated Statements of Comprehensive Income (Loss). Net foreign currency gains (losses) are disclosed in Note 9.

Use of accounting estimates: The preparation of the financial statements in conformity with accounting principles generally accepted in the U.S. requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of net sales and expenses during the reporting period. Judgments, assumptions and estimates are used for, but not limited to: the allowances for doubtful accounts receivable and returned goods; inventory allowances; income tax valuation allowances, uncertain tax positions and pension obligations. Amounts ultimately realized could differ from those estimates.

Recent Accounting Pronouncements:

In May 2014, the FASB issued a new standard related to the “Revenue from Contracts with Customers” which amends the existing accounting standards for revenue recognition. The standard requires entities to recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration the entity expects to be entitled to in exchange for those goods or services. This standard is applicable for fiscal years beginning after December 15, 2017 and for interim periods within those years and early adoption is not permitted. The Company expects to adopt this standard on July 1, 2017. The Company is currently evaluating the impact of the adoption of this standard on its consolidated financial statements.

### **3. INVESTMENT**

In fiscal 2010, the Company entered into an agreement with a private software development company to invest \$1.5 million in exchange for a 36% equity interest therein. The Company recorded other income of \$0.2 million in fiscal 2015, \$0.3 million in fiscal 2014 and \$0.5 million in fiscal 2013 based on the earnings of this entity as allocated under the equity method of accounting. The net carrying value of the investment included in other long-term assets in the Consolidated Balance Sheet as of June 30, 2015 and June 30, 2014 is \$2.1 million and \$1.9 million, respectively. In August 2011, the Company guaranteed a loan of \$0.5 million. The guarantee remains outstanding, between the private software development company and Starrett. There was no debt outstanding as of June 30, 2015.

### **4. STOCK-BASED COMPENSATION**

#### **Long-Term Incentive Plan**

During the quarter ended December 31, 2012, the Company implemented The L.S. Starrett Company 2012 Long-Term Incentive Plan (the “2012 Stock Incentive Plan”), which was adopted by the Board of Directors September 5, 2012 and approved by shareholders October 17, 2012. The 2012 Stock Incentive Plan permits the granting of the following types of awards to officers, other employees and non-employee directors: stock options; restricted stock awards; unrestricted stock awards; stock appreciation rights; stock units including restricted stock units; performance awards; cash-based awards; and awards other than previously described that are convertible or otherwise based on stock. The 2012 Stock Incentive Plan provides for the issuance of up to 500,000 shares of common stock.

Options granted vest in periods ranging from one year to three years and expire ten years after the grant date. Restricted stock units (“RSU”) granted generally vest from one year to three years. Vested restricted stock units will be

settled in shares of common stock. As of June 30, 2015, there were 20,000 stock options and 42,234 restricted stock units outstanding. In addition, there were 431,800 shares available for grant under the 2012 Stock Incentive Plan as of June 30, 2015.

For the stock option grant, the fair value of each grant was estimated at the date of grant using the Binomial Options pricing model. The Binomial Options pricing model utilizes assumptions related to stock volatility, the risk-free interest rate, the dividend yield and employee exercise behavior. Expected volatilities utilized in the model are based on the historic volatility of the Company's stock price. The risk free interest rate is derived from the U.S. Treasury yield curve in effect at the time of the grant. The expected life is determined using the average of the vesting period and contractual term of the options (short-cut method).

There were no stock options granted during fiscal years 2015 or 2014. The fair value of stock options granted during fiscal year 2013 of \$3.82 was estimated using the following weighted-average assumptions:

Risk-free interest rate	1.0 %
Expected life (years)	6.0
Expected stock volatility	52.3 %
Expected dividend yield	4.0 %

The weighted average contractual term for stock options outstanding as of June 30, 2015 was 7.5 years. The aggregate intrinsic value of stock options outstanding as of June 30, 2015 was \$0.1 million. There were 13,167 options exercisable as of June 30, 2015. In recognizing stock compensation expense for the 2012 Stock Incentive Plan management has estimated that there will be no forfeitures of options.

The Company accounts for RSU awards by recognizing the expense of the intrinsic value at award date ratably over vesting periods generally ranging from one year to three years. The related expense is included in selling, general and administrative expenses. During the year ended June 30, 2015, the Company granted 39,500 RSU awards with fair values of \$17.49 per RSU award. There were no RSU awards during the year ended June 30, 2014. During the year ended June 30, 2013, the Company granted 8,200 RSU awards with fair values of \$10.08 per RSU award. There were no RSU awards prior to December 17, 2012.

There were 2,733 RSU awards settled in each of the fiscal years 2015 and 2014. The aggregate intrinsic value of RSU awards outstanding as of June 30, 2015 was \$0.8 million. As of June 30, 2015 all vested RSU awards had been issued and settled.

Compensation expense related to the 2012 Stock Incentive Plan was \$146,000, \$54,000 and \$31,000 for fiscal 2015, 2014 and 2013 respectively. As of June 30, 2015 there was \$0.6 million of total unrecognized compensation costs related to outstanding stock-based compensation arrangements.

Of this cost \$0.4 million relates to performance based RSU grants that are not expected to be awarded. The remaining \$0.2 million is expected to be recognized over a weighted average period of 2.1 years.

### Employee Stock Purchase Plan

The Company's Employee Stock Purchase Plans (ESPP) give eligible employees an opportunity to participate in the success of the Company. The Board of Directors renews each Employee Stock Purchase Plan every five years. Under these plans the purchase price of the optioned stock is 85% of the lower of the market price on the date the option is granted or the date it is exercised. Options become exercisable exactly two years from the date of grant and expire if not exercised on such date. No options were exercisable at fiscal year ends. The Board of Directors last approved an ESPP renewal in 2012. No additional options will be granted under the previous 2007 plan. A summary of option activity is as follows:

	<b>Shares</b>	<b>Weighted Average</b>	<b>Shares Available</b>
	<b>On Option</b>	<b>Exercise Price</b>	<b>For Grant</b>
Balance, June 30, 2012	102,490		352,185
2007 Plan expired	-		(352,185 )
2012 Plan authorized	-		500,000
Options granted	61,382	8.77	(61,382 )
Options exercised	(34,128 )	8.28	-
Options canceled	(41,016 )		9,926
Balance, June 30, 2013	88,728		448,544
Options granted	43,643	10.91	(43,643 )
Options exercised	(26,225 )	9.83	-
Options canceled	(30,758 )		19,711
Balance, June 30, 2014	75,388		424,612
Options granted	35,208	13.97	(35,208 )
Options exercised	(30,718 )	8.82	-
Options canceled	(25,571 )		25,571

Balance, June 30, 2015	54,307	414,975
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The following information relates to outstanding options as of June 30, 2015:

Weighted average remaining life (years)	1.3
Weighted average fair value on grant date of options granted in:	
2013	\$2.73
2014	3.37
2015	4.68

The fair value of each option grant was estimated on the date of grant based on the Black-Scholes option pricing model with the following weighted average assumptions: expected volatility – 33.28% – 34.86%, interest – 0.54% – 0.58%, and expected lives - 2 years. Compensation expense of \$139,006, \$138,677 and \$166,368 has been recorded for fiscal 2015, 2014 and 2013, respectively.

## **Employee Stock Ownership Plan**

On February 5, 2013, the Board of Directors adopted The L.S. Starrett Company 2013 Employee Stock Ownership Plan (the “2013 ESOP”). The purpose of the plan is to supplement existing Company programs through an employer funded individual account plan dedicated to investment in common stock of the Company, thereby encouraging increased ownership of the Company while providing an additional source of retirement income. The plan is intended as an employee stock ownership plan within the meaning of Section 4975 (e) (7) of the Internal Revenue Code of 1986, as amended. U.S. employees who have completed a year of service as of December 31, 2012 are eligible to participate.

On June 5, 2013 the Board of Directors approved a contribution to the 2013 ESOP for fiscal 2013 in the amount of two percent of each participant’s compensation (as defined in the Plan). The 2013 contribution was funded in July 2013 in the amount of \$0.8 million. There was no ESOP contribution in 2014 or 2015.

There was no compensation expense for the ESOP in 2014 or 2015. There was no ESOP Liability in 2014 or 2015. Shares of Class B common stock were contributed to the 2013 ESOP on July 30, 2013 in order to fund the 2013 liability.

## **5. CASH AND SHORT-TERM INVESTMENTS**

Cash and investments held by foreign subsidiaries amounted to \$12.0 million and \$21.0 million at June 30, 2015 and June 30, 2014, respectively. Of the June 30, 2015 balance, \$9.8 million in U.S. dollar equivalents was held in British Pounds Sterling and \$0.8 million in U.S. dollar equivalents was held in Brazilian Reals.

The Company plans to permanently reinvest cash held in foreign subsidiaries. Cash held in foreign subsidiaries is not available for use in the U.S. without the likely incurrence of U.S. federal and state income tax consequences.

As of June 30, 2015 and June 30, 2014, the Company’s U.K. subsidiary held a \$7.9 million 12 month fixed term deposit and a \$8.7 million 95 day fixed rate deposit, respectively, with a financial institution.



**6. INVENTORIES**

Inventories consist of the following (in thousands):

	June 30,	June 30,
	2015	2014
Raw materials and supplies	\$32,784	\$31,303
Goods in process and finished parts	18,569	19,148
Finished goods	39,689	42,459
	91,042	92,910
LIFO reserve	(28,039)	(27,328)
	\$63,003	\$65,582

LIFO inventories were \$14.6 million and \$14.1 million at June 30, 2015 and June 30, 2014, respectively, such amounts being approximately \$28.0 million and \$27.3 million, respectively, less than if determined on a FIFO basis. The use of LIFO compared to FIFO on an annual basis resulted in a \$0.7 million increase in cost of goods sold in fiscal 2015 compared to a decrease in cost of goods sold of \$3.5 million in fiscal 2014.

**7. GOODWILL AND INTANGIBLES**

The following tables present information about the Company's goodwill and identifiable intangible assets on the dates indicated (in thousands):

	<b>June 30, 2015</b>			<b>June 30, 2014</b>		
	Cost	Accumulated Amortization	Net	Cost	Accumulated Amortization	Net
Goodwill	\$3,034	\$ -	\$3,034	\$3,034	\$ -	\$3,034
Identifiable intangible assets	11,368	(4,243 )	7,125	10,720	(2,960 )	7,760

Identifiable intangible assets consist of the following (in thousands):

	June 30, 2015	June 30, 2014
Non-compete agreements	\$600	\$600
Trademarks and trade names	1,480	1,480
Completed technology	2,358	2,358
Customer relationships	4,950	4,950
Software development	1,655	1,007
Other intangible assets	325	325
Total	11,368	10,720
Accumulated amortization	(4,243 )	(2,960 )
Total net balance	\$7,125	\$7,760

Identifiable intangible assets are being amortized on a straight-line basis over the period of expected economic benefit.

The estimated aggregate amortization expense for each of the next five years, and thereafter, is as follows (in thousands):

<u>Fiscal Year</u>	
2016	\$1,434
2017	1,432
2018	1,364
2019	1,285

2020	761
Thereafter	849

Goodwill is measured as the excess of the cost of acquisition over the sum of the amounts assigned to identifiable tangible and intangible assets acquired less liabilities assumed. The Company's acquisition of Bytewise in 2011 gave rise to goodwill. The Company performs an impairment assessment on an annual basis as of the end of our October month end or more frequently if circumstances warrant. For fiscal year 2015, the impairment assessment was a two-step process. The first step requires a comparison of the implied fair value of the reporting unit to its carrying value. If the carrying value of the reporting unit is higher than its fair value, there is an indication that impairment may exist and the second step of the evaluation must be performed. In the second step, the potential impairment is calculated by comparing the implied fair value of the reporting unit's goodwill with the carrying value of the goodwill. If the carrying value of the reporting unit's goodwill is greater than the implied fair value of its goodwill, an impairment loss will be recognized for the excess.

Determining the fair value of a reporting unit is subjective and requires the use of significant estimates and assumptions. With the assistance of an independent third-party appraisal firm, the Company estimates the fair value using an income approach based on the present value of future cash flows. The Company believes this approach yields the most appropriate evidence of fair value. The Company also utilizes the comparable company multiples method and market transaction fair value method to validate the fair value amount it obtains using the income approach. The key assumptions utilized in the discounted cash flow model includes estimates of future cash flows from operating activities offset by estimated capital expenditures of the reporting unit, the estimated terminal value for the reporting unit, a discount rate based on a weighted average cost of capital, overall economic conditions, and an assessment of current market capitalization. Any unfavorable material changes to these key assumptions could potentially impact the Company's fair value determinations.

The fair value of the 2015 goodwill assessment exceeded the carrying amount by approximately 37.4%. Therefore no goodwill impairment was recorded. If future results significantly vary from current estimates, related projections, or business assumptions in the future due to changes in industry or market conditions, the Company may be required to record impairment charges.

**8. PROPERTY, PLANT AND EQUIPMENT**

Property, plant and equipment consists of the following as of June 30, 2015 and 2014 (in thousands):

	<b>As of June 30, 2015</b>		
	<b>Cost</b>	<b>Accumulated</b>	
			<b>Depreciation</b>
Land	\$1,320	\$ -	\$1,320
Buildings and building improvements	45,434	(25,210 )	20,224
Machinery and equipment	132,788	(109,919 )	22,869
Total	\$179,542	\$ (135,129 )	\$44,413

	<b>As of June 30, 2014</b>		
	<b>Cost</b>	<b>Accumulated</b>	
			<b>Depreciation</b>
Land	\$1,376	\$ -	\$1,376
Buildings and building improvements	47,793	(25,994 )	21,799
Machinery and equipment	142,579	(114,217 )	28,362
Total	\$191,748	\$ (140,211 )	\$51,537

Included in machinery and equipment are assets under capital leases of \$0.7 million as of June 30, 2015 and June 30, 2014. The accumulated amortization relating to these leases was \$0.6 million and \$0.6 million as of June 30, 2015 and 2014, respectively.

Operating lease expense was \$2.2 million, \$1.9 million and \$1.9 million in fiscal 2015, 2014 and 2013, respectively. Future commitments under operating leases are as follows (in thousands):

<u>Fiscal Year</u>	
2016	\$1,305
2017	1,552
2018	1,330
2019	1,400

2020	1,204
Thereafter	2,512
	9,303

## 9. OTHER INCOME AND EXPENSE

Other income and expense consists of the following (in thousands):

	<b>2015</b>	<b>2014</b>	<b>2013</b>
Interest income	\$828	\$951	\$786
Interest expense	(713 )	(800)	(968 )
Foreign currency gain (loss), net	705	(840)	1,086
Gain from equity investment	203	257	470
Brazil recovery of export taxes	232	-	-
Sale of scrap material	93	126	167
Gain on resolution of contingency	-	89	501
Other income (expense), net	(9 )	359	32
	\$1,339	\$142	\$2,074

The gain on resolution of contingency represents damages awarded in a Brazilian lawsuit which the Company had filed as plaintiff in 2003.

**10. INCOME TAXES**

Components of earnings (loss) before income taxes are as follows (in thousands):

	<b>2015</b>	<b>2014</b>	<b>2013</b>
Domestic operations	\$8,118	\$5,793	\$(2,633)
Foreign operations	1,824	6,264	3,429
	\$9,942	\$12,057	\$796

The provision for income taxes consists of the following (in thousands):

	<b>2015</b>	<b>2014</b>	<b>2013</b>
Current:			
Federal	\$1,744	\$155	\$124
Foreign	1,855	3,284	1,243
State	114	86	(48 )
Deferred:			
Federal	670	2,175	(1,472)
Foreign	(71 )	(426 )	503
State	386	71	608
	\$4,698	\$5,345	\$958

Reconciliations of expected tax expense at the U.S. statutory rate to actual tax expense (benefit) are as follows (in thousands):

	<b>2015</b>	<b>2014</b>	<b>2013</b>
Expected tax expense	\$3,380	\$4,099	\$271
State taxes, net of federal effect	378	269	26
Foreign taxes, net of federal credits	235	123	353
Change in valuation allowance	(51 )	(428 )	(127)
Tax reserve adjustments	361	465	141
Return to provision and other adjustments	(332 )	(265 )	(764)
Losses not benefited	701	350	370
Dividend from subsidiary (net of foreign tax credit)	1	-	201
Tax rate change applied to deferred tax balances	-	278	880
Other permanent items	25	454	(393)
Actual tax expense (benefit)	\$4,698	\$5,345	\$958

Significant changes in tax expense reconciliation in the year ended June 30, 2015 relate primarily to losses in foreign subsidiaries. In fiscal 2015, several of the subsidiaries in foreign countries reported financial losses. In most cases, no tax benefit from those losses was recognized since future income is not more likely than not to be recognized. Tax expense in fiscal 2015 was higher than previous years both because the losses that were not able to be benefitted for tax purposes were significantly higher and because the Company received no benefit from the lower statutory tax rate in those countries. There was a dividend of \$2.3 million paid from the Company's subsidiary in Brazil to the U.S. parent company out of the subsidiary's fiscal 2015 earnings. While the dividend is fully taxable in the U.S., the impact to tax expense was negligible due to the use of foreign tax credits. Also, there were adjustments made to deferred tax assets due to provision to return adjustments and deferred tax balance adjustments of \$0.3 million.

In the year ended June 30, 2014, the changes in the tax provision related to the following items, including additional reserves related to the settlement of an audit in China; change in the valuation allowance related to operations in China; an additional tax rate change enacted in the U.K.; and return to provision adjustments.

In fiscal 2014, the tax authorities in China reviewed the intercompany transfer pricing of Chinese subsidiary and made adjustments to the prices for tax purposes to the calendar years 2010 through 2012. The net result was a substantial reduction in the Company's carryforward tax losses and a small payment of tax and penalties; the net effect was to increase tax expense by \$0.2 million which is included in the tax reserve adjustments. Since the Company had a history of tax losses, there was a full valuation allowance reflected against the tax impact of the loss carryforward at June 30, 2013. The entity also had substantial profits in fiscal 2014. As a result, the full amount of its carryforward tax losses, after audit adjustments, were utilized and the valuation allowance reducing the deferred tax assets for those losses and other temporary differences was released. The effect was a reduction in the valuation allowance of \$0.4 million.

The Company recorded a \$0.3 million deferred income tax expense in the year ended June 30, 2014 to reflect the impact of a corporate tax rate reduction in the United Kingdom. The tax rate reduction from 23 percent to 20 percent received royal assent during fiscal 2014 and the impact of that reduction on our deferred tax assets was recorded in the first quarter of that year.

A return to provision adjustment reducing tax expense by \$0.3 million was booked in fiscal 2014. The amount relates primarily to a revision of the estimated deduction on the U.S. tax return filed for fiscal 2013 for losses on the intercompany receivable from and investment in the Dominican Republic subsidiary which had ceased operations in a previous year.

No benefit is reflected for losses in subsidiaries outside the U.S. which do not have the ability to carry the losses back for a tax refund and which do not have sufficient positive evidence supporting that the losses will be more likely than not to be used to reduce future taxes.

Significant changes in the tax expense reconciliation in the year ended June 30, 2013 relate to the following items:

For the year ended June 30, 2013 the Company reported an income tax benefit of \$0.8 million related to differences between the Company's tax returns filed in fiscal 2013 for earlier periods and the corresponding original estimates used for financial statement purposes. This benefit was primarily driven by the following four significant return to provision adjustments:

- a. \$0.3 million reduction to tax expense related to foreign tax returns primarily related to our estimates of required Brazilian statutory transfer pricing adjustments compared to actual amounts imposed by the Brazilian government.
- b. \$0.2 million reduction to U.S. tax expense primarily related to changes in U.S. state taxes from the 2012 estimate to the amounts reflected on the actual state tax returns filed.
- c. \$0.2 million reduction to tax expense related to Company's decision to claim foreign tax credits for foreign taxes deducted in the fiscal 2012 provision and on selected tax returns for earlier years. The reduction in tax expense is the net benefit after considering the Company's corresponding valuation allowance on portions of its foreign tax credit carryforward.
- d. \$0.1 million reduction to tax expense related to the Company's decision to elect to use the Simplified Alternative Method of calculating the federal tax credit for research expenses on its 2012 tax return.

The Company also recorded \$0.9 million of deferred income tax expense in the year ended June 30, 2013 to reflect the year over year change in the tax rates the Company applies to our deferred tax balances. Of this amount, \$0.8 million is attributable to a decrease in the Company's state effective tax rate due to changes in state tax rates and apportionment of profits in the jurisdictions the Company operates in. The remaining \$0.1 million of deferred tax expense relates to a corporate tax rate reduction in the United Kingdom, which received royal assent during fiscal 2013.



Total deferred tax assets net of deferred tax liabilities at June 30, 2015 are \$21.8 million. While these deferred tax assets reflect the tax effect of temporary differences between book and taxable income in all jurisdictions in which the Company has operations, the majority of the assets relate to operations in the U.S. where the Company had book losses in several recent years prior to fiscal 2014. The Company has considered the positive and negative evidence to determine the need for a valuation allowance offsetting the deferred tax assets in the U.S. and has concluded that it is more likely than not that the deferred tax assets net of the recorded valuation allowance will be realized.

Key positive evidence considered include: a) Significant domestic book profits in 2014 and 2015; b) losses in prior recent years are primarily due to the recession and one-time events including a \$16 million pension expense in fiscal 2012; c) cost saving plans have been implemented by the Company; d) earnings of a company acquired in fiscal 2012 have created additional domestic income; and e) the Company has had more domestic taxable income than losses in the last four years; The negative evidence considered include: a) before fiscal 2014, the 5 most recent years showed domestic book losses; and b) fiscal 2013 reflects both a book loss and a tax loss.

A valuation allowance has been provided on certain foreign NOLs due to the uncertainty of generating future taxable income in those jurisdictions. Similarly, a valuation allowance has been provided on certain state NOLs as a result of their much shorter carryforward periods and the uncertainty of generating adequate taxable income at the entity and state level. In addition, a valuation allowance has been provided for foreign tax credit carryforwards due to the uncertainty of generating sufficient foreign source income in the future. In fiscal 2015, the valuation allowance increased by \$1.2 million - \$0.7 million due to the increase in foreign carryforward losses and \$0.5 million due to the increase in foreign tax credits in excess of the foreign source income limitation in fiscal 2015. In fiscal 2014, the allowance decreased by \$1.2 million primarily related to operations in China where the Company had sufficient profit in fiscal 2014 to fully utilize its tax loss carryforward and to the portion of foreign tax credits which expired in 2014. The need for a valuation allowance is reevaluated as facts and assumptions change over time.

Accounting Standards Update 2013-11 was approved by the FASB in July 2013 and requires that companies report their tax reserves net of the impact of tax loss and credit carryforwards by its year beginning after December 15, 2013. The Company has implemented this pronouncement in Q1, fiscal 2015 with retrospective application as permitted by the standard; amounts presented for prior periods have been reclassified to conform. There is no effect to tax expense; on the balance sheet, there is a reduction in Deferred Tax Assets of \$6.6 million and a reduction in Other Tax Obligations of \$6.6 million on the June 30, 2015 Consolidated Balance Sheet and \$7.8 million reduction in each of those accounts as of June 30, 2014.

Deferred income taxes at June 30, 2015 and 2014 are attributable to the following (in thousands):

	<b>2015</b>	<b>2014</b>
Deferred tax assets (current):		
Inventories	\$2,597	\$3,596
Employee benefits (other than pension)	1,016	1,331
Book reserves	818	1,244
Other	687	385
Total current deferred tax assets	5,118	6,556
Valuation allowance	(564 )	(519 )
Current deferred tax asset	\$4,554	\$6,037
Deferred tax assets (long-term):		
State NOL, various carryforward periods	801	1,181
Foreign NOL, various carryforward periods	1,908	1,042
Foreign tax credit carryforward, expiring 2017 – 2025	2,405	2,480
Pension benefits	13,224	10,098
Retiree medical benefits	2,499	2,218
Intangibles	1,713	2,178
Other	190	155
Total long-term deferred tax assets	22,740	19,352
Valuation allowance	(3,937 )	(2,815 )
Long-term deferred tax asset	\$18,803	\$16,537
Deferred tax liabilities (long-term):		
Depreciation	(1,548 )	(2,037 )
Long-term deferred tax liabilities	(1,548 )	(2,037 )
Net deferred tax assets	\$21,809	\$20,537

As of June 30, 2015 and 2014, the net long-term deferred tax asset and deferred tax liabilities on the balance sheet are as follows (in thousands):

	<b>2015</b>	<b>2014</b>
Long-term assets	\$18,803	\$16,537
Long-term liabilities	(1,548 )	(2,037 )
	\$17,255	\$14,500

Foreign operations deferred assets relate primarily to inventory and book reserves (current) and pension benefits (long term). Amounts related to foreign operations included in the long-term portion of deferred liabilities relate to depreciation.

The Company is subject to U.S. federal income tax and various state, local and foreign income taxes in numerous jurisdictions. The Company's domestic and international tax liabilities are subject to the allocation of revenues and expenses in different jurisdictions and the timing of recognizing revenues and expenses. Additionally, the amount of income taxes paid is subject to the Company's interpretation of applicable tax laws in the jurisdictions in which it files.

Reconciliations of the beginning and ending amount of unrecognized tax benefits are as follows (in thousands):

Balance at June 30, 2012	\$(10,590)
Increases for tax positions taken during a prior period	(212 )
Increases for tax positions taken during the current period	(381 )
Effect of exchange rate changes	140
Decrease relating to settlement	32
Balance at June 30, 2013	(11,011)
Increases for tax positions taken in prior years	(204 )
Increases for tax positions taken during the current period	(268 )
Effect of exchange rate changes	(9 )
Decrease relating to settlement	241
Balance at June 30, 2014	(11,251)
Increases for tax positions taken during the current period	(423 )
Effect of exchange rate changes	440
Decrease relating to lapse of applicable statute of limitations	42
Balance at June 30, 2015	\$(11,192)

The long-term tax obligations on the balance sheet as of June 30, 2015 and 2014 relate primarily to transfer pricing adjustments. The Company has also recorded a non-current tax receivable for \$3.4 million and \$3.8 million at June 30, 2015 and 2014, respectively, representing the corollary effect of transfer pricing competent authority adjustments.

During the next 12 months, it is possible that the Company will recognize a reduction of \$0.4 million in its long term tax obligations due to the lapse of the applicable statute of limitations. The Company recognizes interest and penalties related to income tax matters in income tax expense.

The Company's U.S. federal tax returns for years prior to fiscal 2012 are no longer subject to U.S. federal examination by the Internal Revenue Service; however, tax losses carried forward from earlier years are still subject to review and

adjustment. In fiscal 2014, the tax authorities in China audited the transfer pricing of Starrett's subsidiary in that country for calendar years 2010 through 2012. Adjustments reduced the tax loss carryforward and required a tax and penalty payment for calendar 2011. As of June 30, 2015, the Company has resolved all open income tax audits. In international jurisdictions: Australia, Brazil, Canada, China, Germany, Japan, Mexico, New Zealand, Singapore and the United Kingdom, the years that may be examined vary by country. The Company's most significant foreign subsidiary in Brazil is subject to audit for the calendar years 2010 through 2014.

The state tax loss carryforwards tax effected benefit of \$0.8 million expires at various times over the next 4 to 19 years. The foreign tax credit carryforward of \$2.4 million expires in the years 2017 through 2025.

At June 30, 2015, the estimated amount of total unremitted earnings of foreign subsidiaries is \$70 million. The Company received a cash dividend from a foreign subsidiary from current year earnings of \$2.3 million in fiscal 2015. The Company has no plans to repatriate additional prior year earnings of its foreign subsidiaries and, accordingly, no estimate of the unrecognized deferred taxes related to these earnings has been made. Cash held in foreign subsidiaries is not available for use in the U.S. without the likely incurrence of U.S. federal and state income tax consequences.

## 11. EMPLOYEE BENEFIT AND RETIREMENT PLANS

The Company has two defined benefit pension plans, one for U.S. employees and another for U.K. employees. The UK plan was closed to new entrants in fiscal 2009. The Company has a postretirement medical and life insurance benefit plan for U.S. employees. The Company also has defined contribution plans.

The Company amended its Postretirement Medical Plan effective December 31, 2013 whereby the Company terminated eligibility for employees ages 55-64. For retirees 65 and older, the Company's contribution is fixed at \$28.50 or \$23.00 per month depending upon the plan the retiree has chosen.

The total cost of all such plans for fiscal 2015, 2014 and 2013 \$4.6 million, \$5.0 million and \$4.4 million, respectively. Included in these amounts are the Company's contributions to the defined contribution plans amounting to \$0.8 million, \$1.2 million and \$1.0 million in fiscal 2015, 2014 and 2013, respectively.

Under both U.S and U.K. defined benefit plans, benefits are based on years of service and final average earnings. Plan assets consist primarily of investment grade debt obligations, marketable equity securities and shares of the Company's common stock. The asset allocation of the Company's domestic pension plan is diversified, consisting primarily of investments in equity and debt securities. The Company seeks a long-term investment return that is reasonable given prevailing capital market expectations. Target allocations are 40% to 70% in equities (including 10% to 20% in Company stock), and 30% to 60% in cash and debt securities.

In fiscal 2016 the Company will use an expected long-term rate of return assumption of 5.5% for the U.S. domestic pension plan, and 4.8% for the U.K. plan. In determining these assumptions, the Company considers the historical returns and expectations for future returns for each asset class as well as the target asset allocation of the pension portfolio as a whole. In fiscal 2015 and 2014, the Company used a discount rate assumption of 4.49% and 4.29% for the U.S. plan and 3.90% and 4.30% for the U.K. plan, respectively. In determining these assumptions, the Company considers published third party data appropriate for the plans.

Other than the discount rate, pension valuation assumptions are generally long-term and not subject to short-term market fluctuations, although they may be adjusted as warranted by structural shifts in economic or demographic outlooks. Long-term assumptions are reviewed annually to ensure they do not produce results inconsistent with current market conditions. The discount rate is adjusted annually based on corporate investment grade (rated AA or better) bond yields, the maturities of which are correlated with the expected timing of future benefit payments, as of the measurement date.

Based upon the actuarial valuations performed on the Company's defined benefit plans as of June 30, 2015, the U.S. plan will require a \$3.3 million contribution in fiscal 2016 and the U.K. plan will require a \$1.1 million contribution in fiscal 2016.

The table below sets forth the actual asset allocation for the assets within the Company's plans.

	<b>2015</b>		<b>2014</b>	
Asset category:				
Cash equivalents	1	%	1	%
Fixed income	17	%	14	%
Equities	25	%	24	%
Mutual and pooled funds	57	%	61	%
	100	%	100	%

The Company determines its investments strategies based upon the composition of the beneficiaries in its defined benefit plans and the relative time horizons that those beneficiaries are projected to receive payouts from the plans. The Company engages an independent investment firm to manage the U.S. pension assets.

Cash equivalents are held in money market funds.

The Company's fixed income portfolio includes mutual funds that hold a combination of short-term, investment-grade fixed income securities and a diversified selection of investment-grade, fixed income securities, including corporate securities and U.S. government securities.

The Company invests in equity securities, which are diversified across a spectrum of value and growth in large, medium and small capitalization as appropriate to achieve the objective of a balanced portfolio and optimize the expected returns and volatility in the various asset classes.

Other assets include pooled investment funds whose underlying assets consist primarily of property holdings as well as financial instruments designed to offset the long-term impact of inflation and interest rate fluctuations.

In accordance with “ASC 820 Fair Value Measurement”, the Company has categorized its financial assets (including its pension plan assets), based on the priority of the inputs to the valuation technique, into a three-level fair value hierarchy as set forth below. If the inputs used to measure the financial instruments fall within different levels of the hierarchy, the categorization is based on the lowest level input that is significant to the fair value measurement of the instrument.

Financial assets are categorized based on the inputs to the valuation techniques as follows:

- Level 1 – Financial assets whose values are based on unadjusted quoted prices for identical assets or liabilities in an active market which the Company has the ability to access at the measurement date.
- Level 2 – Financial assets whose value are based on quoted market prices in markets where trading occurs infrequently or whose values are based on quoted prices of instruments with similar attributes in active markets.
- Level 3 – Financial assets whose values are based on prices or valuation techniques that require inputs that are both unobservable and significant to the overall fair value measurement. These inputs reflect management’s own view about the assumptions a market participant would use in pricing the asset.

The tables below show the portfolio by valuation category as of June 30, 2015 and June 30, 2014 (in thousands).

**June 30, 2015**

<b>Asset Category</b>	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>	<b>Total</b>	<b>%</b>
Cash Equivalent	\$1,064			\$1,064	1 %
Fixed Income		21,058		21,058	17 %
Equities	27,960	3,210		31,170	25 %
Mutual & Pooled Funds	31,873	33,538	4,084	69,495	57 %
<b>Total</b>	<b>\$60,897</b>	<b>\$57,806</b>	<b>\$4,084</b>	<b>\$122,787</b>	<b>100 %</b>



**June 30, 2014**

<b>Asset Category</b>	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>	<b>Total</b>	<b>%</b>
Cash Equivalent	\$1,105			\$1,105	1 %
Fixed Income		16,791		16,791	14 %
Equities	26,210	3,428		29,638	24 %
Mutual & Pooled Funds	37,563	33,932	3,895	75,390	61 %
Total	\$64,878	\$54,151	\$3,895	\$122,924	100 %

Included in equity securities at June 30, 2015 and 2014 are shares of the Company's common stock having a fair value of \$12.5 million and \$13.2 million, respectively.

A reconciliation of the beginning and ending balances of Level 3 assets is as follows (in thousands):

	<b>Fair Value Measurement Using  Significant Unobservable Inputs  (Level 3)</b>	
	<b>2015</b>	<b>2014</b>
Beginning balance	\$3,895	\$3,008
Actual returns on assets	507	490
Translation gain (loss)	(318 )	397
Ending balance	\$4,084	\$3,895

The Level 3 assets consist of units of a pooled investment fund which invests in a mix of properties selected from across retail, office, industrial and other sectors predominantly located in the U.K. In addition to direct investments, the fund may also invest indirectly in property through investment vehicles such as quoted and unquoted property companies or collective investment trusts. Redemptions from the fund are not readily available given the illiquid nature of its assets.

**U.S. and U.K. Plans Combined:**

The status of these defined benefit plans is as follows (in thousands):

	<b>2015</b>	<b>2014</b>	<b>2013</b>
<b>Change in benefit obligation</b>			
Benefit obligation at beginning of year	\$ 161,062	\$ 141,316	\$ 145,595
Service cost	2,663	2,709	3,017
Interest cost	6,818	6,922	6,057
Participant contributions	0	183	242
Exchange rate changes	(4,167 )	5,359	(1,344 )
Benefits paid	(6,524 )	(5,956 )	(5,918 )
Actuarial (gain) loss	6,337	10,529	(6,333 )
Benefit obligation at end of year	166,189	161,062	141,316
<b>Change in plan assets</b>			
Fair value of plan assets at beginning of year	122,924	109,326	107,368
Actual return on plan assets	3,466	14,105	6,878
Employer contributions	6,049	1,171	1,795
Participant contributions	0	183	242
Benefits paid	(6,524 )	(5,956 )	(5,918 )
Exchange rate changes	(3,128 )	4,095	(1,039 )
Fair value of plan assets at end of year	122,787	122,924	109,326
Funded status at end of year	\$(43,402 )	\$(38,138 )	\$(31,990 )
Amounts recognized in balance sheet			
Current liability	\$(37 )	\$(37 )	\$(33 )
Noncurrent liability	(43,365 )	(38,101 )	(31,957 )
Net amount recognized in balance sheet	\$(43,402 )	\$(38,138 )	\$(31,990 )
<b>Amounts not yet reflected in net periodic benefit costs and included in accumulated other comprehensive loss</b>			
Prior service cost	\$0	\$0	\$(116 )
Accumulated loss	(16,795 )	(8,686 )	(5,919 )
Amounts not yet recognized as a component of net periodic benefit cost	(16,795 )	(8,686 )	(6,035 )
Accumulated net periodic benefit cost in excess of contributions	(26,607 )	(29,452 )	(25,955 )
Net amount recognized	\$(43,402 )	\$(38,138 )	\$(31,990 )
<b>Components of net periodic benefit cost</b>			
Service cost	\$2,663	\$2,709	\$3,017
Interest cost	6,818	6,922	6,057
Expected return on plan assets	(6,966 )	(6,332 )	(5,961 )
Amortization of prior service cost	0	116	234
Recognized actuarial loss	1,309	398	0

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Net periodic benefit cost	\$3,824	\$3,813	\$3,347
Estimated amounts that will be amortized from accumulated other comprehensive loss over the next year			
Prior service cost	\$0	\$(30 )	\$(127 )
Net loss	(53 )	0	0
Information for pension plans with accumulated benefits in excess of plan assets			
Projected benefit obligation	\$166,189	\$161,062	\$141,316
Accumulated benefit obligation	159,174	154,163	134,594
Fair value of assets	122,787	122,924	109,326

**U.S. Plan:**

The status of the U.S. defined benefit plan is as follows (in thousands):

	<b>2015</b>		<b>2014</b>		<b>2013</b>
Change in benefit obligation					
Benefit obligation at beginning of year	\$110,054		\$99,788		\$104,537
Service cost	2,663		2,326		2,562
Interest cost	4,839		4,868		4,289
Benefits paid	(4,372 )		(4,263 )		(4,101 )
Actuarial (gain) loss	3,214		7,335		(7,499 )
Benefit obligation at end of year	116,398		110,054		99,788
Weighted average assumptions – benefit obligation					
Discount rate	4.49	%	4.29	%	4.96
Rate of compensation increase	2.64	%	2.64	%	2.64
Change in plan assets					
Fair value of plan assets at beginning of year	\$84,629		\$77,208		\$76,778
Actual return on plan assets	(274 )		11,661		3,958
Employer contributions	4,870		23		573
Benefits paid	(4,372 )		(4,263 )		(4,101 )
Fair value of plan assets at end of year	84,853		84,629		77,208
Funded status at end of year	\$(31,545 )		\$(25,425 )		\$(22,580 )
Amounts recognized in balance sheet					
Current liability	\$(37 )		\$(37 )		\$(33 )
Noncurrent liability	(31,508 )		(25,388 )		(22,547 )
Net amount recognized in balance sheet	\$(31,545 )		\$(25,425 )		\$(22,580 )
Weighted average assumptions – net periodic benefit cost					
Discount rate	4.29	%	4.96	%	3.92
Rate of compensation increase	2.64	%	2.64	%	2.64
Return on plan assets	6.00	%	6.00	%	6.00
Amounts not yet reflected in net periodic benefit cost and included in accumulated other comprehensive loss					
Prior service cost	\$0		\$0		\$(116 )
Accumulated loss	(11,817 )		(3,585 )		(3,438 )
Amounts not yet recognized as a component of net periodic benefit cost	(11,817 )		(3,585 )		(3,554 )
Accumulated contributions less than net periodic benefit cost	(19,728 )		(21,840 )		(19,026 )
Net amount recognized	\$(31,545 )		\$(25,425 )		\$(22,580 )
Components of net periodic benefit cost					

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Service cost	\$2,663	\$2,326	\$2,562
Interest cost	4,839	4,868	4,289
Expected return on plan assets	(5,063 )	(4,484 )	(4,474 )
Amortization of prior service cost	0	116	234
Recognized actuarial loss	319	12	-
Net periodic benefit cost	\$2,758	\$2,838	\$2,611

Estimated amounts that will be amortized from accumulated other comprehensive loss over the next year

Prior service cost	\$0	\$(30 )	\$(127 )
Net loss	(53 )	0	0

Information for plan with accumulated benefits in excess of plan assets

Projected benefit obligation	\$116,398	\$110,054	\$99,788
Accumulated benefit obligation	109,383	103,155	93,066
Fair value of assets	84,853	84,629	77,208

**U.K. Plan:**

The status of the U.K. defined benefit plan is as follows (in thousands):

	<b>2015</b>		<b>2014</b>		<b>2013</b>
Change in benefit obligation					
Benefit obligation at beginning of year	\$51,008		\$41,528		\$41,058
Service cost	0		383		455
Interest cost	1,979		2,054		1,768
Participant contributions	0		183		242
Exchange rate changes	(4,167 )		5,359		(1,344 )
Benefits paid	(2,152 )		(1,693 )		(1,817 )
Actuarial loss	3,123		3,194		1,166
Benefit obligation at end of year	\$49,791		\$51,008		\$41,528
Weighted average assumptions - benefit obligation					
Discount rate	3.90	%	4.30	%	4.70 %
Rate of compensation increase	n/a		n/a		3.10 %
Change in plan assets					
Fair value of plan assets at beginning of year	\$38,295		\$32,118		\$30,590
Actual return on plan assets	3,740		2,444		2,920
Employer contributions	1,179		1,148		1,222
Participant contributions	0		183		242
Benefits paid	(2,152 )		(1,693 )		(1,817 )
Exchange rate changes	(3,128 )		4,095		(1,039 )
Fair value of plan assets at end of year	37,934		38,295		32,118
Funded status at end of year	\$(11,857)		\$(12,713)		(9,410 )
Amounts recognized in balance sheet					
Current liability					\$—
Noncurrent liability	(11,857)		(12,713)		(9,410 )
Net amount recognized in balance sheet	\$(11,857)		\$(12,713)		\$(9,410 )
Weighted average assumptions – net periodic benefit cost					
Discount rate	4.30	%	4.70	%	4.40 %
Rate of compensation increase	n/a		3.10	%	2.60 %
Return on plan assets	5.45	%	5.40	%	4.90 %
Amounts not yet reflected in net periodic benefit costs and included in accumulated other comprehensive loss					
Prior service cost	\$—		\$—		\$—
Accumulated loss	(4,978 )		(5,101 )		(2,481 )
Amounts not yet recognized as a component of net periodic benefit cost	(4,978 )		(5,101 )		(2,481 )

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Accumulated net periodic benefit cost in excess of contributions	(6,879 )	(7,612 )	(6,929 )
Net amount recognized	\$(11,857)	\$(12,713)	\$(9,410)
Components of net periodic benefit cost			
Service cost	\$-	\$383	\$455
Interest cost	1,979	2,054	1,768
Expected return on plan assets	(1,903 )	(1,848 )	(1,487 )
Amortization of net loss	990	386	
Net periodic benefit cost	\$1,066	\$975	\$736
Estimated amounts that will be amortized from accumulated other comprehensive loss over the next year	\$—	\$—	\$—
Information for plan with accumulated benefits in excess of plan assets			
Projected benefit obligation	\$49,791	\$51,008	\$41,528
Accumulated benefit obligation	49,791	51,008	41,528
Fair value of assets	37,934	38,295	32,118



**Postretirement Medical and Life Insurance Benefits:**

The status of the U.S. postretirement medical and life insurance benefit plan is as follows (in thousands):

	<b>2015</b>		<b>2014</b>		<b>2013</b>
Change in benefit obligation:					
Benefit obligation at beginning of year	\$5,867		\$10,964		\$14,230
Service cost	113		225		484
Interest cost	244		396		518
Plan amendments	—		(5,730 )		—
Benefits paid	(647 )		(429 )		(351 )
Actuarial (gain) loss	1,034		441		(3,917 )
Benefit obligation at end of year	\$6,611		\$5,867		\$10,964
Weighted average assumptions: benefit obligations					
Discount rate	4.49	%	4.29	%	4.96
Rate of compensation increase	2.64	%	2.64	%	2.64
Change in plan assets					
Fair value of plan assets at beginning of year	\$—		\$—		\$—
Employer contributions	647		429		351
Benefits paid, net of employee contributions	(647 )		(429 )		(351 )
Fair value of plan assets at end of year	—		—		—
Amounts recognized in balance sheet					
Current postretirement benefit obligation	\$(441 )		\$(379 )		\$(536 )
Non-current postretirement benefit obligation	(6,170 )		(5,488 )		(10,428)
Net amount recognized in balance sheet	\$(6,611 )		\$(5,867 )		\$(10,964)
Weighted average assumptions – net periodic benefit cost					
Discount rate	4.29	%	4.96	%	3.92
Rate of compensation increase	2.64	%	2.64	%	2.64
Amounts not yet reflected in net periodic benefit cost and included in accumulated other comprehensive loss					
Prior service credit	\$5,305		\$6,104		\$1,145
Accumulated gain (loss)	(850 )		185		627
Amounts not yet recognized as a component of net periodic benefit cost	4,455		6,289		1,772
Net periodic benefit cost in excess of accumulated contributions	(11,066)		(12,156)		(12,736)
Net amount recognized	\$(6,611 )		\$(5,867 )		\$(10,964)
Components of net periodic benefit cost					
Service cost	\$113		\$225		\$484
Interest cost	244		396		518

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Amortization of prior service credit	(799 )	(771 )	(743 )
Amortization of accumulated loss	—	(1 )	111
Net periodic benefit cost	\$(442 )	\$(151 )	\$370
Estimated amounts that will be amortized from accumulated other comprehensive loss over the next year			
Prior service credit	\$781	\$799	\$502
Net loss	(15 )	—	—
	\$766	\$799	\$502
Healthcare cost trend rate assumed for next year	8.50 %	8.30 %	7.80 %
Rate to which the cost trend rate gradually declines	4.50 %	4.50 %	4.50 %
Year that the rate reaches the rate at which it is assumed to remain	2026	2026	2026

Assumed health care cost trend rates have a significant effect on the amounts reported for the health care plans. A one percentage point change in assumed health care cost trend rates would have the following effects (in thousands):

	<b>1% Increase</b>		
	<b>2015</b>	<b>2014</b>	<b>2012</b>
Effect on total of service and interest cost	\$0	\$35	\$91
Effect on postretirement benefit obligation	4	7	1,041

	<b>1% Decrease</b>		
	<b>2015</b>	<b>2014</b>	<b>2013</b>
Effect on total of service and interest cost	\$0 )	\$(30)	\$(77 )
Effect on postretirement benefit obligation	(4)	(7 )	(881)

For fiscal 2016, the Company expects to make a \$3.3 million contribution to the qualified domestic pension plan, \$37,000 to the nonqualified domestic pension plan, \$1.1 million to the U.K. pension plan, and \$441,000 to the postretirement medical and life insurance plan.

Future pension and other benefit payments are as follows (in thousands):

<b>Fiscal Year</b>	<b>Pension</b>	<b>Other Benefits</b>
2016	\$6,647	\$441
2017	7,008	370
2018	7,328	340
2019	7,685	336
2020	8,033	340
2021-2025	45,429	1,786

## 12. DEBT

Debt, including capitalized lease obligations, is comprised of the following (in thousands):

	June 30, 2015	June 30, 2014
<u>Short-term and current maturities</u>		
Loan and Security Agreement	\$1,474	\$10,410
Capitalized leases	78	138
	\$1,552	\$10,548
<u>Long-term debt</u>		
Loan and Security Agreement, net of current portion	\$18,552	\$10,726
Capitalized leases	-	78
	18,552	10,804
Total debt	\$20,104	\$21,352

Future maturities of debt are as follows (in thousands):

**Fiscal Year**

2016	\$1,552
2017	1,543
2018	10,914
2019	1,688
2020	1,765
Thereafter	2,642
Total	\$20,104

The Company completed the negotiations for an amended Loan and Security Agreement and executed the new agreement as of April 25, 2015. Borrowings under this agreement may not exceed \$23.0 million. The agreement expires on April 30, 2018 and has an interest rate of LIBOR plus 1.5%. The effective interest rate under the agreement for fiscal 2015 was 2.03%.

The material financial covenants of the amended Loan and Security Agreement are: 1) funded debt to EBITDA, excluding non-cash and retirement benefit expenses (“maximum leverage”), cannot exceed 2.25 to 1; 2) annual capital expenditures cannot exceed \$15.0 million; 3) maintain a Debt Service Coverage Rate of a minimum of 1.25 to 1 and 4) maintain consolidated cash plus liquid investments of not less than \$10.0 million at any time. As of June 30, 2015, the Company was in compliance with all the covenants. The Company expects to be able to meet the covenants in future periods.

On November 22, 2011, in conjunction with the Bytewise acquisition, the Company entered into a new \$15.5 million term loan (the “Term Loan”) under the then existing Loan and Security Agreement. The term loan is a ten year loan bearing a fixed interest rate of 4.5% and is payable in fixed monthly payments of principal and interest of \$160,640. The \$15.5 million term loan is subject to the same financial covenants as the Loan and Security Agreement. As of June 30, 2015, \$10.7 million of the term loan was outstanding.

Availability under the Line of Credit is subject to a borrowing base comprised of accounts receivable and inventory. The Company believes that the borrowing base will consistently produce availability under the Line of Credit in excess of \$23.0 million. As of June 30, 2015, the Company had borrowings of \$9.3 million under this facility. A 0.25% commitment fee is charged on the unused portion of the Line of Credit.

The Company has one standby letter of credit totaling \$0.8 million which reduce the \$23.0 million available Line of Credit to \$22.2 million. As of June 30, 2015, the Company has approximately \$12.9 million available in the Line of Credit.

The obligations under the Credit Facility are unsecured. In the event of certain triggering events, such obligations would become secured by the assets of the Company’s domestic subsidiaries. A triggering event occurs when the Company fails to achieve any of the financial covenants noted above in consecutive quarters.

### **13. COMMON STOCK**

Class B common stock is identical to Class A except that it has 10 votes per share, is generally nontransferable except to lineal descendants of stockholders, cannot receive more dividends than Class A, and can be converted to Class A at any time. Class A common stock is entitled to elect 25% of the directors to be elected at each meeting with the remaining 75% being elected by Class A and Class B voting together.

## 14. CONTINGENCIES

The Company is involved in certain legal matters which arise in the normal course of business, which are not expected to have a material impact on the Company's financial condition, results of operations and cash flows.

## 15. OPERATING DATA

The Company believes it has no significant concentration of credit risk as of June 30, 2015. Trade receivables are dispersed among a large number of retailers, distributors and industrial accounts in many countries, with none exceeding 10% of consolidated sales.

The Company is engaged in the single business segment of producing and marketing industrial, professional and consumer products. It manufactures over 5,000 tools, including precision measuring tools, tape measures, gages and saw blades. Operating segments are identified as components of an enterprise about which separate discrete financial information is used by the chief operating decision maker in determining how to allocate assets and assess performance of the Company.

The Company has (and is managed through) nine manufacturing plants, which are in Jedburgh, Scotland, Itu, Brazil, Athol, MA, Cleveland, OH, Mt. Airy, NC, Suzhou, China, Waite Park, MN, Laguna Hills, CA, and Columbus, GA. Internal operating statements used by the chief operating decision maker (the CEO) are prepared on the basis of the operating results of each of these units, and the Company believes these reporting units meet the aggregation criteria as stated in ASC 280 Segment Reporting.

The Company has concluded that its principal operations in North America, Scotland and Brazil have similar economic characteristics and therefore similar long-term financial prospects because they operate in worldwide markets, produce and market the same or similar finished products in the same way, generate comparable gross margins, have comparable return on equity, and sell primarily through distribution as opposed to directly to the end user of the product. Because the units operate in different countries, the economic climate in each country may affect the short-term results of each unit differently; however, over the long run, the units in general are expected to operate similarly and generate similar returns.



Other reporting unit similarities include:

- a. All the Company's units produce tools and related products used primarily by the metal-working and construction trades. These include rules and tape measures, levels, dial indicators, band saw and hole saw blades, gage blocks, ground flat stock, granite surface plates, micrometers and calipers, etc. All the Company's products are included in a single catalog regardless of where manufactured.
- b. The production processes for all products (regardless of where manufactured) are the same or similar in that they use metal or granite as a raw material.
- c. The Company's products are sold from its manufacturing units through a customer base of resellers, primarily industrial distributors.
- d. The Company and its individual units are not materially affected by the regulatory environment.

For these reasons, the Company believes it is appropriate to report on the basis of one reporting segment.

The Company's operations are primarily in North America, Brazil the United Kingdom and China. Geographic information about the Company's sales and long-lived assets are as follows (in thousands):

	2015	2014	2013
<b>Net Sales</b>			
United States	\$ 147,589	\$ 143,803	\$ 133,129
Brazil	70,629	80,794	86,122
United Kingdom	29,789	31,717	29,260
China	22,385	22,663	17,882
North America (other than U.S.)	11,555	12,062	12,344
Eliminations and other	(40,397 )	(43,905 )	(34,940 )
Total	\$241,550	\$247,134	\$243,797
<b>Long-lived Assets</b>			
United States	\$58,185	\$61,930	\$77,198
Brazil	8,154	12,699	11,044
United Kingdom	5,211	5,779	4,527
China	3,347	3,558	3,460
North America (other than U.S.)	360	387	449



Eliminations and other	3,602	188	168
Total	\$78,859	\$84,541	\$96,846

**16. QUARTERLY FINANCIAL DATA (unaudited)**

(in thousands except per share data)

Quarter Ended	Net Sales	Gross Margin	Earnings		Basic and
			Before Income Taxes	Net Earnings / (Loss)	Diluted Earnings / (Loss) Per Share
September 2013	\$57,487	\$17,809	\$845	\$216	\$0.03
December 2013	61,841	20,345	2,941	1,782	0.26
March 2014	58,281	19,259	2,667	1,682	0.24
June 2014	69,525	23,683	5,604	3,032	0.44
	\$247,134	\$81,096	\$12,057	\$6,712	\$0.97
September 2014	\$60,172	\$19,143	\$1,741	\$923	\$0.13
December 2014	63,821	22,164	4,323	2,447	0.35
March 2015	56,116	18,694	3,508	2,437	0.35
June 2015	61,441	16,694	370	(563)	(0.08)
	\$241,550	\$76,695	\$9,942	\$5,244	\$0.75

Fourth quarter sales in fiscal 2015 declined were \$8.1 million lower than in the fourth quarter of fiscal 2014. Unfavorable exchange rates represented \$7.8 million of the difference. The Brazilian real declined 28% against the U.S. dollar in the fourth quarter of fiscal 2015 compared to fiscal 2014. Gross margins declined \$7.0 million with North American declining \$2.4 million and international sliding \$4.6 million. Reduced sales and higher cost were the prime factors impacting North America. Foreign currency and pension represented \$2.5 million and \$1.0 million respectively of the international gross margin deficit.

**Item 9 - Changes in and Disagreements with Accountants on Accounting and Financial Disclosure**

None.

**Item 9A - Controls and Procedures**

Pursuant to Rule 13a-15(b) under the Securities Exchange Act of 1934, we carried out an evaluation, with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the

effectiveness of our disclosure controls and procedures (as defined under Rule 13a-15(e) under the Securities Exchange Act of 1934) as of the end of the period covered by this annual report. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective as of such date in ensuring that information required to be filed in this annual report was recorded, processed, summarized and reported within the time period required by the rules and regulations of the Securities and Exchange Commission, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

During the fourth quarter of fiscal 2015, the Company effectively remediated the material weakness within its financial reporting process related to revenue transactions and the information technology system at its Bytewise subsidiary. The steps taken to achieve remediation included cooperation between Corporate management and Bytewise staff in the implementation of a Global Finance Policy defining control procedures relevant to the issues identified at Bytewise. There were no other changes in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934) during the fourth quarter of fiscal 2015 identified in connection with our Chief Executive Officer's and Chief Financial Officer's evaluation that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

### **Management's Report on Internal Control Over Financial Reporting**

Management of the Company is responsible for establishing and maintaining adequate internal control over financial reporting. The Company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with accounting principles generally accepted in the United States of America. Internal control over financial reporting includes those written policies and procedures that:

- Pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and acquisitions and dispositions of the assets of the Company;
- Provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with accounting principles generally accepted in the United States of America;
  - Provide reasonable assurance that receipts and expenditures of the Company are being made only in accordance with authorization of management and directors of the Company; and
- Provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of assets that could have a material effect on the consolidated financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect all misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Management assessed the effectiveness of the Company's internal control over financial reporting as of June 30, 2015. Management based this assessment on criteria established in the 2013 *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Management's assessment included an evaluation of the design of the Company's internal control over financial reporting and testing of the operational effectiveness of its internal control over financial reporting. Management reviewed the results of its assessment with the Audit Committee of the Board of Directors.

Based on our assessment, management concluded that as of June 30, 2015 our internal control over financial reporting was effective based on those criteria.

The Company's internal control over financial reporting as of June 30, 2015 has been audited by Grant Thornton LLP, an independent registered public accounting firm, as stated in their report included herein.

## REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders

The L.S. Starrett Company

We have audited the internal control over financial reporting of The L.S. Starrett Company (a Massachusetts corporation) and subsidiaries (the “Company”) as of June 30, 2015, based on criteria established in the 2013 *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company’s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying “Management’s Report on Internal Control Over Financial Reporting.” Our responsibility is to express an opinion on the Company’s internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company’s internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company’s internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company’s assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, The L.S. Starrett Company and subsidiaries maintained, in all material respects, effective internal control over financial reporting as of June 30, 2015, based on criteria established in the 2013 *Internal Control—Integrated Framework* issued by COSO.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated financial statements of the Company as of and for the year ended June 30, 2015 and our report dated August 25, 2015 expressed an unqualified opinion on those financial statements.

/s/ Grant Thornton LLP

Boston, Massachusetts

August 25, 2015

**Item 9B - Other Information**

None.

**PART III****Item 10 – Directors, Executive Officers and Corporate Governance**

The information concerning the Directors of the Registrant will be contained immediately under the heading “Election of Directors” and prior to Section A of Part I in the Company’s definitive Proxy Statement for the Annual Meeting of Stockholders to be held on October 15, 2015 (the “2015 Proxy Statement”), which will be mailed to stockholders on or about September 9, 2015. The information in that portion of the 2015 Proxy Statement is hereby incorporated by reference.

**Executive Officers of the Registrant**

Name	Age	Held Present	
		Office Since	Position
Douglas A. Starrett	63	2001	President and CEO and Director
Francis J. O’Brien	68	2009	Chief Financial Officer and Treasurer
Anthony M. Aspin	62	2000	Vice President Sales
Stephen F. Walsh (1)	69	2001	Senior Vice President Operations and Director
James B. Taylor	49	2015	Vice President Operations

‘(1) Mr. Walsh retired effective June 30, 2015.

Douglas A. Starrett has been President of the Company since 1995 and became CEO in 2001.

Francis J. O’Brien was previously Chief Financial Officer at Delta Education, LLC, an elementary school education company, from 2005 to 2009. Prior to Delta Education, he was Chief Financial Officer at StockerYale Corporation, a publicly traded technology company, from 2001 to 2004 and Director of Finance and Business Development at Analogic Corporation, a publicly traded manufacturer of medical and security systems, from 1998 to 2000. Mr. O’Brien served as Corporate Vice President of Finance & Administration for Addison Wesley, a global education company, from 1982 to 1997 and as Senior Manager at Coopers & Lybrand, an international public accounting firm, from 1976 to 1982. Mr. O’Brien holds a BA from the University of Massachusetts and an MBA from Suffolk



University and is a Certified Public Accountant.

Anthony M. Aspin was previously a divisional sales manager with the Company.

Stephen F. Walsh was previously President of the Silicon Carbide Division of Saint-Gobain Industrial Ceramics before joining the Company in 2001 as Vice President Operations.

Mr. Taylor, age 49, joined the Company on June 22, 2015. He was previously Division Vice President, Operations for Zygo Corporation, a unit of Ametek's Ultra Precision Technologies Division, from 2014 to 2015, Director of Optical components Manufacturing of Zygo Corporation from 2010 to 2014, and Vice President of JML Optical Industries, Inc. from 2004 to 2010. Mr. Taylor holds a Bachelor's degree, a Master's degree, and a Doctorate in Industrial Engineering from Purdue University.

The positions listed above represent their principal occupations and employment during the last five years.

The President and Treasurer hold office until the first meeting of the directors following the next annual meeting of stockholders and until their respective successors are chosen and qualified, and each other officer holds office until the first meeting of directors following the next annual meeting of stockholders, unless a shorter period shall have been specified by the terms of his election or appointment or, in each case, until he sooner dies, resigns, is removed or becomes disqualified.

There have been no events under any bankruptcy act, no criminal proceedings and no judgments or injunctions material to the evaluation of the ability and integrity of any executive officer during the past ten years.

### **Code of Ethics**

The Company has adopted a Policy on Business Conduct and Ethics (the "Ethics Policy") applicable to all directors, officers and employees of the Company. The Code is intended to promote honest and ethical conduct, full and accurate reporting, and compliance with laws as well as other matters. The Ethics Policy is available on the Company's website at [www.starrett.com](http://www.starrett.com). Stockholders may also obtain free of charge a printed copy of the Ethics Policy by writing to the Clerk of the Company at The L.S. Starrett Company, 121 Crescent Street, Athol, MA 01331. We intend to disclose any future amendments to, or waivers from, the Ethics Policy within four business days of the waiver or amendment through a website posting or by filing a Current Report on Form 8-K with the Securities and Exchange Commission.



**Item 11 - Executive Compensation**

The information concerning management remuneration will be contained under the heading “General Information Relating to the Board of Directors and Its Committees,” and in Sections C-H of Part I of the Company’s 2015 Proxy Statement, and is hereby incorporated by reference.

On July 15, 2010, the Company entered into a Change of Control Agreement with Francis J. O’Brien. The terms of Mr. O’Brien’s Agreement are identical to those contained in the Change of Control Agreement between the Company and Stephen F. Walsh dated as of January 16, 2009, a form of which is incorporated by reference as Exhibit 10k to this Form 10-K. Such terms are described in the Company’s Form 10-Q filed for the quarter ended December 27, 2008 and are incorporated herein by reference.

**Item 12 - Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters**

(a) The following table gives information about the Company’s common stock that may be issued upon the exercise of options, warrants and rights under the Company’s 2012 Employees’ Stock Purchase Plan (“2012 Plan”) as of June 30, 2015. The 2012 Plan was approved by stockholders at the Company’s 2012 annual meeting and shares of Class A or Class B common stock may be issued under the 2012 Plan. Options are not issued under the Company’s Employees’ Stock Purchase Plan that was adopted in 1952.

<b>Plan Category</b>	<b>Number of Securities</b>	<b>Weighted Average</b>	<b>Number of Securities</b>
	<b>to be issued</b>	<b>Exercise Price of</b>	<b>Remaining Available</b>
	<b>Upon Exercise of Outstanding Options, Warrants and Rights</b>	<b>Outstanding Options, Warrants and Rights</b>	<b>For Future Issuance Under Equity Compen-</b>
	<b>(a)</b>	<b>(b)</b>	<b>sation Plans (Ex-</b>
			<b>cluding Securities</b>

			<b>Reflected in Column (a)</b>
			<b>(c)</b>
Equity compensation plans approved by security holders	54,307	\$ 12.79	414,975
Equity compensation plans not approved by security holders	—	—	—
Total	54,307	\$ 12.79	414,975

## (b) Security ownership of certain beneficial owners:

The information concerning a more than 5% holder of any class of the Company's voting shares will be contained under the heading "Security Ownership of Certain Beneficial Owners" in Section I of Part I of the Company's 2015 Proxy Statement, and is hereby incorporated by reference.

## (c) Security ownership of management:

The information concerning the beneficial ownership of each class of equity securities by all directors, and all directors and officers of the Company as a group, will be contained under the heading "Security Ownership of Management" in Section I of Part I in the Company's 2015 Proxy Statement. These portions of the 2015 Proxy Statement are hereby incorporated by reference.

## (d) The Company knows of no arrangements that may, at a subsequent date, result in a change in control of the Company.

**Item 13 - Certain Relationships and Related Transactions, and Director Independence**

The information required by this Item 13 will be contained in the Company's 2015 Proxy Statement, and is hereby incorporated by reference.

**Item 14 - Principal Accountant Fees and Services**

The information required by this Item 14 will be contained in the Audit Fee table in Section B of Part I in the Company's 2015 Proxy Statement. These portions of the Proxy Statement are hereby incorporated by reference.



**PART IV**

**Item 15 – Exhibits, Financial Statement Schedules**

(a) 1. Financial statements filed in Item 8 of this annual report:

Consolidated Balance Sheets at June 30, 2015 and June 30, 2014.

Consolidated Statements of Operations for each of the years in the three year period ended June 30, 2015.

Consolidated Statements of Comprehensive Income (Loss) for each of the years in the three year period ended June 30, 2015.

Consolidated Statements of Stockholders' Equity for each of the years in the three year period ended June 30, 2015.

Consolidated Statements of Cash Flows for each of the years in the three year period ended June 30, 2015.

Notes to Consolidated Financial Statements

2. The following consolidated financial statement schedule of the Company included in this annual report on Form 10-K is filed herewith pursuant to Item 15(c) and appears immediately before the Exhibit Index:

**SCHEDULE II – VALUATION AND QUALIFYING ACCOUNTS**

**Schedule II**

**Valuation and Qualifying Accounts****Allowance for Doubtful Accounts**

<i>(in 000)</i>	<b>Balance</b>		<b>Charges</b>		<b>Balance</b>
	<b>at</b>		<b>to</b>		<b>at</b>
	<b>Beginning</b>	<b>Provisions</b>	<b>Other</b>	<b>Write-offs</b>	<b>End of</b>
	<b>of Period</b>		<b>Accounts</b>		<b>Period</b>
Allowance for Doubtful Accounts:					
Year Ended June 30, 2015	\$ 704	\$ 179	\$ (163 )	\$ (108 )	\$ 612
Year Ended June 30, 2014	697	27	27	(47 )	704
Year Ended June 30, 2013	965	7	(42 )	(233 )	697

**Valuation Allowance on Deferred Tax Asset**

<i>(in 000)</i>	<b>Balance</b>		<b>Charges</b>		<b>Balance</b>
	<b>at</b>		<b>to</b>		<b>at</b>
	<b>Beginning</b>	<b>Provisions</b>	<b>Other</b>	<b>Write-offs</b>	<b>End of</b>
	<b>of Period</b>		<b>Accounts</b>		<b>Period</b>
Year Ended June 30, 2015	\$ 3,334	\$ 1,242	\$ (24 )	\$ (51 )	\$ 4,501
Year Ended June 30, 2014	4,539	302	(355 )	(1,152 )	3,334
Year Ended June 30, 2013	2,560	685	1,595	(301 )	4,539

All other financial statement schedules are omitted because they are inapplicable, not required under the instructions, or the information is reflected in the financial statements or notes thereto.

3. See Exhibit Index below. Compensatory plans or arrangements are identified by an “\*.”

(b) See Exhibit Index below.

(c) Not applicable.

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**THE L.S. STARRETT COMPANY AND SUBSIDIARIES - EXHIBIT INDEX**

Exhibit

3a Restated Articles of Organization as amended, filed with Form 10-K for the year ended June 30, 2012, is hereby incorporated by reference.

3b Amended and Restated Bylaws, filed with Form 10-Q for the quarter ended December 31, 2012, is hereby incorporated by reference.

4a Rights Agreement dated as of November 2, 2010 between the Company and Mellon Investor Services LLC, as Rights Agent (together with exhibits, including the Form of Rights Certificate, and the Summary of Rights to Purchase Shares of Class A Common Stock), filed with Form 10-Q for the quarter ended September 25, 2010, is hereby incorporated by reference.

4b Amendment No. 1 to Rights Agreement dated as of February 5, 2013 by and between the Company and Computershare Shareowner Services LLC, filed with Form 10-Q for the quarter ended December 31, 2012, is hereby incorporated by reference.

10a Form of indemnification agreement with directors and executive officers, filed with Form 10-K for the year ended June 29, 2002, is hereby incorporated by reference.

10b\* The L.S. Starrett Company Supplemental Executive Retirement Plan, as amended and restated on January 1, 2009, filed herewith..

10c\* The L.S. Starrett Company 401(k) Stock Savings Plan (2001 Restatement), filed with Form 10-K for the year ended June 29, 2002 is hereby incorporated by reference.

10d\* The L.S. Starrett Company Employee Stock Ownership Plan and Trust Agreement, as amended, filed with Form 10-K for the year ended June 30, 2012 is hereby incorporated by reference.

10e\* Amendment dated April 1, 2003 to the Company's 401(k) Stock Savings Plan, filed with Form 10-K for the year ended June 28, 2003, is hereby incorporated by reference.

10f\* Amendment dated October 20, 2003 to the Company's 401(k) Stock Savings Plan, filed with Form 10-Q for the quarter ended September 27, 2003, is hereby incorporated by reference.

<sup>10g</sup> Amendment dated as of June 24, 2006 to the Company's Amended and Restated Credit Agreement, filed with Form 10-K for the year ended June 24, 2006, is hereby incorporated by reference.

<sup>10h</sup> Loan and Security Agreement dated as of June 30, 2009 by and among the Company, certain subsidiaries of the Company, and TD Bank, N.A., as lender as amended through April 25, 2012, filed with Form 10-K for the year ended June 30, 2012, is hereby incorporated by reference.

<sup>10i\*</sup> 2007 Employees' Stock Purchase Plan filed with the Definitive Proxy Statement for the 2008 Annual Meeting of Stockholders is hereby incorporated by reference.

<sup>10j</sup> Change in Control Agreement, dated January 16, 2009, between the Company and Douglas A. Starrett, filed with Form 10-Q for the quarter ended December 27, 2008, is hereby incorporated by reference.

<sup>10k</sup> Form of Change in Control Agreement, executed separately by the Company and each of Stephen F. Walsh and Francis J. O'Brien on January 16, 2009 and July 15, 2010, respectively, filed with Form 10-Q for the quarter ended December 27, 2008, is hereby incorporated by reference.

<sup>10l</sup> Form of Non-Compete Agreement, dated as of January 16, 2009, executed separately by the Company and each of Francis J. O'Brien, Douglas A Starrett and Stephen F. Walsh on July 15, 2010, January 16, 2009 and January 16, 2009, filed with Form 10-Q for the quarter ended December 27, 2008, is hereby incorporated by reference.

<sup>10m\*</sup> The L. S. Starrett Company 2013 Employee Stock Ownership Plan and Trust Agreement, filed with Form 10-Q for the quarter ended March 31, 2013, is hereby incorporated by reference.

- 10n\* First Amendment to The L. S. Starrett Company 2013 Employee Stock Ownership Plan and Trust Agreement, dated December 31, 2013 is hereby incorporated by reference.
- 10o\* The L.S. Starrett Company 2012 Employees' Stock Purchase Plan, filed with the Company's Registration Statement on Form S-8 (File No. 333-184934) filed on November 14, 2012, is hereby incorporated by reference.
- 10p\* The L.S. Starrett Company 2012 Long-Term Incentive Plan, filed with the Company's Registration Statement on Form S-8 (File No. 333-184934) filed on November 14, 2012, is hereby incorporated by reference.
- 10q Form of Non-Statutory Stock Option Agreement under The L.S. Starrett Company 2012 Long-Term Incentive Plan, filed with Form 10-Q for the quarter ended December 31, 2012, is hereby incorporated by reference.
- 10r Form of Director Non-Statutory Stock Option Agreement under The L.S. Starrett Company 2012 Long-Term Incentive Plan, filed with Form 10-Q for the quarter ended December 31, 2012, is hereby incorporated by reference.
- 10s Form of Restricted Stock Unit Agreement under The L.S. Starrett Company 2012 Long-Term Incentive Plan, filed with Form 10-Q for the quarter ended December 31, 2012, is hereby incorporated by reference.
- 10t Form of Director Restricted Stock Unit Agreement under The L.S. Starrett Company 2012 Long-Term Incentive Plan, filed with Form 10-Q for the quarter ended December 31, 2012, is hereby incorporated by reference.
- 10u\* Cash Bonus Plan for executives officers of the Company, filed with Form 10-K for the year ended June 30, 2013, is hereby incorporated by reference.
- 10v Amendment dated December 23, 2013 to the Company's amended Loan and Security Agreement, is hereby incorporated by reference.
- 10w Amendment dated January 26, 2015 to the Loan and Security Agreement dated as of June 30, 2009 by and among the Company, certain subsidiaries of the Company, and TD Bank, N.A., as lender.
- 21 Subsidiaries of the L.S. Starrett Company
- 23 Consent of Independent Registered Public Accounting Firm, filed herewith.
- 31a Certification of Chief Executive Officer Pursuant to Rule 13a-14(a), filed herewith.
- 31b Certification of Chief Financial Officer Pursuant to Rule 13a-14(a), filed herewith.
- Certification of Chief Executive Officer and Chief Financial Officer Pursuant to Rule 13a-14(b) and Section 906 of the Sarbanes-Oxley Act of 2002 (subsections (a) and (b) of Section 1350, Chapter 63 of Title 18, United States Code), filed herewith.

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The following materials from The L. S. Starrett Company Annual Report on Form 10-K for the year ended June 30, 2015 are furnished herewith, formatted in XBRL (Extensible Business Reporting Language): (i) the Consolidated Balance Sheets, (ii) the Consolidated Statements of Operations, (iii) the Consolidated Statements of Comprehensive Income (Loss), (iv) the Consolidated Statements of Stockholders' Equity (v) the Consolidated Statements of Cash Flows, and (vi) Notes to the Consolidated Financial Statements, tagged as blocks of text.

## SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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.

### THE L.S. STARRETT COMPANY

#### (Registrant)

By: /S/ Francis J. O'Brien  
Francis J. O'Brien

Treasurer and Chief Financial Officer  
(Principal Accounting Officer)

Date: Aug. 25, 2015

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the date indicated:

/S/DOUGLAS A. STARRETT

Douglas A. Starrett, Aug. 25, 2015

President and CEO and Director (Principal Executive Officer)

/S/SALVADOR DE  
CAMARGO, JR.

Salvador de Camargo, Jr., Aug.  
25, 2015

President and Director

Starrett Industria e Comercio  
Ltda, Brazil

By: /S/ Francis J. O'Brien  
Francis J. O'Brien, Aug. 25, 2015

Treasurer and Chief Financial Officer (Principal Accounting Officer) Director

/S/TERRY A. PIPER  
Terry A. Piper, Aug. 25, 2015

/S/RICHARD B. KENNEDY  
Richard B. Kennedy, Aug. 25, 2015  
Director

/S/STEPHEN F. WALSH  
Stephen F Walsh, Aug. 25, 2015  
Senior Vice President Operations and Director

/S/DAVID A. LEMOINE

David A. Lemoine, Aug. 25, 2015

Director

/S/RALPH G. LAWRENCE

Ralph G. Lawrence, Aug. 25, 2015

Director