

STARRETT L S CO  
Form 10-K  
August 25, 2017

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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, 2017**

**OR**

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

**For the transition period from \_\_\_\_\_ to \_\_\_\_\_**

**Commission File No. 1-367**

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**THE L.S. STARRETT COMPANY**

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

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**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      Emerging Growth Company

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

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Act).    Yes      No

The Registrant had 6,286,978 and 766,623 shares, respectively, of its \$1.00 par value Class A and B common stock outstanding on December 31, 2016. On December 31, 2016, the last business day of the Registrant's second fiscal quarter, the aggregate market value of the common stock held by nonaffiliates was approximately \$58,068,772.

There were 6,219,238 and 764,545 shares, respectively, of the Registrant's \$1.00 par value Class A and Class B common stock outstanding as of August 18, 2017.

The exhibit index is located on pages 52-53.

#### DOCUMENTS INCORPORATED BY REFERENCE

The Registrant intends to file a definitive Proxy Statement for the Company's 2017 Annual Meeting of Stockholders within 120 days of the end of the fiscal year ended June 30, 2017. 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, 2017**

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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. Starrett® is brand recognized around the world for precision, quality and innovation.

In accordance with the provisions of Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 280, *Segment Reporting*, for the fiscal year ended June 30, 2017 (fiscal 2017), we determined that we have two reportable operating segments (North America and International). Refer to Note 17, *Financial Statement Information by Segment & Geographical Area*, contained in the Notes to Consolidated Financial Statements included in Part II, Item 8 of this Annual Report on Form 10-K, for more information on our reportable segments.

#### **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 137 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 2015, 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 2016, the Company introduced new products to its hand tool portfolio to extend its reach into the construction and retail trades. 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, 2017, the Company had 1,647 employees, approximately 53% of whom were domestic. This represents a net decrease from June 30, 2016 of 47 employees. The headcount change included a decrease of 13 domestically and a decrease of 34 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 shares 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 2017, 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 has responded 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 17 to the Company's fiscal 2017 financial statements.

## **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 \$58.1 million at June 30, 2017 and \$56.3 million at June 30, 2016.

### **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 2017, 2016, and 2015 were approximately \$1.9 million, \$1.8 million, and \$1.7 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 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, resulting in the Company revising its strategy to fit this new, highly competitive business environment. The Company continuously evaluates most aspects of its business, aiming for new 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 44% of consolidated sales for fiscal 2017.

## **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 2017 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 Company can provide no assurance that current economic trends will or 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 2017, revenue from sales outside of the United States was \$91.5 million, representing approximately 44% 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 and liabilities.**

Currently, the Company's U.S. defined benefit pension plan is underfunded primarily due to lower discount rates which increase the Company's liability. The Company made contributions of \$4.0 million in fiscal 2017, and \$3.4 million in fiscal 2016 and will be required to make additional contributions in fiscal 2018 of \$3.3 million. The Company could be required to provide more funding to the domestic plan in the future. The Company froze the

domestic defined benefit pension plan as of December 31, 2016. As a result of this decision, no future benefits will accrue to employees under that plan. The Company's UK plan, which is also underfunded, required Company contributions of \$1.0 million and \$1.1 million during fiscal 2017 and 2016, respectively. The Company will be required to make a \$1.0 million contribution to its UK pension plan in fiscal 2018.

**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 cannot 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, 2017, the Company was in compliance with all the covenants. The credit facility expires in April of 2018 and the Company intends to negotiate an extension.

**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. and other countries; 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 22,000 square foot leased facility in Columbus, GA.

In addition, the Company operates warehouses and/or sales-support offices in the U.S., Australia, New Zealand, Mexico, 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, 2017, there were approximately 1,169 registered holders of Class A common stock and approximately 961 registered holders of Class B common stock.

<b>Quarter Ended</b>	<b>Dividends</b>	<b>High</b>	<b>Low</b>
September 2015	\$ 0.10	\$17.53	\$11.81
December 2015	0.10	13.31	9.04
March 2016	0.10	10.74	8.46
June 2016	0.10	12.87	9.76
September 2016	0.10	12.74	9.75
December 2016	0.10	11.20	8.80
March 2017	0.10	11.85	9.56
June 2017	0.10	10.35	8.20

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 2017.

The Company repurchased 3,560 shares of Class B and 35,168 shares of Class A stock in the fourth quarter of fiscal 2017.

## 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, National Presto Industries, Regal-Beloit Corp., Tennant Company, The Eastern Company and WD-40.

	<b>BASE</b>	<b>FY2013</b>	<b>FY2014</b>	<b>FY2015</b>	<b>FY2016</b>	<b>FY2017</b>
STARRETT	<b>100.00</b>	<b>91.64</b>	<b>141.97</b>	<b>141.84</b>	<b>116.79</b>	<b>87.87</b>
RUSSELL 2000	<b>100.00</b>	<b>124.21</b>	<b>153.57</b>	<b>163.53</b>	<b>152.52</b>	<b>190.05</b>
PEER GROUP	<b>100.00</b>	<b>110.97</b>	<b>142.76</b>	<b>143.93</b>	<b>140.20</b>	<b>179.16</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>2017</b>	<b>2016</b>	<b>2015</b>	<b>2014</b>	<b>2013</b>
Net sales	\$207,023	\$209,685	\$241,550	\$247,134	\$243,797
Net earnings (loss)	991	(14,130 )	5,244	6,712	(162 )
Basic earnings (loss) per share	0.14	(2.01 )	0.75	0.97	(0.02 )
Diluted earnings (loss) per share	0.14	(2.01 )	0.75	0.97	(0.02 )
Long-term debt	6,095	17,109	18,552	10,804	24,252
Total assets	192,665	201,598	212,272	231,443	230,794
Dividends per share	0.40	0.40	0.40	0.40	0.40



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

**RESULTS OF OPERATIONS**

**Fiscal 2017 Compared to Fiscal 2016**

**Overview**

L. S. Starrett is a global company and is subject to the political and economic issues both domestically and internationally. Domestically, the presidential election and subsequent congressional stalemate has resulted in customers postponing investment, especially in capital equipment, while the international markets have stabilized in Brazil and begun to grow in Europe.

Net sales for fiscal 2017 declined \$2.7 million or 1% compared to fiscal 2016, with North America posting a shortfall of \$5.6 million or 4% and International growing \$2.9 million or 4%. Price increases, predominantly in Brazil, new products and foreign exchange represented sales gains of \$6.4, \$1.8 and \$1.4 million, respectively, which were offset by domestic and international volume declines of \$5.8 million and \$6.5 million, respectively. Gross margins increased \$15.0 million or 32% from \$47.0 million or 22% of sales in fiscal 2016 to \$62.0 million or 30% of sales in fiscal 2017 with North America and International posting gains of \$10.1 million and \$4.9 million, respectively. Selling, general and administrative expenses decreased \$1.3 million or 2% from \$63.3 million in fiscal 2016 to \$62.0 million in fiscal 2017. Operating income improved \$19.4 million from a loss of \$20.4 million in fiscal 2016 to a loss of \$1.0 million in fiscal 2017. Included in operating income was a \$17.5 million pension charge and a \$4.1 million asset impairment in fiscal 2016 compared to a \$1.0 million restructuring charge in fiscal 2017. The U.S. pension plan was frozen as of December 31, 2016. Consequently the Plan will be closed to new participants and current participants will no longer earn additional benefits after December 31, 2016.

**Net Sales**

Net sales in North America decreased \$5.6 million or 4% from \$130.2 million in fiscal 2016 to \$124.6 million in fiscal 2017 principally due to declines in maintenance, repair & operating (MRO) products and capital equipment of 3% and 6%, respectively. International sales grew \$2.9 million or 4% from \$79.5 million in fiscal 2016 to \$82.4 million in fiscal 2017 due to net consolidated currency gains of \$1.4 million and \$1.5 million of new products.

### **Gross Margin**

Gross margin in North America increased \$10.1 million from \$24.3 million in fiscal 2016 to \$34.4 million in fiscal 2017 primarily due to the comparative absence in fiscal 2017 of a \$12.4 million pension charge in fiscal 2016. International gross margins increased \$4.9 million from \$22.7 million in fiscal 2016 to \$27.6 million in fiscal 2017 with currency exchange rates of \$0.6 million and price increases of \$6.3 million offsetting volume declines of approximately \$2.0 million.

The \$1.0 million of restructuring charges in fiscal 2017 are principally related to severance costs, equipment installation and freight which represents expenses associated with the saw plant consolidation. The saw consolidation, discussed in in previous SEC filings, represents reducing saw manufacturing facilities from four to two.

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

North American selling, general and administrative expenses declined \$2.7 million or 7% principally due to the comparative absence in fiscal 2017 of a \$3.0 million pension charge in fiscal 2016. International selling, general and administrative expenses increased \$1.4 million or 5% due to increased sales commissions, professional fees and advertising expenses.

### **Operating Profit**

Operating profit improved \$19.4 million primarily due to the absence in fiscal 2017 of charges of \$17.5 million for pension expense and \$4.1 million for the asset impairment of our Mt. Airy facility related to the saw plant consolidation.

### **Other Income (Expense), Net**

Other income (expense) in fiscal 2017 decreased \$0.6 million compared to fiscal 2016 principally due to lower interest income and legal settlements.

### **Income Taxes**

The income tax rate for fiscal 2017 was 35.6% on pre-tax income of \$1.5 million. This compares to a normalized statutory U.S. federal and state rate of 38%. The primary reasons for a lower effective tax rate is due to the benefit of earnings in foreign jurisdictions with lower effective tax rates and a one-time tax benefit in Canada which was offset by discrete tax charges including the impact of a tax rate change in the U.K. applied to deferred tax assets.

In fiscal 2016, the tax benefit rate was 30.7% on pre-tax losses of \$20.4 million. The primary reason for the lower tax benefit is due to losses in certain foreign subsidiaries for which no tax benefit was taken due to 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.

### **Fiscal 2016 Compared to Fiscal 2015.**

### **Overview**

L. S. Starrett, as a global company, was negatively impacted by political, economic and currency issues during fiscal 2016. The recession, corruption and currency problems in Brazil significantly reduced the sales and profits of our largest international subsidiary compared to fiscal 2015. The slowdown in China and stagnation in Europe resulted in lower sales compared to fiscal 2015 in both regions, while North America suffered from the cost reductions implemented in the oil industry.



The financial markets, including the timing of Brexit, also reduced earnings in fiscal 2016 as the flight to safety increased the demand for bonds and the associated decrease in interest rates, which significantly contributed to a \$17.5 million non-cash pension expense due to higher liabilities. The pension liability is based upon the ten year Corporate Bond Rate and is set on the last day of the fiscal year. This generally accepted accounting principle coupled with the volatility of interest rates results in fourth quarter financial variations which management cannot control. The pension discount rate as of June 30, 2016 was 3.77% compared to 4.00% at the end of May 2016 and 4.49% at the end of June 2015 the total consolidated expense in fiscal 2016 was \$21.4 million. Excluding the fourth quarter adjustment of \$17.5 million, normal annual pension expense is \$3.9 million.

In addition, due to excess saw manufacturing capacity, the Company decided to reduce its manufacturing footprint resulting in a \$4.1 million non-cash charge in the fourth quarter of fiscal 2016.

Net sales for fiscal 2016 were \$209.7 million, a decline of \$31.9 million or 13% compared to \$241.6 in fiscal 2015, with North America and International posting decreases of \$7.0 million and \$24.9 million, respectively. Price increases, particularly in Brazil, and new products represented sales gains of \$6.5 and \$4.7 million, respectively, which were offset by volume declines of \$24.3 million and unfavorable exchange rates of \$18.9 million. Gross margins declined \$29.7 million from \$76.7 million, or 31.8%, of sales in fiscal 2015 to \$47.0 million, or 22.4% of sales, in fiscal 2016 with North America and International posting decreases of \$19.3 and \$10.4 respectively. Selling, general and administrative expenses decreased \$4.8 million, or 7%, from \$68.1 million in fiscal 2015 to \$63.3 million in fiscal 2016 principally due to reduced International expenses expressed in U. S. dollars. Operating income, including a \$4.1 asset impairment charge, declined \$29.0 million from profit of \$8.6 million in fiscal 2015 to a loss of \$20.4 million in fiscal 2016.

### **Net Sales**

Net sales in North America decreased \$7.0 million or 5% from \$137.1 million in fiscal 2015 to \$130.1 million in fiscal 2016 with a 9% decline in precision hand tools offsetting high end metrology gains of 8%. International sales decreased \$24.9 million or 24% from \$104.5 million in fiscal 2015 to \$79.6 million in fiscal 2016 with the weak Brazilian Real translated to the strong U. S. dollar representing \$16.0 million and the recession in Brazil accounting for a \$10.0 million volume decline.

### **Gross Margin**

Gross margin in North America decreased \$20.7 million from \$43.6 million in fiscal 2015 to \$22.9 million in fiscal 2016 with a non-cash pension charge representing \$12.4 million or 60% of the margin erosion. Lower sale volume and level fixed overhead costs accounted for the majority of the additional \$8.3 million in the deficit. International gross margins decreased \$10.4 million from \$33.1 million in fiscal 2015 to \$22.7 million in fiscal 2016 with unfavorable exchange rates representing \$5.3 million. A United Kingdom non-cash pension charge of \$1.8 million coupled with a \$3.3 million associated with lower sales volume accounted for the additional \$5.1 million in the

decline.

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

North American selling, general and administrative expenses increased \$1.0 million or 3% as savings in salaries, incentive payments, travel and entertainment of \$2.3 million was offset by a \$3.0 million non-cash pension charge and higher professional fees. International selling, general and administrative expenses decreased \$6.0 million or 19% with a \$5.5 million savings due to the stronger U. S. dollar. Reduced sales commissions due to lower sales, particularly in Brazil, accounted for the additional \$0.5 million in savings.

### **Operating Profit**

The operating profit declined \$29.0 million with a non-cash fourth quarter pension expense of \$17.5 million and a \$4.1 million non-cash asset impairment charge representing \$21.6 million or 75% of the difference. Lower sales and associated gross margins contributed to the remaining \$7.4 million decline.

### **Other Income, Net**

Other income in fiscal 2016 decreased \$1.2 million compared to fiscal 2015 principally due to \$0.3 million of lower interest income and a \$1.1 million loss related to dollar denominated debt of our Chinese subsidiary as a result of the Chinese Yuan currency declining in value relative to the U. S. dollar.

### **Income Taxes**

The income tax rate for fiscal 2016 was 30.7% on pre-tax losses of \$20.4 million. This compares to a normalized statutory U.S. federal and state tax rate of 38%. The primary reason for the lower tax benefit is due to losses in certain foreign subsidiaries for which no tax benefit is taken due to the uncertainty of future profits in those entities.

The income tax rate for fiscal 2015 was 47.2% on pre-tax profits of \$9.9 million. This compares to a normalized statutory U.S. federal and state tax rate of 38%. The primary reason for the higher tax cost is due to losses in certain foreign subsidiaries for which no tax benefit is taken due to 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 for foreign NOLs increased by \$0.5 million and to foreign tax credits increased by \$0.2 million.

## **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 tracking, market-making or other speculative activities in derivatives markets. The Company engages in an immaterial amount of hedging activity to minimize the impact of foreign currency fluctuations and had \$1.4 million in forward currency contracts outstanding at June 30, 2017. Net foreign monetary assets are approximately \$17.1 million as of June 30, 2017.

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% increase in interest rates would not have a material impact on our borrowing costs. See Note 13 to the Consolidated Financial Statements for details concerning the Company's long-term debt outstanding of \$6.1 million.

**LIQUIDITY AND CAPITAL RESOURCES**

	<b>Years ended June 30</b>		
	<b>(\$000)</b>		
	<b>2017</b>	<b>2016</b>	<b>2015</b>
Cash provided by operating activities	\$2,888	\$14,336	\$6,800
Cash used in investing activities	(3,839)	(619 )	(5,544)
Cash used in financing activities	(3,911)	(4,294 )	(3,547)

The Company has a working capital ratio of 3.6 as of June 30, 2017 as compared to 5.5 as of June 30, 2016 due to the reclassification of the line of credit of \$9.9 million from long-term to short-term. The reclassification of the line of credit to short-term is required as the agreement expires in April 2018, which is less than twelve months. Cash, accounts receivable and inventories represent 94% and 91% of current assets in fiscal 2017 and fiscal 2016, respectively. The Company had accounts receivable turnover of 6.4 in fiscal 2017 and 5.6 in fiscal 2016 and an inventory turnover ratio of 2.5 in fiscal 2017 and 2.7 in fiscal 2016.

Net cash provided by operations of \$2.9 million in fiscal 2017 was principally due to the add back of non-cash depreciation and amortization plus reduced accounts receivable more than offsetting increases in inventory and pension funding.

The Company posted a \$5.2 million cash flow deficit in fiscal 2017 as \$2.9 million provided by operations was offset by \$3.8 million in investing, \$3.9 million in financing and \$0.3 million in currency cash translation.

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 the Company has maintained a \$23.0 million line of credit, of which, \$0.9 million is reserved for letters of credit and \$9.9 million was outstanding as of June 30, 2017.

The Company amended its Loan and Security Agreement, which includes a Line of Credit and a Term Loan, in January 2015 with changes that took effect on April 25, 2015. Borrowings under the Line of Credit may not exceed \$23.0 million. The agreement expires on April 30, 2018 and has an interest rate of LIBOR plus 1.5%. As of June 30, 2017, \$9.9 million was outstanding on the Line of Credit.

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.

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. The financial covenants of the amended Loan and Security Agreement are: 1) funded debt to EBITDA, excluding non-cash and retirement benefit expenses (“maximum leverage”), not to exceed 2.25 to 1.0, 2) annual capital expenditures not to exceed \$15.0 million, 3) maintain a Debt Service Coverage Rate of a minimum of 1.25 to 1.0 and 4) maintain consolidated cash plus liquid investments of not less than \$10.0 million at any time. 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, 2017, the Company was in compliance with all 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. Note 2 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 and goodwill impairment; as well as 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 accounts 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.

The allowance for doubtful accounts of \$0.9 million at the end of both fiscal 2017 and 2016 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. The Company establishes 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 salvage 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. In fiscal 2016 the Company determined that the carrying value of a building exceeded its fair value. Consequently, the Company recorded an impairment loss of \$4.1 million, which represents the excess of the carrying value of a building over its fair value. See also Impairment of Assets and Restructuring Costs (Note 9 to the Consolidated Financial Statements.)

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 cost and included in costs of goods sold upon sale. Depreciation of equipment used for office and administrative functions is an expense included 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.



