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With New Methodologies and Systems of Metrics in Place, the New Management Team has Completed the Turnaround of Sparton Corporation Achieving a Debt/Equity Ratio of Less Than 3% with \$30 Million in Cash on its Balance Sheet

**Technology
Diversified Electronics
(SPA-NYSE)**

Sparton Corporation

**425 North Martingale Road
Suite 2050
Schaumburg, IL 60173-2213
Phone: 800-772-7866**



**Cary Wood
President and CEO**

BIO:

Cary B. Wood is president and chief executive officer of Sparton Corporation, a full service developer, designer, and manufacturer of complex and sophisticated electromechanical devices with a leadership position in the defense and medical sectors. Under his leadership, Sparton began a disciplined turnaround in November 2008 and returned to profitability during fiscal 2010. With the turnaround essentially complete, Mr. Wood is now driving Sparton's growth strategy - beginning with the recent acquisitions of Delphi Medical Systems and Byers Peak.

Mr. Wood has over 20 years experience in both public and private com-

pany settings and began his career with General Motors, spending nearly 10 years there. United Technologies recruited him to initially serve as a plant manager and then, ultimately, as general manager with full profit and loss responsibility. He executed an operating turnaround in a division that included stamping, molding, assembly and distribution operations.

In the private company sector, Mr. Wood has worked with companies such as Formica Corporation and Elkay Manufacturing and has led closures, consolidations, divestitures, merger and acquisition integration efforts, and Greenfield site development as well as lean deployment, Six Sigma and the implementation of growth strategies. He joined Citation Corporation in late 2004 as the Chief Operating Officer and oversaw the company's financial and operational reorganization. Because of that reorganization effort, the balance sheet was substantially deleveraged, cash management and working capital was significantly improved, capacity utilization improved, and the management team was upgraded. Additionally, the corporation achieved growth in spite of market contractions.

Company Profile:

Sparton Corporation (NYSE: SPA) is a provider of complex and sophisticated medical devices and instrumentation, anti-submarine warfare technology, and other electronic related products to leading edge companies in diverse markets. The Company breaks out its operations into three reporting segments: Medical Devices, Defense & Security Systems, and Electronic Manufacturing Services

(EMS). Headquartered in Schaumburg, IL, the company started in 1900 and offers its customers development, design, manufacturing, and distribution capabilities in a highly collaborative environment.

**Interview conducted by:
Lynn Fosse, Senior Editor
CEOCFOinterviews.com**

CEOCFO: Mr. Wood, what attracted you to Sparton?

Mr. Wood: That is an interesting question. I was working for a long time with a company as their interim-CEO prior to taking this job. A firm representing the Sparton board approached me, as they were frustrated with the company's preceding three to four years of poor performance. After spending a little time understanding what precipitated the issues, I became comfortable that the company was a good fit for my expertise and skill set, as well as my own professional interests. I then spent some time acquainting myself with Sparton by facilitating my own level of direct and indirect due diligence. By the time I was finished, I had spent several weeks, even months, looking at the opportunity. I modeled what I felt the plan to fix it was and the opportunity to join Sparton became even more compelling. I approached this no differently than any other kind of M&A due diligence activity you walk into, clearly saw the path to righting this company, and felt very comfortable that it was doable. From there, I just jumped in the deep end of the pool and started swimming.

CEOCFO: How has Sparton changed under your leadership?

Mr. Wood: Transformed...and I do not like to credit it solely to my leadership because there have been so many people involved in this company's transformation. However, it is not lost on me that the leadership as a whole has changed and it has left an indelible mark on the company. We are far more cognizant of the company's financials and introduced a great many methodologies that are more contemporary including metrics across all functions. We have contemporized the company's operations by having gone from a traditional setting to one that puts to work tools such as lean deployment and Six Sigma, quality at the source, process capability, and other contemporary best practices. We have essentially gutted and synergized the company's go-to-market branding and business development efforts and that is all starting to build some momentum, from top to bottom and side to side. We have approached every functional area and have almost started over. As I look around at the leadership team, middle management, and even the folks that work on the floor every day, many either have turned over or are brand new to the company in the last few years. Interestingly, in our corporate office, I am one of the higher seniority folks at a little more than two years.

CEOCFO: What is Sparton all about today?

Mr. Wood: We are a contract manufacturer of electromechanical devices. That is the general description or types of products that we design and manufacture for our customers. Although the electromechanical device market is broad, we are predominantly involved in four spaces: medical, defense (particularly in Anti-Submarine Warfare), Aerospace, and Industrial. As a public company, we have segmented ourselves into three distinct financial and operational

segments: Medical, Defense & Security, and Complex Systems.

Starting with the Medical segment, we manufacture products on behalf of a number of partners needing our help to bring their idea to market. We work with them in the early phases to materialize concepts using our engineering and manufacturing resources to bring their ideas to reality. We also have the capability to test their products in an environment using live specimens to ensure the product is ready for the end user. Some of our customers are

There is an important piece to add to this discussion and that is this company had almost gone into bankruptcy, as it was facing serious liquidity issues in late 2008. However, we turned the corner, paid down all of the debt and extracted every bit of working capital we could out of the company, transforming it to cash to invest in the restructuring. We now have a debt/equity ratio of less than 3% and almost had \$30 million of cash on hand as of our last quarter end. Because of these actions, Sparton is able to move forward in the way of new business development, internal research and development, and mergers and acquisitions... We have a bit of a handicap when it comes to our organic growth efforts, but that is starting to be behind us now. More importantly, our operating performance, our pricing, the breadth of our capabilities, and the rebranding of the company has certainly turned many heads and, generally, folks are starting to realize we are somebody to join as opposed to avoid. - Cary Wood

better suited and positioned to focus their resources on marketing, product development, and distribution and not on manufacturing - which is our area of expertise.

We are clearly a leader in Defense, primarily in the area of Anti-Submarine Warfare, as we are one of only a handful of sonobuoy providers globally and the only U.S.-owned organization that produces this proprietary product. The U.S. Navy highly depends upon these products to be used out in front of every fleet to make sure of a safe arrival to port as well as to passively or actively moni-

tor the waters for submarines or other underwater threats.

Our last business segment is Complex Systems. We provide engineering and manufacturing support in a number of aerospace and industrial applications from heads-up displays, instrumentation, cargo-hold electronics, and fuel systems, to name a few. Our research has shown that these markets are in the early stages of outsourcing, so we certainly believe that they play well to our future. We have certain niche capabilities as well as having secured facility designations that differentiate us from our competition. These are highly regulated spaces based on defense related restrictions or with the FDA. Further, we have contemporized every bit of our operations allowing us to provide solutions to our customers faster and cheaper than our competition by utilizing our rapid prototyping, engineering, and low cost country capabilities, to name a few.

CEOCFO: Given Sparton's long history, do most of your customers come to you or do you still have to beat the drum and go out and find them?

Mr. Wood: I would be surprised if there was a company out there that is able to sit on its hands and not pursue customers. By definition, we are a contract

manufacturer, which means that our business generally ebbs and flows. We have to consider that when it comes to our mission of continued profitable growth on a year over year basis. Generally, we are comfortable with many of our partnerships as we do have longstanding, loyal customers. However, given our growth ambitions, which are different today from the company's previous 111 years, we are aggressively out there pursuing new sectors, new customers, and new opportunities. We are reintroducing who we are in a way that some of them have never seen us and we expect that it is going to lead to signifi-

cant organic growth.

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CEOCFO: Would you tell us about the Delphi Medical System's acquisition and what other acquisitions may be in the future?

Mr. Wood: We are certainly pleased with this acquisition. It was not Delphi's core business and I do not think it played to their strengths. Delphi, having its own liquidity issues over the past few years, certainly put the medical device segment of a predominantly automotive company on the back burner. You could see that in the way it was operating and our view was that by managing it differently, by embracing the same contemporary methods we used for the Sparton turnaround, it would be a great addition. Within one hundred days, we closed and consolidated the Delphi operation, went through a significant

head-count reduction to concentrate on improving the facility's efficiencies, and started to talk to customers about expanding opportunities to serve them better. In addition, within 5 months after we closed on buying the business, it went from being a break-even enterprise to one of the most profitable facilities in our company's portfolio. It is surprising just how quickly its performance has improved, so we are very pleased with it.

We have other opportunities and recently announced that we acquired Byers Peak, which is a small medical device manufacturer located close to our Delphi acquisition. We have publicly disclosed that we have purchased the contracts and other certain assets and it is our plan to fold it into the former Delphi location. This will add additional revenue without having to carry over the fixed overhead and, generally, we expect even better things to come from the combined entity once it's integrated into the Delphi facility.

As far as what else we have on tap, we have a three-legged stool to our growth ambitions – new business development, investing in internal research and development, and M&A. I talked a bit about our organic growth and the new business development effort earlier, but we have not had a chance yet to talk about what it is we are doing in the way of product line extensions. We are making investment on internal R&D opportunities by taking advantage of our internally developed intellectual property in ways that we have not applied them before in existing and new markets. The third leg of that stool is M&A and we are certainly ambitious. We have the debt capacity with a certain amount of cash available and there are many opportunities to evaluate. In addition, the flow of M&A opportunities has substantially improved and the credit market is going to lend itself well to companies with circumstances like ours. We have a willing and interested Board of Directors and we are well suited for opportunities that could range in size from a Byers Peak to a Delphi, if not larger. We have certainly expressed that we have a long-term ambition by 2015 to take this

company to a \$500 million top-line organization and M&A is very much a part of the way to get there from here.

CEOCFO: Do you see a consolidation in the industry, and do you see more opportunity because of the current and recent financial situation?

Mr. Wood: I do see opportunities for consolidation. We have done a good job understanding the markets that we serve. We have come to conclude that there is a degree of fragmentation that could become part of an industry roll-up. We do understand that along with that fragmentation, there are a lot of smaller organizations that probably went through one of the more turbulent economic times, which has a lot of them now stepping back from what would at one point been viewed as the abyss. They may be asking themselves, "Do I have it in me to go through another cycle and survive that, or do I want to start to evaluate what the opportunities that partnering with somebody like Sparton might bring me personally from a financial or professional perspective?" We see that probably more now than I have ever seen it before in my professional career. Therefore, there are a great number of potential opportunities for Sparton out there. However, the right opportunity is very difficult to find and we are certainly not going to get involved in paying a premium for organizations. We like the idea of finding organizations that synergize and finding all the right ingredients for a good deal is easier said than done. The economic times of the past several years have lent themselves well to interested parties in the way of divesting that leaves opportunities for us to buy. We are just going to have to hold out for the next year or two to find out how all that plays out.

CEOCFO: Would you tell me about the R&D and where you see great opportunities in newer areas?

Mr. Wood: We have disclosed in a variety of venues, particularly in our quarterly financial analyst calls that we are investing in a way that this company has never invested in its 111 year history. We have appropriated up to about one percentage point of our company's annual revenue in new product development efforts. At

one time, we were looking at five different distinct products within our company's portfolio that could be extended to applications and markets beyond where they are used today. A good example is that the company owns the outright intellectual property on a digital compass that is a component in our sonobuoy, one of our Anti-Submarine Warfare devices. It is a multi-access compass with many capabilities and we are providing a considerable amount of investment to repackage it to increase its durability and accuracy in a way that it will not be rivaled by any other product at the moment. We are in conversations with potential end users, particularly in the defense arena, that we can ultimately provide the product to new customers we have not even thought of working with before now. Sparton has cash availability and it has to find the proper uses of it to advance shareholder value, and, if not as a growth investment, it certainly begs the question of things like dividends or stock buy-backs. We think the better use of the cash today is in product line extensions, M&A activity, and organic growth endeavors - and that is where we are certainly focused.

CEOCFO: Sparton has facilities worldwide; where is your manufacturing located, and do you see the need for additional facilities?

Mr. Wood: We have reduced our footprint down significantly in the last 18 months. We have cut out about a third of the company's overall operating footprint by closing down older facilities in Canada and the United States. We currently have four facilities in the U.S. and we have one more in Southeast Asia, specifically in Ho Chi Min City, Viet Nam. All of them are utilized better today than what they were two years ago, but we have not run up against full capacity issue yet. Therefore, considering additional capacity is not something that is a near-term action, but we continuing to look for ways to maximize our

existing footprint fully. In addition to our facility in Viet Nam, our manufacturing locations in the U.S. are located near the major cities of Cleveland, Orlando, Tampa, and Denver.

CEOCFO: Is having facilities in the U.S. a factor for your customers?

Mr. Wood: In the primary markets we serve, the answer is yes - without a doubt. The fact that we are in defense products and the majority of the technology you are dealing with cannot be produced anywhere other than within the U.S. is certainly a barrier to producing it offshore. Medical device manufacturing is not exactly the same, but similar in the way that it is regulated by the FDA. The FDA is not interested in regulating medical device production in offshore facilities as it brings about a degree of complexity that we do not even have to discuss. Sparton's employees are very professional and capable of effectively servicing these highly regulated environments - whether it is ITAR in the defense industry, the FDA in the medical device industry, or other regulatory environments and/or requirements within the electromechanical device design and manufacturing spectrum. These regulated markets present opportunities for us to continue to effectively and affordably produce domestically and that is why we have paid attention them.

CEOCFO: In closing, why should potential investors pay attention to Sparton?

Mr. Wood: I have spoken to about 1,000 funds over the course of the last 18 months and I have personally had face-to-face meetings with over 100 of them. I always take a degree of pride in meeting with a fund for the second time when the first thing that comes out of their mouth is woulda, coulda, shoulda. Sparton's stock and market cap has more than doubled in the last year and a half and it had almost quadrupled since the prior year. That kind of movement and market

cap comes from only one thing - the company's operating performance, its improved balance sheet, and its guidance about where the company is strategically expecting to be headed in the next several years. We have had those discussions with all those various funds and explained the fact that we have a \$500 million top line ambition and it does not take much to figure out what that translates to in the way of compounded annual growth objectives. We have given some level of expectation about what we plan to do with the company's earnings as well as some guidance on the company's debt to equity ambitions, which is almost nothing today. Many of our benchmarks are well above the 1 to 1 ratio and we do not believe that even over the course of the next five years, we will have to take it up to that level. In addition, a great many of our comparatives are trading at up to 16 times earnings and we are trading currently at 7 to 9 times earnings. Therefore, if you stand back and you objectively look at where we are from an investor's perspective, it appears as though we are undervalued while performing better as compared to many of our peers. As an electromechanical device manufacturer, we have a number of unique capabilities to offer our customers coupled with a very strong management team that has turned around the company. The balance sheet has been wiped clean giving us an opportunity to grow which all translates into an opportunity that, if I were an investor, I would grab onto as quickly as I could and I personally have, as have my management team. That being said, it is important to note that a third of our investor base is new to Sparton over the course of the proceeding twelve months and they have been very pleased with our vision, the ability to quickly execute on our plans, and the return on their investment.



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