TESSCO TECHNOLOGIES INC
Form 10-Q
November 08, 2012
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended September 30, 2012

or

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

For the transition period from to

Commission File Number: 0-24746
TESSCO Technologies Incorporated
(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	52-0729657 (I.R.S Employer Identification No.)
11126 McCormick Road, Hunt Valley, Maryland (Address of principal executive offices)	21031 (Zip Code)

(410) 229-1000
(Registrant's telephone number, including area code)

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 þ No ¨

Indicate by check mark whether the registrant submitted electronically and posted on its corporate Website, 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 þ No ¨

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

Large accelerated filer ¨	Accelerated filer þ
Non-accelerated filer ¨	Smaller reporting company ¨

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

The number of shares of the registrant's Common Stock, $0.01 par value per share, outstanding as of October 29, 2012, was 8,037,654.

TESSCO Technologies Incorporated

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements.

TESSCO Technologies Incorporated
Consolidated Balance Sheets

	September 30, 2012 (unaudited)	April 1, 2012
ASSETS		
Current assets:		
Cash and cash equivalents	$ 16,985,900	$ 18,211,600
Trade accounts receivable, net	93,744,500	88,748,200
Product inventory, net	76,289,800	53,360,300
Deferred tax assets	3,135,100	3,135,100
Prepaid expenses and other current assets	4,149,600	2,308,200
Total current assets	194,304,900	165,763,400
Property and equipment, net	22,999,100	22,905,700
Goodwill, net	11,684,700	11,684,700
Other long-term assets	2,095,200	2,143,900
Total assets	$ 231,083,900	$ 202,497,700
LIABILITIES AND SHAREHOLDERS’ EQUITY		
Current liabilities:		
Trade accounts payable	$ 108,433,000	$ 78,344,700
Payroll, benefits and taxes	8,467,600	17,211,600
Income and sales tax liabilities	2,253,400	3,137,000
Accrued expenses and other current liabilities	1,000,500	1,041,100
Current portion of long-term debt	249,200	249,200
Total current liabilities	120,403,700	99,983,600
Deferred tax liabilities	2,243,500	2,243,500
Long-term debt, net of current portion	2,583,500	2,708,000
	3,894,100	3,910,700

Other long-term liabilities				
Total liabilities		129,124,800		108,845,800
Commitments and Contingencies				
Shareholders’ equity:				
Preferred stock, $0.01 par value, 500,000 shares authorized and no shares issued and outstanding		--		--
Common stock $0.01 par value, 15,000,000 shares authorized, 13,298,264 shares issued and 7,940,277 shares outstanding as of September 30, 2012, and 13,017,172 shares issued and 7,744,528 shares outstanding as of April 1, 2012		91,000		88,000
Additional paid-in capital		48,653,100		45,135,900
Treasury stock, at cost, shares 5,357,987 outstanding as of September 30, 2012 and 5,272,644 shares outstanding as of April 1, 2012		(48,075,400)		(46,276,400)
Retained earnings		101,290,400		94,704,400
Total shareholders’ equity		101,959,100		93,651,900
Total liabilities and shareholders’ equity	$	231,083,900	$	202,497,700

See accompanying notes.

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TESSCO Technologies Incorporated
Unaudited Consolidated Statements of Comprehensive Income

	Fiscal Quarters Ended		Six Months Ended	
	September 30, 2012	September 25, 2011	September 30, 2012	September 25, 2011
Revenues	$ 197,238,300	$ 148,837,400	$ 389,656,500	$ 312,352,400
Cost of goods sold	158,613,300	114,847,500	315,538,300	241,162,100
Gross profit	38,625,000	33,989,900	74,118,200	71,190,300
Selling, general and administrative expenses	29,887,000	28,159,900	58,449,400	57,835,000
Income from operations	8,738,000	5,830,000	15,668,800	13,355,300
Interest, net	12,000	72,900	69,400	178,400
Income before provision for income taxes	8,726,000	5,757,100	15,599,400	13,176,900
Provision for income taxes	3,457,100	2,216,900	6,124,000	5,062,500
Net income	$ 5,268,900	$ 3,540,200	$ 9,475,400	$ 8,114,400
Basic earnings per share	$ 0.66	$ 0.46	$ 1.19	$ 1.05
Diluted earnings per share	$ 0.64	$ 0.44	$ 1.15	$ 1.01
Cash dividends declared per common share	$ 0.18	$ 0.15	$ 0.36	$ 0.25
Comprehensive income	$ 5,268,900	$ 3,543,300	$ 9,475,400	$ 8,139,000

See accompanying notes.

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TESSCO Technologies Incorporated
Unaudited Consolidated Statements of Cash Flows

	Six Months Ended September 30, 2012	Six Months Ended September 25, 2011
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 9,475,400	$ 8,114,400
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	2,495,100	2,330,700
Non-cash stock-based compensation expense	1,102,700	1,522,700
Deferred income taxes and other	(16,500)	366,900
Change in trade accounts receivable	(4,996,300)	(5,487,000)
Change in product inventory	(22,929,500)	(10,955,900)
Change in prepaid expenses and other current assets	(1,841,400)	(454,000)
Change in trade accounts payable	30,088,300	12,841,600
Change in payroll, benefits and taxes	(8,744,000)	2,292,600
Change in income and sales tax liabilities	(883,600)	(690,700)
Change in accrued expenses and other current liabilities	145,800	(50,900)
Net cash provided by operating activities	3,896,000	9,830,400
CASH FLOWS FROM INVENSTING ACTIVITIES		
Purchases of property and equipment	(2,539,800)	(2,448,500)
Net cash used in investing activities	(2,539,800)	(2,448,500)
CASHFLOWS FROM FINANCING ACTIVITIES		
Payments on long-term debt	(124,500)	(199,500)
Proceeds from issuance of common stock	90,900	211,100
Cash dividends paid	(2,889,500)	(1,939,300)
Purchases of treasury stock and repurchases of common stock from employees and directors for minimum tax withholdings	(1,799,000)	(655,700)
Excess tax benefit from stock-based compensation	2,140,200	471,600
Net cash used in financing activities	(2,581,900)	(2,111,800)
Net (decrease) increase in cash and cash equivalents	(1,225,700)	5,270,100
CASH AND CASH EQUIVALENTS, beginning of period	18,211,600	8,178,200
CASH AND CASH EQUIVALENTS, end of period	$ 16,985,900	$ 13,448,300

See accompanying notes.

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TESSCO Technologies Incorporated
Notes to Unaudited Consolidated Financial Statements

Note 1. Description of Business and Basis of Presentation

TESSCO Technologies Incorporated, a Delaware corporation (TESSCO, we, or the Company), architects and delivers innovative product and value chain solutions to support wireless broadband systems. The Company provides marketing and sales services, knowledge and supply chain management, product-solution delivery and control systems utilizing extensive Internet and information technology. Approximately 98% of the Company’s sales are made to customers in the United States. The Company takes orders in several ways, including phone, fax, online and through electronic data interchange. Over 99% of the Company’s sales are made in United States Dollars.

In management’s opinion, the accompanying interim consolidated financial statements of the Company include all adjustments, consisting only of normal, recurring adjustments, necessary for a fair presentation of the Company’s financial position for the interim periods presented. These statements are presented in accordance with the rules and regulations of the United States Securities and Exchange Commission (“SEC”). Certain information and footnote disclosures normally included in the Company’s annual financial statements have been omitted from these statements, as permitted under the applicable rules and regulations. The results of operations presented in the accompanying interim consolidated financial statements are not necessarily representative of operations for an entire year. The information included in this Form 10-Q should be read in conjunction with the consolidated financial statements and notes thereto included in the Company’s Annual Report on Form 10-K for the fiscal year ended April 1, 2012.

Note 2. Recently Issued Accounting Pronouncements

In September 2011, the FASB issued an accounting standard which simplifies how entities test goodwill for impairment. This guidance was extended to other indefinite lived intangible assets in July 2012. The accounting standard permits an entity to first assess qualitative factors to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying amount as a basis for determining whether it is necessary to perform the two-step goodwill impairment test. The accounting standard was effective for the Company beginning April 2, 2012 for goodwill and September 15, 2012 for other indefinite lived intangible assets. The adoption of this guidance did not have a material impact on its consolidated financial position, results of operations or cash flows.

In June 2011, the FASB issued accounting guidance related to the presentation of comprehensive income which requires an entity to present the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements and eliminates the option to present the components of other comprehensive income as part of the statement of equity. This guidance was amended in December 2011 to defer the requirements that companies present reclassification adjustments out of accumulated other comprehensive income on the face of the financial statements. This guidance was effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2011. While the adoption of this guidance impacted the Company’s disclosures, it did not have an impact on the Company’s results of operations or financial condition.

Note 3. Stock-Based Compensation

The Company’s selling, general and administrative expenses for the fiscal quarter and six months ended September 30, 2012 includes $764,900 and $1,102,700, respectively, of non-cash stock-based compensation expense. The Company’s selling, general and administrative expenses for the fiscal quarter and six months ended September 25, 2011 includes $701,400 and $1,522,700, respectively, of non-cash stock-based compensation expense. Stock-based compensation expense is primarily related to our Performance Stock Unit (PSU) Program. In addition, the Company recorded an excess tax benefit directly to shareholders’ equity of $2,140,200 and $471,600, primarily related to the PSUs which vested during the six months ended September 30, 2012 and September 25, 2011, respectively.

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Performance Stock Units: The following table summarizes the activity under the Company's PSU program for the first six months of fiscal 2013:

	Six Months Ended September 30, 2012	Weighted Average Fair Value at Grant Date
Unvested shares available for issue under outstanding PSUs, beginning of period	604,844	$ 9.81
Granted	151,200	19.30
Vested	(258,186)	8.87
Forfeited/cancelled	(2,800)	10.89
Unvested shares available for issue under outstanding PSUs, end of period	495,058	$ 13.19

Of the 495,058 shares available for issuance under outstanding PSUs but not yet vested as of September 30, 2012, 343,858 shares have been earned, and assuming the respective participants remain employed by or associated with the Company on these dates, the shares earned in respect of each measurement year will vest and be issued in installments beginning on or about May 1 of the year following the applicable measurement year and continuing on or about May 1 of each of the three immediately following years.

The PSUs cancelled during fiscal 2013 related to the fiscal 2012 grant of PSUs, which had a 1-year measurement period (fiscal 2012). The PSUs were cancelled because the applicable fiscal 2012 performance targets were not fully satisfied. Per the provisions of the 1994 Plan, the shares related to these forfeited and cancelled PSUs were added back to the 1994 Plan and became available for future issuance.

During fiscal 2013, the Compensation Committee of the Board of Directors, with the concurrence of the full Board of Directors, granted additional PSUs to select key employees, providing them with the opportunity to earn up to 151,200 additional shares of the Company's common stock in the aggregate, depending upon whether certain threshold or goal earnings per share targets are met, and subject to individual performance. These PSUs have one measurement year (fiscal 2013), with any shares earned at the end of fiscal 2013 to vest and be issued ratably on or about May 1 of each of 2013, 2014, 2015 and 2016, provided that the respective participants remain employed by the Company on each such date.

If the maximum number of PSUs granted in fiscal 2013 is assumed to be earned, total unrecognized compensation costs, on these and all earned but unvested PSU's would be approximately $3.5 million, net of estimated forfeitures, as of September 30, 2012, and would be expensed through fiscal 2016. To the extent the actual forfeiture rate is different from what is anticipated, stock-based compensation related to these awards will be different from the Company's expectations.

Restricted Stock: In fiscal 2007, the Company granted 225,000 shares of the Company's common stock to its Chairman and Chief Executive Officer as a restricted stock award under the 1994 Plan. These shares are issued and vest (subject to the risk of forfeiture) ratably over ten fiscal years based on service, beginning on the last day of fiscal 2007 and ending on the last day of fiscal 2016, subject, however, to the terms applicable to the award, including terms providing for possible acceleration of vesting upon death, disability, change in control or certain other events. The fair value for these shares at the grant date was $10.56. As of September 30, 2012, 90,000 shares remained unvested, and there was no activity related to these restricted shares during the first six months of fiscal 2013. As of September 30, 2012, there was approximately $0.8 million of total unrecognized compensation costs, net of estimated forfeitures, related to this issuance of restricted stock. Unrecognized compensation costs are expected to be recognized ratably over a remaining period of approximately four years.

On April 25, 2011 an aggregate of 36,000, and on May 3, 2012 an aggregate of 20,100, restricted stock awards were granted to the non-employee directors of the Company. These awards provide for the issuance of shares of the Company's common stock in accordance with a four year annual vesting schedule, provided that the director remains associated with the Company (or meets other criteria as prescribed in the applicable award agreement) on each such date. As of September 30, 2012, there was approximately $0.6 million of total unrecognized compensation cost, net of estimated forfeitures, related to the issuance of these restricted stock awards.

PSUs and RSUs are expensed based on the grant date fair value, calculated as the closing price of TESSCO common stock as reported by NASDAQ on the date of grant minus the present value of dividends expected to be paid on the common stock before the award vests, because dividends or dividend-equivalent amounts do not accrue and are not paid on unvested PSUs and RSUs.

To the extent the actual forfeiture rates are different from what is estimated, stock-based compensation related to the restricted awards will be different from the Company's expectations.

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Note 4. Fair Value of Financial Instruments

The Company complies with the FASB standard regarding fair value measurement and disclosure requirements for assets and liabilities carried at fair value. Accordingly, assets and liabilities carried at fair value are classified and disclosed in one of the following three categories:

- Level 1: Quoted prices (unadjusted) in active markets for identical assets or liabilities.
- Level 2: Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly. These include quoted prices for similar assets or liabilities in active markets, and quoted prices for identical or similar assets or liabilities in markets that are not active.
- Level 3: Unobservable inputs for the asset or liability that reflect the reporting entity's own assumptions about the inputs used in pricing the asset or liability.

The Company had no assets and liabilities recorded at fair value as of September 30, 2012 or as of April 1, 2012.

The carrying amounts of cash and cash equivalents, trade accounts receivable, product inventory, trade accounts payable, accrued expenses and other current liabilities approximate their fair values as of September 30, 2012 and April 1, 2012 due to their short term nature.

Fair value of long term debt is calculated using current market interest rates and future principal payments, as of September 30, 2012 and April 1, 2012 is estimated as follows:

	September 30, 2012		April 1, 2012	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Note payable to a bank	$ 2,662,600	$ 2,440,000	$ 2,775,000	$ 2,517,000
Note payable to Baltimore County	$ 170,100	$ 155,300	$ 182,200	$ 165,000

Note 5. Income Taxes

As of September 30, 2012, the Company has a gross amount of unrecognized tax benefits of $980,600, and if the Company were to prevail on all uncertain tax positions, the net effect would be a benefit to the Company's effective tax rate of $662,600.

A reconciliation of the changes in the gross balance of unrecognized tax benefits is as follows:

Beginning balance at April 1, 2012 of unrecognized tax benefit	$ 895,300
Increases related to prior period tax positions	35,000
Increases related to current period tax positions	50,300
Ending balance at September 30, 2012 of unrecognized tax benefits	$ 980,600

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Note 6. Earnings Per Share

The Company calculates earnings per share considering the FASB standard regarding accounting for participating securities, which requires the Company to use the two-class method to calculate earnings per share. Under the two-class method, earnings per common share is computed by dividing the sum of the distributed earnings to common shareholders and undistributed earnings allocated to common shareholders by the weighted average number of common shares outstanding for the period. In applying the two-class method, undistributed earnings are allocated to both common shares and participating securities based on the weighted average shares outstanding during the period.

The following table presents the calculation of basic and diluted earnings per common share (in thousands, except per share amounts):

Amounts in thousands, expect per share amounts	Fiscal Quarter Ended		Six Months Ended	
	September 30, 2012	September 25, 2011	September 30, 2012	September 25, 2011
Earnings per share – Basic:				
Net earnings	$ 5,269	$ 3,540	$ 9,475	$ 8,114
Less: Distributed and undistributed earnings allocated to nonvested stock	(59)	(51)	(106)	(118)
Earnings available to common shareholders – Basic	$ 5,210	$ 3,489	$ 9,369	$ 7,996
Weighted average common shares outstanding – Basic	7,935	7,640	7,901	7,609
Earnings per common share – Basic	$ 0.66	$ 0.46	$ 1.19	$ 1.05
Earnings per share – Diluted:				
Net earnings	$ 5,269	$ 3,540	$ 9,475	$ 8,114
Less: Distributed and undistributed earnings allocated to nonvested stock	(58)	(50)	(88)	(103)
Earnings available to common shareholders – Diluted	$ 5,211	$ 3,490	$ 9,387	$ 8,011
Weighted average common shares outstanding – Basic	7,935	7,640	7,901	7,609
Effect of dilutive options	228	302	256	298
Weighted average common shares outstanding – Diluted	8,163	7,942	8,157	7,907
Earnings per common share – Diluted	$ 0.64	$ 0.44	$ 1.15	$ 1.01
Anti-dilutive equity awards not included above	--	--	--	--

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Note 7. Business Segments

Since the beginning of the second quarter of fiscal 2012, the Company has evaluated its business in two segments – commercial and retail. The commercial segment includes: (1) public carriers, contractors and program managers that are generally responsible for building and maintaining the infrastructure system and provide airtime service to individual subscribers; (2) private system operators and governments including commercial entities such as major utilities and transportation companies, federal agencies and state and local governments that run wireless networks for their own use; and (3) commercial dealers and resellers that sell, install and/or service cellular telephone, wireless networking, broadband and two-way radio communications equipment primarily for the enterprise market. The retail segment includes: (1) retailers, dealer agents and Tier 2 and 3 carriers; and (2) Tier 1 carriers (including the Company's largest customer, AT&T Mobility, Inc.).

The Company evaluates revenue, gross profit and net profit contribution for each of its segments. Net profit contribution is defined as gross profit less any expenses that can be directly attributed or allocated to each segment. This includes sales, product management, purchasing, credit and collections and distribution team expenses, plus freight out and internal and external marketing costs. Corporate support expenses, which are not allocated to each segment, includes administrative costs – finance, human resources, information technology, operating facility occupancy expenses, depreciation, amortization and interest, plus the company-wide pay on performance bonus expense.

The Company does not segregate assets by segments, for internal reporting, for evaluating performance or for allocating capital. The Company has, however, allocated all goodwill and indefinite-lived intangible assets to the applicable segments (and reporting units within segments, where applicable) for purposes of its annual impairment tests. The Company's goodwill at September 30, 2012 relates to acquisitions within its commercial segment. Certain cost of sales and other applicable expenses have been allocated to each segment based on a percentage of revenues and/or gross profit, where appropriate.

Segment activity for the second quarter and first six months of fiscal years 2013 and 2012 is as follows (in thousands):

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	Three months ended September 30, 2012		
	Commercial Segment	Retail Segment	Total
Revenues			
Public carrier, contractor & program manager market	$ 25,811	$ --	$ 25,811
Private system operator & government market	34,264	--	34,264
Commercial dealer & reseller market	35,655	--	35,655
Retailer, dealer agent & Tier 2/3 carrier market	--	36,363	36,363
Revenues, excluding Tier 1 carrier market	95,730	36,363	132,093
Tier 1 carrier market	--	65,145	65,145
Total revenues	95,730	101,508	197,238
Gross Profit			
Public carrier, contractor & program manager market	5,635	--	5,635
Private system operator & government market	9,238	--	9,238
Commercial dealer & reseller market	9,801	--	9,801
Retailer, dealer agent & Tier 2/3 carrier market	--	7,569	7,569
Gross profit, excluding Tier 1 carrier market	24,674	7,569	32,243
Tier 1 carrier market	--	6,382	6,382
Total gross profit	24,674	13,951	38,625
Directly allocatable expenses	10,701	7,384	18,085
Segment net profit contribution	$ 13,973	$ 6,567	20,540
Corporate support expenses			11,814
Income before provision for income taxes			$ 8,726

	Six months ended September 30, 2012		
	Commercial Segment	Retail Segment	Total
Revenues			
Public carrier, contractor & program manager market.	$ 45,829	$ -	$ 45,829
Private carrier & government system market	63,864	-	63,864
Commercial dealer & reseller market	67,263	-	67,263
Retailer, dealer agent & tier 2/3 carrier market	-	68,005	68,005
Revenues, excluding Tier 1 carrier market	176,956	68,005	244,961
Tier 1 carrier market	-	144,696	144,696
Total revenues	176,956	212,701	389,657
Gross Profit			
Public carrier, contractor & program manager market	10,093	-	10,093
	17,391	-	17,391

Private carrier & government system market						
Commercial dealer & reseller market		18,599		-		18,599
Retailer, dealer agent & tier 2/3 carrier market		-		14,196		14,196
Gross profit, excluding tier 1 carrier market		46,083		14,196		60,279
Tier 1 carrier market		-		13,839		13,839
Total gross profit		46,083		28,035		74,118
Directly allocatable expenses		20,812		14,530		35,342
Segment net profit contribution	$	25,271	$	13,505		38,776
Corporate support expenses						23,177
Income before provision for income taxes					$	15,599

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	Three months ended September 25, 2011		
	Commercial Segment	Retail Segment	Total
Revenues			
Public carrier, contractor & program manager market	$ 20,065	$ -	$ 20,065
Private system operator & government market	31,268	-	31,268
Commercial dealer & reseller market	31,257	-	31,257
Retailer, dealer agent & Tier 2/3 carrier market	-	26,847	26,847
Revenues, excluding Tier 1 carrier market	82,590	26,847	109,437
Tier 1 carrier market	-	39,400	39,400
Total revenues	82,590	66,247	148,837
Gross Profit			
Public carrier, contractor & program manager market	4,309	-	4,309
Private system operator & government market	8,763	-	8,763
Commercial dealer & reseller market	8,962	-	8,962
Retailer, dealer agent & Tier 2/3 carrier market	-	5,911	5,911
Gross profit, excluding Tier 1 carrier market	22,034	5,911	27,945
Tier 1 carrier market	-	6,045	6,045
Total gross profit	22,034	11,956	33,990
Directly allocatable expenses	10,322	6,701	17,023
Segment net profit contribution	$ 11,712	$ 5,255	16,967
Corporate support expenses			11,210
Income before provision for income taxes			$ 5,757

	Six months ended September 25, 2011		
	Commercial Segment	Retail Segment	Total
Revenues			
Public carrier, contractor & program manager market	$ 38,231	$ -	$ 38,231
Private system operator & government market	62,541	-	62,541
Commercial dealer & reseller market			