

LSI INDUSTRIES INC  
Form 10-K  
September 08, 2017

---

---

**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**WASHINGTON, D.C. 20549**

**FORM 10-K**

**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. 0-13375**

**LSI INDUSTRIES INC.**

(Exact name of Registrant as specified in its charter)

Ohio  
(State or other jurisdiction of  
incorporation or organization)  
(513) 793-3200  
(Telephone number of principal executive offices)

10000 Alliance Road  
Cincinnati, Ohio 45242  
(Address of principal executive offices)

IRS Employer I.D.  
No. 31-0888951

Edgar Filing: LSI INDUSTRIES INC - Form 10-K

Securities Registered Pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common shares, no par value	The NASDAQ Stock Market LLC (NASDAQ Global Select Market)

Securities Registered Pursuant to Section 12(g) of the Act:

None

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 Exchange 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 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 any amendment to this Form 10-K.

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 whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or smaller reporting company or an emerging growth company. See the definitions of “large accelerated filer,” “accelerated filer,” “smaller reporting company,” and “emerging growth company” in Rule 12b-2 of the Exchange Act.

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

Emerging growth company

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

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.

As of December 31, 2016, the aggregate market value of the registrant’s common stock held by non-affiliates of the registrant was approximately \$244,069,995 based upon a closing sale price of \$9.74 per share as reported on The NASDAQ Global Select Market.

At August 27, 2017 there were 25,507,466 no par value Common Shares issued and outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Registrant’s Proxy Statement filed with the Commission for its 2017 Annual Meeting of Shareholders are incorporated by reference in Part III, as specified.

**LSI INDUSTRIES INC.  
2017 FORM 10-K ANNUAL REPORT  
TABLE OF CONTENTS**

	Begins on Page
<u>PART I</u>	
<u>ITEM 1. BUSINESS</u>	1
<u>ITEM 1A. RISK FACTORS</u>	6
<u>ITEM 1B. UNRESOLVED STAFF COMMENTS</u>	10
<u>ITEM 2. PROPERTIES</u>	10
<u>ITEM 3. LEGAL PROCEEDINGS</u>	11
<u>ITEM 4. MINE SAFETY DISCLOSURES</u>	11
<u>PART II</u>	
<u>ITEM 5. MARKET FOR REGISTRANT’S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES</u>	11
<u>ITEM 6. SELECTED FINANCIAL DATA</u>	12
<u>ITEM 7. MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS</u>	12
<u>ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK</u>	12
<u>ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA</u>	13
<u>ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE</u>	14
<u>ITEM 9A. CONTROLS AND PROCEDURES</u>	14
<u>ITEM 9B. OTHER INFORMATION</u>	14
<u>PART III</u>	
<u>ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE</u>	15

<u>ITEM 11. EXECUTIVE COMPENSATION</u>	15
<u>ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS</u>	15
<u>ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE</u>	15
<u>ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES</u>	15
<u>PART IV</u>	
<u>ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES</u>	15
<u>ITEM 16. FORM 10-K SUMMARY</u>	17

---

***“Safe Harbor” Statement under the Private Securities Litigation Reform Act of 1995***

This document contains certain forward-looking statements that are subject to numerous assumptions, risks or uncertainties. The Private Securities Litigation Reform Act of 1995 provides a safe harbor for forward-looking statements. Forward-looking statements may be identified by words such as “estimates,” “anticipates,” “projects,” “plans,” “expects,” “intends,” “believes,” “seeks,” “may,” “will,” “should” or the negative versions of those words and similar expressions and by the context in which they are used. Such statements, whether expressed or implied, are based upon current expectations of the Company and speak only as of the date made. Actual results could differ materially from those contained in or implied by such forward-looking statements as a result of a variety of risks and uncertainties over which the Company may have no control. These risks and uncertainties include, but are not limited to, the impact of competitive products and services, product demand and market acceptance risks, potential costs associated with litigation and regulatory compliance, reliance on key customers, financial difficulties experienced by customers, the cyclical and seasonal nature of our business, the adequacy of reserves and allowances for doubtful accounts, fluctuations in operating results or costs whether as a result of uncertainties inherent in tax and accounting matters or otherwise, failure of an acquisition or acquired company to achieve its plans or objectives generally, unexpected difficulties in integrating acquired businesses, the ability to retain key employees, unfavorable economic and market conditions, the results of asset impairment assessments, the ability to maintain an effective system of internal control over financial reporting, the ability to remediate any material weaknesses in internal control over financial reporting and any other risk factors that are identified herein. You are cautioned to not place undue reliance on these forward-looking statements. In addition to the factors described in this paragraph, the risk factors identified in our Form 10-K and other filings the Company may make with the SEC constitute risks and uncertainties that may affect the financial performance of the Company and are incorporated herein by reference. The Company does not undertake and hereby disclaims any duty to update any forward-looking statements to reflect subsequent events or circumstances.

---

## **PART I**

### ITEM 1. BUSINESS

#### **Our Company**

We are a customer-centric company that positions itself as a value-added, trusted partner in developing superior image solutions through our lighting, graphics, and technology capabilities. Our products and services include digital signage, printed and structural graphics, and electrical signage capabilities, a wide variety of high quality indoor and outdoor lighting products, lighting control systems, and related professional services including engineering, installation, and project management. We also provide graphics and lighting products on a stand-alone basis. Our company is the leading provider of corporate visual image solutions to the petroleum / convenience store industry. We use this leadership position to penetrate national retailers and multi-site retailers, including quick service and casual restaurants, retail chain stores and automobile dealerships, located primarily in the United States. We seek to expand our market share in the traditional commercial / industrial lighting market by combining our LED product innovation and lighting control solutions utilizing the latest technology along with a strong emphasis on high service levels and market focused solutions. Our solutions are targeted at both renovation and new construction markets. We design and develop most aspects of the solid-state LED lighting, from the electronic circuit board, to the software to drive and control the LEDs, to the structure of the LED product. We also provide a variety of lighting control solutions which allow our customers to reduce energy and maintenance costs. In addition to designing and producing printed graphics and structural graphics, we design and integrate our digital signage offering where customers are provided a turnkey solution that includes design, software, hardware content development, implementation, service and support.

We believe that national retailers and other companies in the markets we serve are increasingly seeking single-source suppliers with the project management skills and service expertise necessary to execute a comprehensive visual image program. The integration of our graphics, lighting, and technology coupled with our professional services capabilities allows our customers to outsource to us the development of an entire visual image program from the planning and design stage through installation. Our approach is to combine our lighting products and custom graphics applications utilizing the latest technology along with our professional service capabilities to create complete customer-focused visual image solutions. We also offer our lighting products and graphics elements on a stand-alone basis to service our existing image solutions customers, to establish a presence in a new market or to create a relationship with a new customer. We believe that our ability to combine lighting, graphics, and technology coupled with professional services into a comprehensive visual image solution differentiates us from our competitors who offer only stand-alone products for lighting or graphics and who lack professional services offerings. During the past several years, we have continued to enhance our ability to provide comprehensive corporate visual image solutions by adding additional graphics capabilities such as digital signage and media content management, wireless lighting control systems, new and innovative LED lighting products and professional services through acquisitions and internal development.

Our focus on product development and innovation creates products that are essential components of our customers' corporate visual image strategy. Our spending on research and development was \$5.7 million in fiscal 2017, and \$5.5 million in fiscal 2016, and \$5.6 million in fiscal 2015. We develop and manufacture lighting including solid-state LED lighting, lighting control systems, and graphics and distribute them through an extensive multi-channel distribution network that allows us to effectively service our target markets. Representative customers include BP, Chevron Texaco, ExxonMobil, Shell, Burger King, Dairy Queen, Taco Bell, Wendy's, Best Buy, CVS Caremark, Phillips 66, Target Stores, Wal-Mart Stores, Chrysler, Ford, General Motors, Nissan, Toyota, Sports Clips, AAA, Panda Express, and SunTrust Bank. We service our customers at the corporate, franchise and local levels.

We also focus on the elimination of non-value added activities throughout our organization through the LSI Business System, a Lean Management System utilizing kaizen events and lean tools to drive continuous improvement in our processes. The LSI Business System improves shareholder value by increasing customer satisfaction and eliminating waste, both of which will improve the bottom line. We are committed to this company-wide initiative through employee education and training with the ultimate goal to make it part of the corporate culture and way of thinking of all employees.



Our business is organized as follows: the Lighting Segment, which represented 72% of our fiscal 2017 net sales; the Graphics Segment, which represented 22% of our fiscal 2017 net sales; and the Technology Segment, which represented 6% of our fiscal 2017 net sales. See Note 2 of Notes to Consolidated Financial Statements beginning on page 46 of this Form 10-K for additional information on business segments. Net sales by segment are as follows (in thousands):

	2017	2016	2015
Lighting Segment	\$239,005	\$226,889	\$219,920
Graphics Segment	72,395	77,968	67,152
Technology Segment	19,992	17,339	20,744
All Other Category	--	--	41
Total Net Sales	\$331,392	\$322,196	\$307,857

### **Lighting Segment**

Our Lighting Segment manufactures and markets outdoor and indoor lighting and lighting controls for the commercial, industrial and multi-site retail markets including the petroleum / convenience store, quick-service, and automotive markets. Our products are designed and manufactured to provide maximum value and meet the high-quality, competitively-priced product requirements of the markets we serve. We generally avoid specialty or custom-designed, low-volume products for single order opportunities. Our concentration is on our high-volume, standard product lines that meet our customers' needs. By focusing our product offerings, we achieve significant manufacturing and cost efficiencies.

Our lighting fixtures, poles and brackets are produced in a variety of designs, styles and finishes. Important functional variations include types of mounting, such as pole, bracket and surface, and the nature of the light requirement, such as interior and exterior down-lighting, wall-wash lighting, canopy lighting, flood-lighting, area lighting and security lighting. Our engineering staff performs photometric analyses and wind load safety studies for all light fixtures and also designs our fixtures and lighting systems. Our lighting products utilize a variety of different light sources, with the primary light source being solid-state LED, along with high-intensity discharge and fluorescent. The major products and services offered within our lighting segment include: exterior area lighting, interior lighting, canopy lighting, landscape lighting, lighting controls, light poles, lighting system design, and photometric layouts. All of our products are designed for performance, reliability, ease of installation and service, as well as attractive appearance. The Company also has a focus on designing lighting system solutions and implementing strategies related to energy savings in substantially all markets served.

We offer our customers expertise in developing and utilizing high-performance solid-state LED solutions, which when combined with the Company's lighting fixture expertise and technology, has the potential to result in a broad spectrum of white light LED fixtures that offer equivalent or improved lighting performance with significant energy and maintenance savings as compared to the present metal halide and fluorescent lighting fixtures.

Lighting Segment net sales of \$239,005,000 in fiscal 2017 increased 5.3% from fiscal 2016 net sales of \$226,889,000. Fiscal 2017 Lighting Segment net sales include \$17.8 million of net sales of Atlas Lighting Products, which was acquired in February 2017. The Lighting Segment's net sales of light fixtures having solid-state LED technology totaled \$186.5 million in fiscal 2017 (78.0% of total lighting net sales), representing a \$31.0 million or 20.0% increase from fiscal 2016 net sales of solid-state LED light fixtures of \$155.5 million (68.5% of total Lighting net sales). The trend of a reduction in the Company's traditional lighting sales (metal halide and fluorescent light sources) continued from fiscal 2016 to fiscal 2017 as customers converted from traditional lighting to light fixtures having solid-state LED technology. The market shift from fluorescent lighting to LED lighting was the basis for management's decision to close its Kansas City facility which produced fluorescent lighting.

### **Graphics Segment**

Our Graphics Segment manufactures and sells exterior and interior visual image elements related to signage and graphics, including integrated digital signage solutions. These products are used in graphics displays and visual image programs in several markets, including the petroleum / convenience store market, quick-service restaurant, grocery, and multi-site retail operations. Our extensive lighting and graphics expertise, product offering, visual image solution implementation capabilities and other professional services represent significant competitive advantages. We work with corporations and design firms to establish and implement cost effective corporate visual image programs to advance our customer's brand. Increasingly, we have become the primary supplier of exterior and interior graphics for our customers. We also offer installation management services for those customers who require the installation of interior or exterior products (utilizing pre-qualified independent subcontractors throughout the United States).

Our business can be significantly impacted by participation in a customer's "image conversion program," especially if it were to involve a "roll out" of that new image to a significant number of that customer's and its franchisees' retail sites. The impact to our business can be very positive with growth in net sales and profitability when we are engaged in an image conversion program. This can be followed in subsequent periods by lesser amounts of business or negative comparisons following completion of an image conversion program, unless we are successful in replacing that completed business with participation in new image conversion programs of similar size with one or more customers. An image conversion program can potentially involve any or all of the following improvements, changes or refurbishments at a customer's retail site: interior or exterior lighting (see discussion above about our lighting segment), interior or exterior store signage and graphics, and installation of these products in both the prototype and roll out phases of their program.

The major products and services offered within our Graphics Segment include the following: signage and canopy graphics, pump dispenser graphics, building fascia graphics and ACM systems, electrical signage, decals, interior signage and marketing graphics, aisle markers, wall mural graphics, fleet graphics, prototype program graphics, video boards, and digital signage and media content management. Our Company also manages and executes the implementation of large rollout programs.

Graphics Segment net sales of \$72,395,000 in fiscal 2017 decreased \$5.6 million or 7.1% from fiscal 2016 net sales of \$77,968,000. The \$5.6 million decrease in Graphics Segment net sales is primarily the net result of sales to the petroleum / convenience store market (\$2.3 million net decrease), sales to the national drug store market (\$3.0 million decrease), sales to the quick-service restaurant market (\$0.5 million net increase), sales to the retail market (\$1.2 million increase), sales to the retail grocery market (\$1.5 million decrease), and changes in volume to several other markets (\$0.5 million decrease).

### **Technology Segment**

Our Technology Segment designs, engineers, and manufactures electronic circuit boards, assemblies, and lighting controls. Applications for these products include, but are not limited to, OEM, transportation, commercial, industrial, and medical markets. This segment also has significant inter-segment sales to the Lighting Segment to support that segment's customer sales of solid-state LED lighting and lighting controls.

Technology Segment net customer sales of \$19,992,000 in fiscal 2017 increased 15.3% from fiscal 2016 net sales of \$17,339,000. The \$2.7 million increase in Technology Segment net sales is primarily the net result of a \$1.7 million increase in sales to the transportation market, a \$0.8 million increase in sales to original equipment manufacturers, and a \$0.2 million net increase in sales to various other markets. The decrease in net customer sales is due to the cyclic nature of the markets the Company serves in this segment. While net customer sales increased, the Technology Segment inter-company sales of electronic circuit boards and lighting control systems to the Lighting Segment decreased \$1.8 million or 4.9%.

### **Our Competitive Strengths**

*Single Source Comprehensive Visual Image Solution Provider.* We believe that we are the only company serving our target markets that combines significant graphics capabilities, lighting products and installation implementation capabilities to create comprehensive image solutions. We believe that our position as a single-source provider creates a competitive advantage over competitors who can only address either the lighting or the graphics component of a customer's corporate visual image program. Using our broad visual image solutions capabilities, our customers can maintain complete control over the creation of their visual image programs while avoiding the added complexity of coordinating separate lighting and graphics suppliers and service providers. We can use high technology software to produce computer-generated virtual prototypes of a customer's new or improved retail site image. We believe that these capabilities are unique to our target markets and they allow our customers to make educated, cost-effective decisions quickly.

*Proven Ability to Penetrate Target Markets.* We have grown our business by establishing a leadership position in many of the markets we serve, including petroleum / convenience stores, automobile dealerships and specialty retailers. Although our relationship with our customers may begin with the need for a single product or service, we leverage our broad product and service offering to identify additional products and solutions. We promote the combination of graphics, lighting, and technology, along with image element offerings, and services to create comprehensive solutions for our customers.

*Focus on Product Innovation.* We believe that our ability to successfully identify, develop and patent new products has allowed us to expand our market opportunity and enhance our market position. Our product innovation initiatives are designed to increase the value of our product offering by addressing the needs of our customers and target markets through retrofit enhancements to existing products or the development of new products. New product development includes developing an expanding portfolio of technology patents related to the design of LED based products. We believe our product innovation process creates value for our customers by producing products that offer energy efficiency, low maintenance requirements and long-term operating performance at competitive prices based upon the latest technologies available.

*Strong Relationships with our Customers.* We have used our innovative products and high-quality services to develop close, long-standing relationships with a large number of our customers. Many of our customers are recognized among the leaders in their respective markets, including customers such as Wal-Mart, BP, Phillips 66, Exxon Mobil, Carmax, Chevron, CVS Caremark, Stop & Shop, and Burger King. Their use of our products and services raises the visibility of our capabilities and facilitates the acceptance of our products and services in their markets. Within each of these markets, our ability to be a single source provider of image solutions often creates repeat business opportunities through corporate reimaging programs. We have served some of our customers since our inception in 1976.

*Well-capitalized Balance Sheet.* As part of our long-term operating strategy, we believe the Company maintains a conservative capital structure. With a strong equity base, we are able to preserve operating flexibility in times of industry expansion and contraction. In the current business environment, a strong balance sheet demonstrates financial viability to our existing and targeted customers. In addition, a strong balance sheet enables us to invest in the company through research and development and allows the Company to invest in capital projects that support the Company's growth.

*Aggressive Use of Our Marketing Center.* The capabilities of our Image Center, Innovation Center, Inspiration Center and, I-Zone Marketing Center provide us with a distinct competitive advantage to demonstrate the effectiveness of integrating graphics, lighting, and technology into a complete corporate visual image program. These four centers, which demonstrate the depth and breadth of our product and service offerings, have become an effective component of our sales process.

*Maintain our Vertically Integrated Business Model.* We consider our Company to be a vertically integrated manufacturer rather than just a product assembler. We focus on developing lighting and graphics products coupled with technology, and outsource certain non-core processes and product components as necessary.

*Commitment to Continuous Improvement.* We are committed to a philosophy of continuous improvement through the LSI Business System, which is a Lean Management System utilizing Kaizen events and lean tools to identify and eliminate waste and increase customer satisfaction with the ultimate goal to improve shareholder value.

**Sales, Marketing and Customers**

*Sales:* Our lighting products including lighting controls, are sold primarily throughout the United States, but also in Canada, Australia, and Latin America (about 3.1% of consolidated net sales are outside the United States) using a combination of regional sales managers and independent sales representatives serving primarily the commercial / industrial market along with several of the other markets we serve. LSI has traditionally been a project based business, quoting and receiving orders as a preferred vendor for product sales to multiple end-users, including customer-owned as well as franchised and licensed dealer operations. With the recent acquisition of Atlas, we now market and sell standard product to stocking distributors, who subsequently provide product to electrical contractors and end users for a variety of lighting applications. Our graphics products, which in many instances are program-driven, are sold primarily through our own sales force. Our marketing approach and means of distribution vary by product line and by type of market.

Sales are developed through a wide variety of contacts such as, but not limited to, national retail marketers, branded product companies, franchise and dealer operations. In addition, sales are also achieved through recommendations from local architects, engineers, petroleum and electrical distributors and contractors. The Company utilizes the latest technology to track sales leads and customer quotes with the ultimate goals to turn them into orders from our customers. Our sales are partially seasonal as installation of outdoor lighting and graphic systems in the northern states decreases during the winter months.

*Marketing:* The capabilities of our Image Center, Innovation Center, Inspiration Center, and iZone Marketing Center are important parts of our sales process. These four centers, unique within the lighting and graphics industry, are facilities that can produce a computer-generated virtual prototype of a customer's facility on a large screen through the combination of high technology software and audio/visual presentation. The i-Zone marketing center is a digitally controlled facility containing a large solid-state LED video screen and several displays that showcase our LED technology and LED products. With these capabilities, our customers can instantly explore a wide variety of lighting and graphics alternatives to develop consistent day and nighttime images. These centers give our customers more options, greater control, and more effective time utilization in the development of lighting, graphics and visual image solutions, all with much less expense than traditional prototyping. In addition to being cost and time effective for our customers, we believe that the capabilities of these marketing centers contribute to the development of the best solution for our customers' needs.

The Image and iZone marketing centers also contain comprehensive indoor and outdoor product display areas that allow our customers to see many of our products and services in one setting. This aids our customers in making quick and effective lighting and graphic design decisions through hands-on product demonstrations and side-by-side comparisons. More importantly, these capabilities allow us to expand our customer's interest from just a single product into other products and solutions. We believe that the capabilities of these centers have further enhanced our position as a highly qualified outsourcing partner capable of guiding a customer through image alternatives utilizing our lighting and graphics products and services. We believe this capability distinguishes us from our competitors and will become increasingly beneficial in attracting additional customers.

In addition to the capabilities of our Image Center, Innovation Center, Inspiration Center, and iZone Marketing Center, the Company markets its products and service capabilities to end users in multiple channels through a broad spectrum of marketing and promotional methods, including direct customer contact, trade shows, on-site training, print advertising in industry publications, product brochures and other literature, as well as the internet and social media.

### **Manufacturing and Operations**

We design, engineer and manufacture substantially all of our lighting and graphics products through a vertically integrated business model. By emphasizing high-volume production of standard product lines, we achieve significant manufacturing efficiencies. We periodically invest in new machinery and equipment utilizing the latest technology in order to leverage the manufacturing efficiencies gained from our high-volume production. When appropriate, we utilize alliances with domestic and international vendors to outsource certain products and components. LED products and related software are engineered, designed and final-assembled by the Company, while a portion of the manufacturing has been performed by select qualified vendors. We are not dependent on any one supplier for any of our component parts.

The principal raw materials and purchased components used in the manufacturing of our products are steel, aluminum, aluminum castings, fabrications, LEDs, power supplies, powder paint, steel and aluminum poles, wire harnesses, acrylic and glass lenses, inks, various graphics substrates such as foam board and vinyls, and digital screens. We source these materials and components from a variety of suppliers. Although an interruption of these supplies and components could disrupt our operations, we believe generally that alternative sources of supply exist and could be readily arranged. We strive to reduce price volatility in our purchases of raw materials and components through annual contracts with strategic suppliers. The Company experienced rapid and significant material price inflation in the range of 5.0% to 6.0% in fiscal 2017 driven by increases in several key commodities. Material inflation has stabilized at these higher price levels in the first few months of fiscal 2018 and we expect these elevated levels to continue in the short term. Our Lighting operations generally carry a certain level of sub-assemblies finished goods inventory to meet quick delivery requirements. Most lighting products are made to order and shipped shortly after they are manufactured. Our Graphics operations manufacture custom graphics products for customers who require us to stock certain amounts of finished goods in exchange for their commitment to that inventory. In some Graphics programs, customers also give us a cash advance for the inventory that we stock for them. The Company's operations dealing with LED products generally carry LED and LED component inventory due to longer lead times. Our Technology Segment operations purchase electronic components from multiple suppliers and manufacture custom electronic circuit boards and lighting control systems. Most products are made to order and, as a result, these operations do not carry very many finished goods.

We currently operate out of ten manufacturing facilities in six U.S. states.

A majority of our operations received ISO 9001:2015 Certification thru ANAB (Cert# 5369-Eagle Registrations Inc.), with plans to seek additional certifications in future years. Our manufacturing operations are subject to various federal, state and local regulatory requirements relating to environmental protection and occupational health and safety. We do not expect to incur material capital expenditures with regard to these matters and believe our facilities are in compliance with such regulations.

### **Goodwill and Intangible Asset Impairment**

There was no impairment of the Company's goodwill or indefinite-lived intangible assets in fiscal 2016 or 2015. The Company recorded a \$479,000 impairment of a finite-lived intangible asset in the Graphics Segment in fiscal 2017.



## **Competition**

We experience strong competition in all segments of our business, and in all markets served by our product lines. Although we have many competitors, some of which have greater financial and other resources, we do not compete with the same companies across our entire product and service offerings. We believe product quality and performance, price, customer service, prompt delivery, and reputation to be important competitive factors. We also have several product and process patents which have been obtained in the normal course of business which provide a competitive advantage in the marketplace.

## **Additional Information**

Our sales are partially seasonal as installation of outdoor lighting and graphic systems in the northern states lessens during the harshest winter months. We had a backlog of orders, which we believe to be firm, of \$30.2 million and \$29.1 million at June 30, 2017 and 2016, respectively. All orders are expected to be shippable or installed within twelve months.

We have 1,232 full-time employees and 113 agency employees as of June 30, 2017. We offer a comprehensive compensation and benefits program to most employees, including competitive wages, a cash-based incentive plan that is based upon the achievement of the Company's business plan goals, a 401(k) retirement savings plan, a nonqualified deferred compensation plan (for certain employees), an equity compensation plan, and medical and dental insurance.

We file reports with the Securities and Exchange Commission ("SEC") on Forms 10-K, 10-Q and 8-K. You may read and copy any materials filed with the SEC at its public reference room at 100 F. Street, N.E., Room 1580, Washington, D.C. 20549. You may also obtain that information by calling the SEC at 1-800-SEC-0330. The SEC maintains an internet website that contains reports, proxy and information statements and other information regarding us. The address of that site is <http://www.sec.gov>. Our internet address is <http://www.lsi-industries.com>. We make available free of charge through our internet website our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and any amendments to those reports filed or furnished pursuant to Section 13(a) of the Securities Exchange Act of 1934, as amended, as soon as reasonably practical after we electronically file them with the SEC. LSI is not including the other information contained on its website as part of or incorporating it by reference into this Annual Report on Form 10-K.

LSI Industries Inc. is an Ohio corporation, incorporated in 1976.

ITEM 1A. RISK FACTORS

In addition to the other information set forth in this report, you should carefully consider the following factors which could materially affect our business, financial condition, cash flows or future results. Any one of these factors could cause the Company's actual results to vary materially from recent results or from anticipated future results. The risks described below are not the only risks facing our Company. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition and/or operating results.

**Lower levels of economic activity in our end markets could adversely affect our operating results.**

Our businesses operate in several market segments including, but not limited to, commercial, industrial, retail, petroleum / convenience store and automotive. Operating results can be negatively impacted by volatility in these markets. Future downturns in any of the markets we serve could adversely affect our overall sales and profitability.

**The markets in which we operate are subject to competitive pressures that could affect selling prices, and therefore could adversely affect our operating results.**

Our businesses operate in markets that are highly competitive, and we compete on the basis of price, quality, service and/or brand name across the industries and markets served. Some of our competitors for certain products, primarily in the Lighting Segment, have greater sales, assets and financial resources. Some of our competitors are based in foreign countries and have cost structures and prices in foreign currencies. Accordingly, currency fluctuations could cause our U.S. dollar-priced products to be less competitive than our competitors' products which are priced in other currencies. Competitive pressures could affect prices we charge our customers or demand for our products, which could adversely affect our operating results. Additionally, customers for our products may attempt to reduce the number of vendors from which they purchase in order to reduce the size and diversity of their inventories and their transaction costs. To remain competitive, we will need to invest continuously in research and development, manufacturing, marketing, customer service and support, and our distribution networks. We may not have sufficient resources to continue to make such investments and we may be unable to maintain our competitive position.

**Our operating results may be adversely affected by unfavorable economic, political and market conditions.**

Economic and political conditions worldwide have from time to time contributed to slowdowns in our industry at large, as well as to the specific segments and markets in which we operate. When combined with ongoing customer consolidation activity and periodic manufacturing and inventory initiatives, an uncertain macro-economic and political climate, including but not limited to the effects of possible weakness in domestic and foreign financial and credit markets, could lead to reduced demand from our customers and increased price competition for our products, increased risk of excess and obsolete inventories and uncollectible receivables, and higher overhead costs as a percentage of revenue. If the markets in which we participate experience further economic downturns, as well as a slow recovery period, this could negatively impact our sales and revenue generation, margins and operating expenses, and consequently have a material adverse effect on our business, financial condition and results of operations.

**Price increases or significant shortages of raw materials and components could adversely affect our operating margin.**

The Company purchases large quantities of raw materials and components — mainly steel, aluminum, LEDs, electronic components, light bulbs and fluorescent tubes, lighting ballasts, sockets, wire harnesses, plastic lenses, glass lenses, vinyls, inks, and corrugated cartons. Materials comprise the largest component of costs, representing approximately 60% and 58% of the cost of sales in 2017 and 2016, respectively. While we have multiple sources of supply for most of our material requirements, significant shortages could disrupt the supply of raw materials. Further significant increases in the price of these raw materials and components could further increase the Company's operating costs and materially adversely affect margins. Although the Company attempts to pass along increased costs in the form of price increases to customers, the Company may be unsuccessful in doing so for competitive reasons. Even when price increases are successful, the timing of such price increases may lag significantly behind the incurrence of higher costs. On occasion, there are selected electronic component parts and certain other parts shortages in the market place, some of which have affected the Company's manufacturing operations and shipment schedules even though multiple suppliers may be available. The lead times of these suppliers can increase and the prices of some of these parts have increased during periods of shortages.

**We have a concentration of net sales to the petroleum / convenience store market, and any substantial change in this market could have an adverse effect on our business.**

Approximately 30% of our net sales in fiscal year 2017 are concentrated in the petroleum / convenience store market. Sales to this market segment are dependent upon the general conditions prevailing in and the profitability of the petroleum and convenience store industries and general market conditions. Our petroleum market business can be subject to reactions by the petroleum industry to world political events, particularly those in the Middle East, and to the price and supply of oil. Major disruptions in the petroleum industry generally result in a curtailment of retail marketing efforts, including expansion and refurbishing of retail outlets, by the petroleum industry and adversely

affect our business. Any substantial change in purchasing decisions by one or more of our larger customers whether due to actions by our competitors, customer financial constraints, industry factors or otherwise, could have an adverse effect on our business.

**Difficulties with integrating acquisitions could adversely affect operating costs and expected benefits from those acquisitions.**

We have pursued and may continue to seek potential acquisitions to complement and expand our existing businesses, increase our revenues and profitability, and expand our markets. We cannot be certain that we will be able to identify, acquire or profitably manage additional companies or successfully integrate such additional companies without substantial costs, delays or other problems. Also, companies acquired recently and in the future may not achieve revenues, profitability or cash flows that justify our investment in them. We expect to spend significant time and effort in expanding our existing businesses and identifying, completing and integrating acquisitions. We expect to face competition for acquisition candidates which may limit the number of acquisition opportunities available to us, possibly leading to a decrease in the rate of growth of our revenues and profitability, and may result in higher acquisition prices. The success of these acquisitions we do make will depend on our ability to integrate these businesses into our operations. We may encounter difficulties in integrating acquisitions into our operations, retaining key employees of acquired companies and in managing strategic investments. Therefore, we may not realize the degree or timing of the benefits anticipated when we first enter into a transaction.

**Goodwill and intangible assets that are recorded on the balance sheet from a previous or future acquisition could be written off if circumstances arise whereby the goodwill or intangible assets have been impaired.**

We have pursued and will continue to seek potential acquisitions, at the appropriate time, to complement and expand our existing businesses, increase our revenues and profitability, and expand our markets. As a result of acquisitions, we have significant goodwill and intangible assets recorded on our balance sheet. We will continue to evaluate the recoverability of the carrying amount of our goodwill and intangible assets on an ongoing basis, and we may incur substantial non-cash impairment charges, which would adversely affect our financial results. There can be no assurance that the outcome of such reviews in the future will not result in substantial impairment charges. Impairment assessment inherently involves judgment as to assumptions about expected future cash flows and the impact of market conditions on those assumptions. Future events and changing market conditions may impact our assumptions as to prices, costs, holding periods or other factors that may result in changes in our estimates of future cash flows. Although we believe the assumptions we used in testing for impairment are reasonable, significant changes in any one of our assumptions could produce a significantly different result. If there were to be a decline in our market capitalization and/or a decline in estimated forecasted discounted cash flows, there could be an impairment of the goodwill and intangible assets. A non-cash impairment charge could be material to the earnings of the reporting period in which it is recorded.

**If we do not develop the appropriate new products or if customers do not accept new products, we could experience a loss of competitive position which could adversely affect future revenues.**

The Company is committed to product innovation on a timely basis to meet customer demands. Development of new products for targeted markets requires the Company to develop or otherwise leverage leading technologies in a cost-effective and timely manner. Failure to meet these changing demands could result in a loss of competitive position and seriously impact future revenues. Products or technologies developed by others may render the Company's products or technologies obsolete or noncompetitive. A fundamental shift in technologies in key product markets could have a material adverse effect on the Company's operating results and competitive position within the industry. More specifically, the development of new or enhanced products is a complex and uncertain process requiring the anticipation of technological and market trends. Rapidly changing product technologies could adversely impact operating results due to potential technological obsolescence of certain inventories or increased warranty expense related to newly developed LED lighting products. We may experience design, manufacturing, marketing or other difficulties, such as an inability to attract a sufficient number of experienced engineers that could delay or prevent our development, introduction or marketing of new products or enhancements and result in unexpected expenses. Such difficulties could cause us to lose business from our customers and could adversely affect our competitive position. In addition, added expenses could decrease the profitability associated with those products that do not gain market acceptance.

**Our business is cyclical and seasonal, and in downward economic cycles our operating profits and cash flows could be adversely affected.**

Historically, sales of our products have been subject to cyclical variations caused by changes in general economic conditions. Our revenues in our third quarter ending March 31 are also affected by the impact of weather on construction and installation programs and the annual budget cycles of major customers. The demand for our products reflects the capital investment decisions of our customers, which depend upon the general economic conditions of the markets that our customers serve, including, particularly, the petroleum and convenience store industries. During periods of expansion in construction and industrial activity, we generally have benefited from increased demand for our products. Conversely, downward economic cycles in these industries result in reductions in sales and pricing of our products, which may reduce our profits and cash flow. During economic downturns, customers also tend to delay purchases of new products. The cyclical and seasonal nature of our business could at times adversely affect our liquidity and financial results.

**A loss of key personnel or inability to attract qualified personnel could have an adverse effect on our operating results.**

The Company's future success depends on the ability to attract and retain highly skilled technical, managerial, marketing and finance personnel, and, to a significant extent, upon the efforts and abilities of senior management. The Company's management philosophy of cost-control results in a lean workforce. Future success of the Company will depend on, among other factors, the ability to attract and retain other qualified personnel, particularly management, research and development engineers and technical sales professionals. The loss of the services of any key employees or the failure to attract or retain other qualified personnel could have a material adverse effect on the Company's results of operations.

**The costs of litigation and compliance with environmental regulations, if significantly increased, could have an adverse effect on our operating profits.**

We are, and may in the future be, a party to any number of legal proceedings and claims, including those involving patent litigation, product liability, employment matters, and environmental matters, which could be significant. Given the inherent uncertainty of litigation, we can offer no assurance that existing litigation or a future adverse development will not have a material adverse impact. We are also subject to various laws and regulations relating to environmental protection and the discharge of materials into the environment, and it could potentially be possible we could incur substantial costs as a result of the noncompliance with or liability for clean up or other costs or damages under environmental laws.

**The turnover of commissioned sales representatives could cause a significant disruption in sales volume.**

Commissioned sales representatives are critical to generating business in the Lighting Segment. From time to time, commissioned sales representatives representing a particular region resign or are terminated and replaced with new commissioned sales representatives. During this period of transition from the previous agency to the new one, sales in the particular region will likely fall as business is disrupted. It may take several months for the new sales representative to generate sales that will equal or exceed the previous sales representative. There is also the risk that the new sales agency will not attain the sales volume of the previous agency. These sales representative changes may occur individually as one agency is replaced due to lack of performance. On the other hand, these sales representative changes can be widespread as a result of the competitive nature of the lighting industry as LSI and its competition vie for the strongest sales agency in a particular region.

**Changes in a customer's demands and commitment to proprietary inventory could result in significant inventory write-offs.**

Upgrading or replacing a customer's current image requires the manufacture of inventory that is specific to the particular customer. This is particularly true in the Graphics Segment. In as many instances as possible, we require a commitment from the customer before the inventory is produced. Our request for a commitment can range from a single site or store to a large roll-out program involving many sites or stores. The risk does exist that a customer cannot or will not honor its commitment to us. The reasons a customer cannot or will not honor its commitment can range from the bankruptcy of the customer, to the change in the image during the roll-out program, to canceling the program before its completion and before the inventory is sold to the customer. In each of these instances, we could be left with significant amounts of inventory required to support the customer's re-imaging. While all efforts are made to hold the customer accountable for its commitment, there is the risk that a significant amount of inventory could be deemed obsolete or no longer usable which could result in significant inventory write-offs.

**If we are unable to adequately protect our intellectual property, we may lose some of our competitive advantage.**

Our success is determined in part by our ability to obtain United States and foreign patent protection for our technology and to preserve our trade secrets. Our ability to compete and the ability of our business to grow could suffer if our intellectual property rights are not adequately protected. There can be no assurance that our patent applications will result in patents being issued or that current or additional patents will afford protection against competitors. We rely on a combination of patents, copyrights, trademarks and trade secret protection and contractual rights to establish and protect our intellectual property. Failure of our patents, copyrights, trademarks and trade secret protection, non-disclosure agreements and other measures to provide protection of our technology and our intellectual property rights could enable our competitors to more effectively compete with us and have an adverse effect on our business, financial condition and results of operations. In addition, our trade secrets and proprietary know-how may otherwise become known or be independently discovered by others. No guarantee can be given that others will not independently develop substantially equivalent proprietary information or techniques, or otherwise gain access to our proprietary technology.

**Sudden or unexpected changes in a customer's creditworthiness could result in significant accounts receivable write-offs.**

The Company takes a conservative approach when extending credit to its customers. Customers are granted an appropriate credit limit based upon the due diligence performed on the customer which includes, among other things, the review of the company's financial statements and banking information, various credit checks, and payment history the customer has with the Company. At any given time, the Company can have a significant amount of credit exposure with its larger customers. While the Company is frequently monitoring its outstanding receivables with its customers, the likelihood does exist that a customer with large credit exposure is unable to make payment on its outstanding receivables which could result in a significant write-off of accounts receivable.



**Failure of the Company's operating or information system or a compromise of security with respect to its operating system or portable electronic devices could adversely affect the Company's results of operations and financial condition or the effectiveness of internal controls over operations and financial reporting.**

Information technology system failures, network disruptions and breaches of data security caused by such factors, including, but not limited to, earthquakes, fire, theft, fraud, malicious attack or other causes could disrupt the Company's operations by causing delays or cancellation of customer orders, negatively affecting the Company's online offerings and services, impeding the manufacture or shipment of products, processing transactions and reporting financial results, resulting in the unintentional disclosure of customer or Company information, or damage to the Company's reputation. While management has taken steps to address these concerns by implementing network security and internal control measures, there can be no assurance that a system failure or loss or data security breach will not materially adversely affect the Company's financial condition and operating results.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

The Company operates ten facilities and has one vacant facility held for sale:

Description	Size	Location	Status
1) LSI Industries Corporate Headquarters and lighting fixture manufacturing	243,000 sq. ft. (includes 66,000 sq. ft. of office space)	Cincinnati, OH	Owned
2) LSI Industries pole manufacturing and dry powder-coat painting	122,000 sq. ft.	Cincinnati, OH	Owned
3) LSI Industries technology center	9,000 sq. ft.	Cincinnati, OH	Leased
4) LSI Industries lighting assembly	12,000 sq. ft.	Hawthorne, CA	Leased
5) LSI Metal Fabrication manufacturing and dry powder-coat painting	96,000 sq. ft. (includes 5,000 sq. ft. of office space)	Independence, KY	Owned
6) LSI Integrated Graphics office; screen printing manufacturing; and architectural graphics manufacturing	141,000 sq. ft. (includes 34,000 sq. ft. of office space)	Houston, TX	Leased

Edgar Filing: LSI INDUSTRIES INC - Form 10-K

7) Grady McCauley office and manufacturing	212,000 sq. ft. (includes 22,000 sq. ft. of office space)	North Canton, OH	Owned
8) LSI Lightron office and manufacturing	170,000 sq. ft. (includes 10,000 sq. ft. of office space)	New Windsor, NY	Owned and Leased (a)
9) LSI ADL Technology office and manufacturing	57,000 sq. ft. (includes 5,000 sq. ft. of office space)	Columbus, OH	Owned
10) Atlas Lighting Products office and manufacturing	336,000 sq. ft. (included 60,000 sq. ft. of office space)	Burlington, NC	Leased
11) LSI Retail Graphics office and manufacturing	33,000 sq. ft. (includes 5,000 sq. ft. of office space)	Woonsocket, RI	Owned (b)

(a) The land at this facility is leased and the building is owned.

(b) This facility is vacant and is currently offered for sale.

*The Company considers these ten operating facilities, excluding the Woonsocket facility (total of 1,398,000 square feet) adequate for its current level of operations.*

ITEM 3. LEGAL PROCEEDINGS

See Note 13 of Notes to the Consolidated Financial Statements beginning on page 60 of this Form 10-K

ITEM 4. MINE SAFETY DISCLOSURES

None.

**PART II**

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Common share information appears in Note 19 — SUMMARY OF QUARTERLY RESULTS (UNAUDITED) under "Range of share prices" beginning on page 65 of this Form 10-K. Information related to (a) "Earnings (loss) per share" and "Cash dividends paid per share" appears in SELECTED FINANCIAL DATA on page 66 of this Form 10-K. LSI's shares of common stock are traded on the NASDAQ Global Select Market under the symbol "LYTS."

The Company's Board of Directors has adopted a dividend policy which indicates that dividends will be determined by the Board of Directors in its discretion based upon its evaluation of earnings, cash flow requirements, financial condition, debt levels, stock repurchases, future business developments and opportunities, and other factors deemed relevant by the Board of Directors. The Company has paid annual cash dividends beginning in fiscal 1987 through fiscal 1994, and quarterly cash dividends since fiscal 1995. The Company's indicated annual rate for payment of a cash dividend at the end of fiscal 2017 was \$0.20 per share.

At August 30, 2017, there were approximately 630 shareholders of record. The Company believes this represents approximately 3,000 beneficial shareholders.

In connection with the acquisition of Atlas on February 21, 2017 LSI issued to sellers of Atlas warrants to purchase an aggregate of 200,000 shares of the Company's Common Stock at an exercise price of \$9.95 per share expiring

February 2022. The warrants were issued pursuant to an exemption from the registration requirements under the Securities Act of 1933, as amended, under Section 4(2) thereof.

The Company does not purchase into treasury its own common shares for general purposes. However, the Company does purchase its own common shares, through a Rabbi Trust, as investments of employees/participants of the LSI Industries Inc. Nonqualified Deferred Compensation Plan. Purchases of Company common shares for this Plan in the fourth quarter of fiscal 2017 were as follows:

ISSUER PURCHASES OF EQUITY SECURITIES

Period	(a) Total Number of Shares Purchased	(b) Average Price Paid per Share	(c) Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	(d) Maximum Number (or Approximate Dollar Value) of Shares that May Yet Be Purchased Under the Plans or Programs
4/1/17 to 4/30/17	1,766	\$ 9.05	1,766	(1 )
5/1/17 to 5/31/17	1,833	\$ 8.72	1,833	(1 )
6/1/17 to 6/30/17	1,845	\$ 8.75	1,845	(1 )
Total	5,444	\$ 8.84	5,444	(1 )

All acquisitions of shares reflected above have been made in connection with the Company's Nonqualified (1)Deferred Compensation Plan, which does not contemplate a limit on shares to be acquired or acquired into this plan.

The following graph compares the cumulative total shareholder return on the Company's common shares during the five fiscal years ended June 30, 2017 with a cumulative total return on the NASDAQ Stock Market Index (U.S. companies) and the Dow Jones Electrical Equipment Index. The comparison assumes \$100 was invested June 30, 2012 in the Company's Common Shares and in each of the indexes presented; it also assumes reinvestment of dividends.

*The stock price performance included in this graph is not necessarily indicative of future stock price performance.*

#### ITEM 6. SELECTED FINANCIAL DATA

"Selected Financial Data" begins on page 66 of this Form 10-K.

#### ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

"Management's Discussion and Analysis of Financial Condition and Results of Operations" appears on pages 19 through 33 of this Form 10-K.

#### ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company is exposed to market risk from changes in variable interest rates, changes in prices of raw materials and component parts, and changes in foreign currency translation rates. Each of these risks is discussed below.

##### **Interest Rate Risk**

The Company earns interest income on its cash, cash equivalents, and short-term investments (if any) and pays interest expense on its debt (if any). Because of variable interest rates, the Company is exposed to the risk of interest rate fluctuations, which impact interest income, interest expense, and cash flows.

The Company's \$100,000,000 line of credit is subject to interest rate fluctuations, should the Company borrow certain amounts on this line of credit. Additionally, the Company expects to generate cash from its operations that will subsequently be used to pay down as much of the debt (if any is outstanding) as possible or invest cash in short-term investments (if no debt is outstanding), while still funding the growth of the Company.

**Raw Material Price Risk**

The Company purchases large quantities of raw materials and components, mainly steel, aluminum, castings, fabrications, LEDs, electronic components, power supplies, powder paint, wire harnesses, plastic and glass lenses, vinyls, inks, and corrugated cartons. The Company’s operating results could be affected by the availability and price fluctuations of these materials. The Company’s strategic sourcing plans include mitigating risk by utilizing multiple suppliers for a commodity to avoid significant dependence on any single supplier. Other than the possibility of industry-wide supply shortages, the Company has not experienced any significant supply problems in recent years. Price risk for these materials is related to price increases in commodity items that affect all users of the materials, including the Company’s competitors. For the fiscal year ended June 30, 2017, the raw material component of cost of goods sold subject to price risk was approximately \$150 million. The Company does not actively hedge or use derivative instruments to manage its risk in this area. The Company does, however, seek and qualify new suppliers, negotiate with existing suppliers, and arranges stocking agreements to mitigate risk of supply and price increases. On occasion, the Company’s Lighting Segment has announced price increases with customers in order to offset raw material price increases. In fiscal 2017, the Company announced price increases for all lighting and pole products in order to attempt to offset the rapid and significant material price inflation across several commodities. While the Company experienced material price inflation of 5% to 6%, price increases with customers has not fully offset the commodity price increases. The Company’s Graphics Segment generally establishes new sales prices, reflective of the then current raw material prices, for each custom graphics program as it begins.

**Foreign Currency Translation Risk**

The Company has essentially no foreign currency risk as all operations are conducted in U.S. dollars.

**ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA**

Index to Financial Statements

	Begins
	on Page
Financial Statements:	
<u>Management’s Report On Internal Control Over Financial Reporting</u>	34

<u>Report of Independent Registered Public Accounting Firm</u>	35
<u>Report of Independent Registered Public Accounting Firm</u>	36
<u>Consolidated Statements of Operations for the years ended June 30, 2017, 2016, and 2015</u>	37
<u>Consolidated Balance Sheets at June 30, 2017 and 2016</u>	38
<u>Consolidated Statements of Shareholders' Equity for the years ended June 30, 2017, 2016, and 2015</u>	40
<u>Consolidated Statements of Cash Flows for the years ended June 30, 2017, 2016, and 2015</u>	41
<u>Notes to Consolidated Financial Statements</u>	42
Financial Statement Schedules:	
Schedule II – Valuation and Qualifying Accounts for the years ended June 30, 2017, 2016, and 2015	67

Schedules other than those listed above are omitted for the reason(s) that they are either not applicable or not required or because the information required is contained in the financial statements or notes thereto. Selected quarterly financial data is found in Note 19 of the accompanying consolidated financial statements.



ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

ITEM 9A. CONTROLS AND PROCEDURES

Disclosure Controls and Procedures

The Company maintains disclosure controls and procedures (as such term is defined Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934, as amended (the “Exchange Act”), that are designed to ensure that information required to be disclosed by the Company in the reports that it files under the Exchange Act is recorded, processed, summarized and reported within required time periods specified in the SEC’s rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed is accumulated and communicated to management, including the Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

We conducted, under the supervision of our management, including the Chief Executive Officer and Chief Financial Officer, an evaluation of the effectiveness of the internal control over financial reporting as defined in Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934. Based upon our evaluation, our Chief Executive Officer and Chief Financial Officer concluded that, as of June 30, 2017, our disclosure controls and procedures were effective. Management believes that the consolidated financial statements included in this Annual Report on Form 10-K are fairly presented in all material respects in accordance with U.S GAAP, and the Company’s Chief Executive Officer and Chief Financial Officer have certified that, based on their knowledge, the consolidated financial statements included in this report fairly present in all material respects the Company’s financial condition, results of operations, statement of shareholders’ equity, and cash flows for each of the periods presented in this report.

The Company acquired Atlas Lighting Products, Inc. (“Atlas”) on February 21, 2017. Management excluded Atlas from its evaluation of the effectiveness of the internal control over financial reporting as of June 30, 2017. Atlas represented 39% of the Company’s total consolidated assets as of June 30, 2017, and 5% of the Company’s total consolidated sales for the fiscal year ended June 30, 2017.

Changes in Internal Control

There have been no changes in the Company's internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the fiscal quarter ended June 30, 2017, that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting, except as otherwise described in this Item 9A. See Management's Report On Internal Control Over Financial Reporting on page 34.

ITEM 9B. OTHER INFORMATION

None.

- 14 -

---

**PART III**

ITEMS 10, 11, 12, 13 and 14 of Part III are incorporated by reference to the LSI Industries Inc. Proxy Statement for its Annual Meeting of Shareholders to be held November 16, 2017, as filed with the Commission pursuant to Regulation 14A.

**ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED SHAREHOLDER MATTERS**

The description of equity compensation plans required by Regulation S-K, Item 201(d) is incorporated by reference to the LSI Industries Inc. Proxy Statement for its Annual Meeting of Shareholders to be held November 16, 2017, as filed with the Commission pursuant to Regulation 14A.

The following table presents information about the Company's equity compensation plans (LSI Industries Inc. 2003 Equity Compensation Plan and the 2012 Stock Incentive Plan) as of June 30, 2017.

Plan category	(a) Number of securities to be issued upon exercise of outstanding options, warrants and rights	(b) Weighted average exercise price of outstanding options, warrants and rights	(c) Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))
Equity compensation plans approved by security holders	3,453,023	\$9.22	2,188,509
Equity compensation plans not approved by security holders	—	\$—	—
Total	3,453,023	\$9.22	2,188,509

**PART IV**

ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

(a) The following documents are filed as part of this report:

- (1) Consolidated Financial Statements  
Appear as part of Item 8 of this Form 10-K.
- (2) Exhibits — Exhibits set forth below are either on file with the Securities and Exchange Commission and are incorporated by reference as exhibits hereto, or are filed with this Form 10-K.

Exhibit

Exhibit No.	Exhibit Description
3.1	<u>Articles of Incorporation of LSI (incorporated by reference to Exhibit 3.1 to LSI's Form S-3 Registration Statement File No. 33-65043).</u>
3.2	<u>Amended Article Fourth of LSI's Amended and Restated Articles of Incorporation (incorporated by reference to Exhibit 3.1 to LSI's Form 8-K filed November 19, 2009).</u>
3.3	<u>Amended and Restated Code of Regulations of LSI (incorporated by reference to Exhibit 3 to LSI's Form 8-K filed January 22, 2009).</u>
10.1	<u>Third Amendment to Loan Documents dated February 21, 2017 between the Registrant and PNC Bank, National Association (incorporated by reference to Exhibit 42 to LSI's Form 8-K filed February 21, 2017).</u>

- 10.2 Stock Purchase Agreement dated as of February 21, 2017 among LSI Industries Inc., James Hewes Bennett, Rector Samuel Hunt III and Atlas Lighting Products, Inc. (incorporated by reference to Exhibit 21 to LSI's Form 8-K filed February 21, 2017).
- 10.9 \* LSI Industries Inc. 401(k) Retirement Savings Plan (Amended and Restated as of July 1, 2017)
- 10.10 \* LSI Industries Inc. 2003 Equity Compensation Plan (Amended and Restated through November 19, 2009) (incorporated by reference to Exhibit 10.1 to LSI's Form 8-K filed November 19, 2009).
- 10.11 \* Amended and Restated 2012 Stock Incentive Plan as of November 17, 2016 (incorporated by reference to Exhibit 10.1 to LSI's Form 10-Q filed February 3, 2017).
- 10.12 \* Trust Agreement Establishing the Rabbi Trust Agreement by and between LSI Industries Inc. and Prudential Bank & Trust, FSB (incorporated by reference to Exhibit 10.1 to LSI's Form 8-K filed January 5, 2006).
- 10.13 \* LSI Industries Inc. Nonqualified Deferred Compensation Plan (Amended and Restated as of November 20, 2014) (incorporated by reference to Exhibit 10.2 to LSI's Form 10-Q filed February 5, 2015).
- 10.14 \* Amended Agreement dated January 25, 2005 with James P. Sferra (incorporated by reference to Exhibit 10.2 to LSI's Form 8-K filed January 27, 2005).
- 10.15 \* Amendment to Amended Agreement dated September 16, 2014 between LSI Industries Inc. and James P. Sferra (incorporated by reference to Exhibit 10.15 to LSI's Form 10-K filed September 8, 2015).
- 10.16 \* Employment Offer Letter between LSI and James E. Galeese (incorporated by reference to Exhibit 10.1 to LSI's Form 8-K filed on June 13, 2017).
- 10.17 \* Amended and Restated Employment Agreement between Dennis W. Wells and LSI (incorporated by reference to Exhibit 10.1 to LSI's Form 8-K filed February 27, 2017).
- 10.18 \* Non-Competition, Non-Solicitation and Non-Disclosure Agreement dated as of February 24, 2017 between LSI Industries Inc. and Dennis W. Wells (incorporated by reference to Exhibit 10.2 to LSI's Form 8-K filed February 27, 2017).
- 10.20 \* Change of Control Policy (incorporated by reference to Exhibit 10 to LSI's Form 8-K filed October 3, 2011).
- 10.23 \* Form of Restricted Stock Unit Award Agreement (incorporated by reference to Exhibit 10.3 to LSI's Form 8-K filed July 6, 2015).
- 10.24 \* Form of Nonqualified Stock Option Award Agreement - Service-Based (incorporated by reference to Exhibit 10.5 to LSI's Form 8-K filed July 6, 2015).
- 10.25 \* Form of Nonqualified Stock Option Award Agreement – Performance-Based (incorporated by reference to Exhibit 10.4 to LSI's Form 8-K filed July 6, 2015).
- 10.26 \* Form of Incentive Stock Option Award Agreement (incorporated by reference to Exhibit 10.6 to LSI's Form 8-K filed July 6, 2015).

- 10.27\* Form of Warrant Agreement issued by LSI Industries Inc. (incorporated by reference to Exhibit 4.1 to LSI's Form 8-K filed February 21, 2017).
- 10.28\* LSI Industries Inc. Long Term Incentive Plan FY2017 for Named Executive Officers (incorporated by reference to Exhibit 10.1 to LSI's Form 8-K filed July 5, 2016).
- 10.29\* LSI Industries Inc. Short Term Incentive Plan FY2017 for Named Executive Officers (incorporated by reference to Exhibit 10.1 to LSI's Form 8-K filed August 22, 2016).
- 10.30\* Form of Indemnification Agreement between LSI and certain indemnities (incorporated by reference to Exhibit 10.1 to LSI's Form 8-K filed June 23, 2016).

- 14 Code of Ethics (incorporated by reference to exhibit 14 to LSI's Form 10-K for the fiscal year ended June 30, 2004).
- 21 Subsidiaries of the Registrant
- 23.1 Consent of Independent Registered Public Accounting Firm (Grant Thornton LLP)
- 24 Power of Attorney (included as part of signature page)
- 31.1 Certification of Principal Executive Officer required by Rule 13a-14(a)
- 31.2 Certification of Principal Financial Officer required by Rule 13a-14(a)
- 32.1 18 U.S.C. Section 1350 Certification of Principal Executive Officer
- 32.2 18 U.S.C. Section 1350 Certification of Principal Financial Officer

101.INS XBRL Instance Document

101.SCH XBRL Taxonomy Extension Schema

101.CAL XBRL Taxonomy Extension Calculation Linkbase

101.LAB XBRL Taxonomy Extension Label Linkbase

101.PRE XBRL Taxonomy Extension Presentation Linkbase

101.DEF XBRL Taxonomy Extension Definition Document

\*Management Compensatory Agreements

LSI will provide shareholders with any exhibit upon the payment of a specified reasonable fee, which fee shall be limited to LSI's reasonable expenses in furnishing such exhibit. The exhibits identified herein as being filed with the SEC have been so filed with the SEC but may not be included in this version of the Annual Report to Shareholders.

## **SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

LSI INDUSTRIES INC.

September 8, 2017 BY:/s/ Dennis W. Wells  
Date Dennis W. Wells  
Chief Executive  
Officer and President

We, the undersigned directors and officers of LSI Industries Inc. hereby severally constitute Dennis W. Wells and James E. Galeese, and each of them singly, our true and lawful attorneys with full power to them and each of them to sign for us, in our names in the capacities indicated below, any and all amendments to this Annual Report on Form 10-K filed with the Securities and Exchange Commission.

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

ITEM 16. FORM 10-K SUMMARY

Not included.



Edgar Filing: LSI INDUSTRIES INC - Form 10-K

Signature	Title
/s/ Dennis W. Wells Dennis W. Wells Date: September 8, 2017	Chief Executive Officer and President; Director (Principal Executive Officer)
/s/ James E. Galeese James E. Galeese Date: September 8, 2017	Executive Vice President, and Chief Financial Officer (Principal Financial Officer)
/s/ Jeffery S. Bastian Jeffery S. Bastian Date: September 8, 2017	Vice President and Chief Accounting Officer (Principal Accounting Officer)
/s/ Robert P. Beech Robert P. Beech Date: September 8, 2017	Director
/s/ Gary P. Kreider Gary P. Kreider Date: September 8, 2017	Chairman of the Board of Directors
/s/ Wilfred T. O’Gara Wilfred T. O’Gara Date: September 8, 2017	Director
/s/ James P. Sferra James P. Sferra Date: September 8, 2017	Director
/s/ John K. Morgan John K. Morgan Date: September 8, 2017	Director
/s/ Robert A. Steele  Robert A. Steele Date: September 8, 2017	Director



## MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The Company's "forward looking statements" and disclosures as presented earlier in this Form 10-K in the "Safe Harbor" Statement, as well as the Company's consolidated financial statements and accompanying notes presented later in this Form 10-K should be referred to when reading Management's Discussion and Analysis of Financial Condition and Results of Operations.

### Net Sales by Business Segment

<i>(In thousands)</i>	<b>2017</b>	2016	2015
Lighting Segment	<b>\$239,005</b>	\$226,889	\$219,920
Graphics Segment	<b>72,395</b>	77,968	67,152
Technology Segment	<b>19,992</b>	17,339	20,744
All Other Category	--	--	41
Total Net Sales	<b>\$331,392</b>	\$322,196	\$307,857

### Operating Income (Loss) by Business Segment

<i>(In thousands)</i>	<b>2017</b>	2016	2015
Lighting Segment	<b>\$10,566</b>	\$15,785	\$14,775
Graphics Segment	<b>2,439</b>	5,246	952
Technology Segment	<b>3,885</b>	4,028	3,153
All Other Category	--	--	(183 )
Corporate and Eliminations	<b>(13,281)</b>	(11,103)	(11,164)
Total Operating Income	<b>\$3,609</b>	\$13,956	\$7,533

### Summary Comments

Fiscal 2017 net sales of \$331,392,000 increased \$9.2 million or 2.9% as compared to fiscal 2016 net sales of \$322,196,000. Net sales were favorably influenced by increased net sales of the Lighting Segment (up \$12.1 million or 5.3%) and the Technology Segment (up \$2.7 million or 15.3%). Net sales were unfavorably influenced by net sales of the Graphics Segment (down \$5.6 million or 7.1%). The Company acquired Atlas Lighting Products, Inc. (Atlas) on February 21, 2017. Atlas is a manufacturer of high-quality LED lighting products sold in the electrical distribution market. The operating results of Atlas beginning February 21, 2017 have been included in the Company's consolidated operating results in the Lighting Segment results. Atlas contributed \$17.8 million to net sales during fiscal 2017 since

the date of acquisition.

Fiscal 2017 operating income of \$3,609,000 decreased 74.1% from operating income of \$13,956,000 in fiscal 2016. The \$10.3 million decrease in operating income was the net result of increased net sales, a decrease in gross profit and a decrease in gross profit as a percentage of net sales from 26.0% in fiscal 2016 to 24.7% in fiscal 2017, an increase in selling and administrative expenses, restructuring and plant closure costs as well as acquisition deal costs in fiscal 2017 with no comparable events in fiscal 2016, and an intangible asset impairment in fiscal 2017.

Fiscal 2016 net sales of \$322,196,000 increased \$14.3 million or 4.7% as compared to fiscal 2015 net sales of \$307,857,000. Net sales were favorably influenced by increased net sales of the Lighting Segment (up \$7.0 million or 3.2%), the Graphics Segment (up \$10.8 million or 16.1%) and the Technology Segment (down \$3.4 million or 16.4%).

Fiscal 2016 operating income of \$13,956,000 increased 85.3% from operating income of \$7,533,000 in fiscal 2015. The \$6.4 million increase in operating income was the net result of increased net sales, an increase in gross profit and an increase in gross profit as a percentage of net sales from 24.2% in fiscal 2015 to 26.0% in fiscal 2016, an increase in selling and administrative expenses, and the net effect of the gain on the sale of a facility more than offset by the loss on the sale of a subsidiary in fiscal 2015 with no comparable events in fiscal 2016.

The Company recorded intangible asset impairment expense in the Graphics Segment in fiscal 2017 totaling \$479,000. There was no intangible asset impairment expense in fiscal 2015 or 2016. There was no goodwill impairment expense in fiscal 2015, 2016, or 2017.

Fiscal 2017 net sales of LED lighting products of \$186,532,000 in the Lighting Segment were up \$31.0 million or 20.0% from the fiscal 2016 net sales of LED lighting products. Fiscal 2016 net sales of LED lighting products of \$155,485,000 in the Lighting Segment were up \$24.1 million or 18.4% from the fiscal 2015 net sales of LED lighting products.

### Non-GAAP Financial Measures

The Company believes it is appropriate to evaluate its performance after making adjustments to net income for the 2017, 2016 and 2015 fiscal years reported in conformity with accounting principles generally accepted in the United States of America (U.S. GAAP). We adjusted operating income, net income and earnings per share, which exclude the impact of restructuring and plant closure costs, along with severance costs, intangible asset impairment expense, acquisition deal costs, and fair market value inventory adjustments, are non-GAAP financial measures. We believe that these adjusted supplemental measures are useful in assessing the operating performance of our business. These supplemental measures are used by our management, including our chief operating decision maker, to evaluate business results. We exclude these items because they are not representative of the ongoing results of operations of our business. Below is a reconciliation of these non-GAAP financial measures to operating income, net income, and adjusted diluted earnings per share for the periods indicated.

<i>(In thousands; unaudited)</i>	<b>FY 2017</b>	FY 2016	FY 2015
Reconciliation of operating income to adjusted operating income:			
Operating income as reported	<b>\$3,609</b>	\$13,956	\$7,533
Adjustment for impairment of intangible asset	<b>479</b>	—	—
Adjustment for restructuring, plant closure costs, and related inventory write-downs (includes sale of the Kansas City facility – See Note 15)	<b>897</b>	—	—
Adjustment for other severance costs	<b>506</b>	469	1,083
Adjustment for acquisition deal costs	<b>1,608</b>	—	—
Adjustment for fair market value inventory write-up	<b>155</b>	—	—
Adjustment for a self-insured death benefit expense	—	—	1,000
Adjustment for the gain on sale of a manufacturing facility	—	—	(343 )

Adjustment for the loss on sale of a subsidiary	—	—	565
Adjusted operating income	<b>\$7,254</b>	\$14,425	\$9,838

- 20 -

---

Edgar Filing: LSI INDUSTRIES INC - Form 10-K

<i>(In thousands, except per share data; unaudited)</i>	FY 2017		FY 2016		FY 2015	
	Amount	Diluted EPS	Amount	Diluted EPS	Amount	Diluted EPS
Reconciliation of net income (loss) to adjusted net income:						
Net income as reported	<b>\$3,000</b>	<b>\$ 0.12</b>	\$9,482	\$ 0.37	\$5,151	\$ 0.21
Adjustment for impairment of intangible asset	<b>335</b> <sup>(1)</sup>	<b>0.01</b>	—	—	—	—
Adjustment for restructuring, plant closure costs, and related inventory write-downs, inclusive of the income tax effect (See Note 11)	<b>81</b> <sup>(2)</sup>	—	—	—	—	—
Adjustment for severance costs, inclusive of the income tax effect	<b>347</b> <sup>(3)</sup>	<b>0.01</b>	318 <sup>(4)</sup>	0.01	691 <sup>(5)</sup>	0.03
Adjustment for acquisition deal costs, inclusive of the income tax effect	<b>1,103</b> <sup>(6)</sup>	<b>0.04</b>	—	—	—	—
Adjustment for fair market value inventory write-up, inclusive of the income tax effect	<b>108</b> <sup>(7)</sup>	—	—	—	—	—
Adjustment for self-insured death benefit expense, inclusive of the income tax effect	—	—	—	—	637 <sup>(8)</sup>	0.03
Adjustment for the gain on the sale of a manufacturing facility, inclusive of the income tax effect	—	—	—	—	(224) <sup>(9)</sup>	(0.01)
Adjustment for the loss on sale of a subsidiary, inclusive of the income tax effect	—	—	—	—	565 <sup>(10)</sup>	0.02
Income tax effect of utilization of a long-term capital loss	—	—	—	—	(101) <sup>(11)</sup>	0.00
Adjusted net income and earnings per share	<b>\$4,974</b>	<b>\$ 0.19</b>	\$9,800	\$ 0.38	\$6,719	\$ 0.27

The income tax effects of the adjustments in the tables above were calculated using the estimated U.S. effective income tax rates for the periods indicated. The income tax effects were as follows (in thousands):

- (1) \$144
- (2) \$816
- (3) \$159
- (4) \$151

- (5) \$392
- (6) \$505
- (7) \$47
- (8) \$363
- (9) (\$119)
- (10) \$0
- (11) \$0



**Results of Operations****2017 Compared to 2016****Lighting Segment**

<i>(In thousands)</i>	2017	2016
Net Sales	\$239,005	\$226,889
Gross Profit	\$57,241	\$56,674
Operating Income	\$10,566	\$15,785

The Company acquired Atlas Lighting Products, Inc. (Atlas) on February 21, 2017. Atlas is a manufacturer of high-quality LED lighting products sold in the electrical distribution market. The operating results of Atlas beginning February 21, 2017 have been included in the Company's consolidated operating results and in the Lighting Segment results. Atlas contributed \$17.8 million to net sales during fiscal 2017 since the date of acquisition.

Lighting Segment net sales of \$239,005,000 in the fiscal 2017 increased 5.3% from fiscal 2016 net sales of \$226,889,000. While Lighting Segment net sales increased, net sales excluding Atlas decreased \$5.7 million or 2.5% from fiscal 2016. The overall market for lighting products is soft, particularly in the second half of fiscal 2017. The softness in the lighting market has continued into the first few months of fiscal 2018. The Lighting Segment's net sales of light fixtures having solid-state LED technology totaled \$186.5 million in fiscal 2017, representing a \$31.0 million or 20.0% increase from fiscal 2016 net sales of solid-state LED light fixtures of \$155.5 million. Net sales of light fixtures having solid-state LED technology accounted for 78.0% of total Lighting Segment net sales in fiscal 2017 compared to 68.5% of total Lighting Segment net sales in fiscal 2016. There was a reduction in the Company's traditional lighting sales (metal halide and fluorescent light sources) from fiscal 2016 to fiscal 2017 as customers converted from traditional lighting to light fixtures having solid-state LED technology.

Lighting Segment total net sales of solid-state LED technology in light fixtures have been recorded as indicated in the table below.

## LED Net Sales

<i>(In thousands)</i>	FY 2017	FY 2016	% change	% change
-----------------------	---------	---------	-------------	-------------

Edgar Filing: LSI INDUSTRIES INC - Form 10-K

			(FY 17 vs FY 16)	FY 2015	(FY 16 vs FY 15)		
First Quarter	\$43,146	\$37,393	15.4	% \$29,607	26.3	%	
Second Quarter	46,137	41,612	10.9	% 37,068	12.3	%	
First Half	89,283	79,005	13.0	% 66,675	18.5	%	
Third Quarter	44,946	33,670	33.5	% 29,498	14.1	%	
Nine Months	134,229	112,675	19.1	% 96,173	17.2	%	
Fourth Quarter	52,303	42,810	22.2	% 35,175	21.7	%	
Full Year	\$186,532	\$155,485	20.0	% \$131,348	18.4	%	

Gross profit of \$57,241,000 in fiscal 2017 increased \$0.6 million or 1.0% from fiscal 2016, and decreased from 24.7% to 23.7% as a percentage of Lighting Segment net sales (customer plus inter-segment net sales). The Company incurred restructuring and plant closure costs, including the write-down of inventory, that were recorded in cost of sales related to the closure of the Kansas City, Kansas manufacturing facility of \$1,325,000 in fiscal 2017 with no comparable costs in fiscal 2016. The Lighting Segment's gross profit was also influenced by the net effect of increased product net sales, improved manufacturing efficiencies as a result of the Company's lean initiatives, competitive pricing pressures, product mix, and rapid and significant inflationary pressures including the rising cost of steel, aluminum, copper, and other commodities. In fiscal 2017, the Company announced price increases for all lighting and pole products in order to attempt to offset the rapid and significant material price inflation across several commodities. While the Company experienced material price inflation of 5% to 6%, price increases with customers has not fully offset the commodity price increases. Also contributing to the net change in gross profit is decreased employee compensation and benefits expense (\$1.2 million), decreased warranty costs (\$0.3 million), increased customer relations expense (\$0.5 million), increased depreciation expense (\$0.6 million), increased rent expense (\$0.5 million), decreased supplies expense (\$0.1 million), and decreased outside service expense (\$0.4 million).

Selling and administrative expenses of \$47,932,000 in fiscal 2017 increased \$7.0 million or 17.2% from fiscal 2016. The \$7.0 million increase is primarily the result of increased employee compensation and benefits expense (\$1.5 million), increased intangible asset amortization expense due to the increase in intangible assets resulting from the acquisition of Atlas (\$0.8 million), increased samples expense (\$0.2 million), increased outside service expense (\$0.2 million), increased sales commission expense (\$3.1 million), increased bad debt expense (\$0.2 million), increased supplies expense (\$ 0.1 million), decreased convention expense (\$0.1 million), an increase in audit fees (\$0.1 million), a loss on the sale of fixed assets (\$0.1 million), an increase in research and development expense (\$0.3 million), use tax recorded on current and prior year purchases as a result of a use tax audit (\$0.2 million), and small net increases in several other categories (\$0.3 million). Also contributing to the increase in selling and administrative expenses are restructuring and plant closure costs of \$104,000 related to the closure of the Kansas City, Kansas manufacturing facility that were recorded in fiscal 2017 with no comparable costs in fiscal 2016, and a gain on the sale of the Kansas City facility of \$1,361,000 with no comparable gain in fiscal 2016.

The Lighting Segment fiscal 2017 operating income of \$10,566,000 decreased \$5.2 million or 33.1% from operating income of \$15,785,000 in fiscal 2016. The decrease of \$5.2 million was the net result of increased net sales, an increase in gross profit, increased selling and administrative expenses, restructuring and plant closure costs, and related inventory write-downs of \$1.4 million with no comparable costs in fiscal 2016, and a gain on the sale of the Kansas City facility of \$1.4 million with no comparable gain in fiscal 2016.

## Graphics Segment

<i>(In thousands)</i>	2017	2016
Net Sales	\$72,395	\$77,968
Gross Profit	\$17,113	\$19,526
Operating Income	\$2,439	\$5,246

Graphics Segment net sales of \$72,395,000 in fiscal 2017 decreased \$5.6 million or 7.1% from fiscal 2016 net sales of \$77,968,000. The markets that the Graphics Segment serves were soft as evidenced by the decline in several key markets described below. The softness in these markets has continued into the first few months of fiscal 2018. The \$5.6 million decrease in Graphics Segment net sales is primarily the net result of sales to the petroleum / convenience store market (\$2.3 million net decrease), sales to the national drug store market (\$3.0 million decrease), sales to the quick-service restaurant market (\$0.5 million net increase), sales to the retail market (\$1.2 million increase), sales to the retail grocery market (\$1.5 million decrease), and changes in volume to several other markets (\$0.5 million decrease).

Gross profit of \$17,113,000 in fiscal 2017 decreased \$2.4 million or 12.4% from fiscal 2016, and decreased from 24.5% to 23.3% as a percentage of Graphics Segment net sales (customer plus inter-segment net sales). The Company

incurred restructuring and plant closure costs that were recorded in cost of sales related to the closure of the Woonsocket, Rhode Island manufacturing facility of \$444,000. The remaining \$1.9 million decrease in the amount of gross profit is due to the net effect of decreased net product sales (customer plus inter-segment net product sales were down \$6.2 million or 7.8%), significant inflationary pressures in several key commodities, a drop in customer installation sales related to the Company's traditional graphics of \$5.5 million partially offset by higher margins on installation sales, slightly decreased freight expense as a percentage of shipping and handling revenue, increased depreciation expense (\$0.3 million), decreased real estate taxes (\$0.1 million), decreased supplies expense (\$0.2 million), decreased repair and maintenance expense (\$0.1 million), decreased rent expense (\$0.1 million), decreased outside services (\$0.1 million), and decreased compensation and benefits expense (\$0.6 million). Material inflation has stabilized at these higher price levels in the first few months of fiscal 2018 and are likely to remain at these levels in the short term.

Selling and administrative expenses of \$14,187,000 in fiscal 2017 increased \$0.1 million or 0.7% from fiscal 2016 primarily as a result of decreased compensation and benefits expense (\$0.5 million), increased outside services expense (\$0.4 million), increased convention and shows expense (\$0.1 million), increased travel expense (\$0.1 million), increased supplies expense (\$0.1 million), decreased commissions expense (\$0.1 million), decreased rent expense (\$0.1 million), increased depreciation expense (\$0.1 million), and other small net decreases in other categories (\$0.2 million). Also contributing to the higher selling and administrative expense in fiscal 2017 was intangible asset impairment expense of \$479,000 related to a customer relationship intangible asset that was determined to be fully impaired with no comparable expenses in the prior period of fiscal 2016.

Graphics Segment fiscal 2017 operating income of \$2,439,000 decreased \$2.8 million or 53.5% from fiscal 2016 and is the net result of decreased net sales, decreased gross profit and decreased gross profit as a percentage of net sales, restructuring and plant closure costs of \$448,000 with no comparable costs in fiscal 2016, and intangible asset impairment expense of \$479,000 with no comparable cost in fiscal 2016, and a decrease in other selling and administrative expenses.

### Technology Segment

<i>(In thousands)</i>	2017	2016
Net Sales	\$19,992	\$17,339
Gross Profit	\$7,359	\$7,620
Operating Income	\$3,885	\$4,028

Technology Segment net customer sales of \$19,992,000 in fiscal 2017 increased \$2.7 million or 15.3% from fiscal 2016 net sales of \$17,339,000. The \$2.7 million increase in Technology Segment net sales is primarily the net result of a \$1.7 million increase in sales to the transportation market, a \$0.8 million increase in sales to original equipment manufacturers, and a \$0.1 million net increase in sales to various other markets. The increase in net customer sales is due to the cyclic nature of the markets the Company serves in this segment. While net customer sales increased, the Technology Segment inter-company sales of electronic circuit boards and lighting control systems to the Lighting Segment decreased \$1.8 million or 4.9% due to demand and the outsourcing of some products.

Gross profit of \$7,359,000 in the fiscal 2017 decreased \$0.3 million or 3.4% from the same period of fiscal 2016, and decreased from 14.4% to 13.6% as a percentage of Technology Segment net sales (customer plus inter-segment net sales). The Company incurred restructuring charges of \$0.2 million related to the consolidation of its Beaverton, Oregon facility into other LSI facilities, with no comparable costs in fiscal 2016. The remaining \$0.1 million decrease in amount of gross profit is due to the net effect of increased customer net sales, partially offset by decreased inter-segment sales, increased employee compensation and benefits expense (\$0.3 million), increased warranty expense (\$0.3 million), decreased rent expense (\$0.1 million), and decreased outside services expense (\$0.2 million).

Selling and administrative expenses of \$3,441,000 in fiscal 2017 decreased \$151,000 or 4.2% from the same period of fiscal 2016. The decrease in selling and administrative expenses is primarily the net result of an increase in employee compensation and benefits expense (\$0.1 million), an increase in bad debt expense (\$0.1 million), a decrease in research and development expense (\$0.3 million), a decrease in the amortization expense (\$0.1 million), and other changes to selling and administrative expenses (\$0.1 million decrease).

Technology Segment fiscal 2017 operating income of \$3,885,000 decreased \$0.1 million or 0.4% from operating income of \$4,028,000 in the same period of fiscal 2016. The decrease of \$0.1 million was the net result of increased net customer sales, decreased inter-segment sales, restructuring costs in fiscal 2017 of \$0.3 million with no

comparable costs in fiscal 2016, decreased gross profit, and decreased operating expenses.

In September 2016, the Company announced the consolidation of the Beaverton, Oregon facility into other LSI facilities. The light assembly of products in the Beaverton facility was moved to the Company's Columbus, Ohio facility, and administration and engineering functions were moved to the Company's Cincinnati, Ohio facility. This consolidation was completed September 30, 2016.

**Corporate and Eliminations**

<i>(In thousands)</i>	2017	2016
Gross Profit	\$164	\$(149 )
Operating (Loss)	\$(13,281)	\$(11,103)

The gross profit (loss) relates to the intercompany profit in inventory elimination.

Administrative expenses of \$11,712,000 in fiscal 2017 increased \$0.8 million or 6.9% from the same period of the prior year. The \$0.8 million change in administrative expenses is primarily the net result of decreased employee compensation and benefits expense (\$0.6 million), an increase in legal expense (\$0.1 million), decreased depreciation expense (\$0.1 million), increased research and development expense (\$0.3 million), increased telephone expense (\$0.1 million), increased outside services expense (\$0.5 million), a change in the allocation of corporate expense to the operating units (\$0.2 million increase), and several small net increases in various other expenses (\$0.3 million). Also contributing to the increased administrative expenses are acquisition costs of \$1,608,000 recorded in fiscal 2017 and restructuring costs of \$0.1 million recorded in fiscal 2017 related to the consolidation of its Beaverton, Oregon facility into other LSI facilities, with no comparable costs in fiscal 2016. These restructuring expenses were primarily for severance costs for employees located in the Beaverton, Oregon facility that were previously included in corporate research and development expenses.

## **Consolidated Results**

The Company reported net interest expense of \$529,000 in fiscal 2017 as compared to net interest income of \$48,000 in the same period of fiscal 2016. The change from interest income in fiscal 2016 to interest expense in fiscal 2017 is the result of borrowing against the Company's line of credit to acquire Atlas. Commitment fees related to the unused portion of the Company's line of credit and interest income on invested cash are included in both fiscal years. The Company was in a positive cash position and was debt free for approximately the first eight and a half months of fiscal 2017 and generated interest income on invested cash. The Company was in a borrowing position beginning on February 21, 2017 primarily as a result of the Atlas Lighting Products acquisition.

The \$80,000 income tax expense in fiscal 2017 represents a consolidated effective tax rate of 2.6% influenced by certain permanent book-tax differences, by a benefit related to uncertain income tax positions, a tax benefit related to disqualifying dispositions, and the reduction of the valuation reserve related to the sale of the Kansas City facility. The \$4,522,000 income tax expense in fiscal 2016 represents a consolidated effective tax rate of 32.3%, influenced by certain permanent book-tax differences, an \$111,000 tax benefit related to the R&D tax credit, and by a tax benefit related to uncertain income tax positions.

The Company reported net income of \$3,000,000 in fiscal 2017 compared to net income of \$9,482,000 in the prior year. The \$6.5 million decrease in net income is primarily the net result of increased net sales, decreased gross profit, increased operating expenses, restructuring and plant closure costs in fiscal 2017 with no comparable costs in fiscal 2016, intangible asset impairment expense in fiscal 2017 with no comparable cost in fiscal 2016, and lower income tax expense in fiscal 2017 compared to fiscal 2016. Diluted earnings per share of \$0.12 was reported in fiscal 2017 as compared to diluted earnings per share of \$0.37 in fiscal 2016. The weighted average common shares outstanding for purposes of computing diluted earnings per share in fiscal 2017 was 25,988,000 shares as compared to 25,592,000 shares in the prior year.

**Results of Operations****2016 Compared to 2015****Lighting Segment**

<i>(In thousands)</i>	2016	2015
Net Sales	\$226,889	\$219,920
Gross Profit	\$56,674	\$54,542
Operating Income	\$15,785	\$14,775

Lighting Segment net sales of \$226,889,000 in fiscal 2016 increased 3.2% from fiscal 2015 net sales of \$219,920,000. The Lighting Segment's net sales of light fixtures having solid-state LED technology totaled \$155,485,000 in fiscal 2016, representing a \$24.1 million or 18.4% increase from fiscal 2015 net sales of solid-state LED light fixtures of \$131.3 million. Net sales of light fixtures having solid-state LED technology accounted for 68.5% of total Lighting Segment net sales. There was a reduction in the Company's traditional lighting sales (metal halide and fluorescent light sources) from fiscal 2015 to fiscal 2016 as customers converted from traditional lighting to light fixtures having solid-state LED technology.

Gross profit of \$56,674,000 in fiscal 2016 increased \$2.1 million or 3.9% from fiscal 2015, and increased from 24.5% to 24.7% as a percentage of Lighting Segment net sales (customer plus inter-segment net sales). The increase in amount of gross profit is due to the net effect of increased net sales, the improved procurement of material, competitive pricing pressures, and improved manufacturing efficiencies as a result of the Company's lean initiatives. Also contributing to the changes in gross profit is increased employee compensation and benefits expense (\$0.8 million), increased supplies expense (\$0.2 million), increased repair and maintenance expense (\$0.2 million), increased outside services (\$0.1 million), decreased utilities (\$0.1 million), increased depreciation expense (\$0.1 million), increased rent expense (\$0.2 million), increased customer relations expense (\$0.3 million), and increased warranty expense (\$1.8 million). The Company experienced a higher than normal level of warranty claims in the third quarter of fiscal 2016, primarily driven by older generation LED drivers.



Selling and administrative expenses of \$40,889,000 in fiscal 2016 increased \$1.1 million or 2.8% from fiscal 2015 primarily as the net result of increased employee compensation and benefits expense (\$0.3 million), increased travel and entertainment expenses (\$0.2 million), increased samples expense (\$0.3 million), decreased convention and show expense (\$0.1 million), decreased literature expense (\$0.1 million), decreased outside services (\$0.1 million), decreased depreciation expense (\$0.2 million), decreased bad debt expense (\$0.1 million), increased sales commissions at a slightly higher commission rate due to higher net sales (\$0.7 million), decreased lease expense (\$0.1 million), an increase in corporate shared service costs (\$1.8 million), and a decrease in research and development expenses (\$1.4 million).

The Lighting Segment fiscal 2016 operating income of \$15,785,000 increased \$1.0 million or 6.8% from operating income of \$14,775,000 in fiscal 2015. This increase of \$1.0 million was the net result of increased net sales, an increase in gross profit and an increase in the gross margin as a percentage of net sales, and increased selling and administrative expenses.

### Graphics Segment

<i>(In thousands)</i>	2016	2015
Net Sales	\$77,968	\$67,152
Gross Profit	\$19,526	\$13,126
Operating Income	\$5,246	\$952

Graphics Segment net sales of \$77,968,000 in fiscal 2016 increased \$10.8 million or 16.1% from fiscal 2015 net sales of \$67,152,000. The \$10.8 million increase in Graphics Segment net sales is primarily the net result of sales to the petroleum / convenience store market (\$16.9 million net increase), sales to the national drug store market (\$0.8 million decrease), sales to the quick-service restaurant market (\$4.0 million net decrease), sales to the banking industry (\$0.4 million decrease), sales to the retail grocery market (\$1.7 million increase), sales to the sports market (\$1.3 million decrease), and changes in volume to several other markets (\$1.3 million decrease). The Graphics Segment net sales of graphic identification products that contain solid-state LED light sources and LED lighting for signage totaled \$3.4 million in fiscal 2016, representing a \$0.2 million increase from fiscal 2015 net sales of \$3.6 million.

Gross profit of \$19,526,000 in fiscal 2016 increased \$6.4 million or 48.6% from fiscal 2015, and increased from 19.4% to 24.5% as a percentage of Graphics Segment net sales (customer plus inter-segment net sales). The increase in the amount of gross profit is due to the net effect of increased net sales, customer and product mix related to large petroleum/convenience store rollout programs, lower margins on installation sales, increased freight expense on higher sales, increased property and real estate taxes (\$0.3 million), increased outside service expense (\$0.2 million), decreased utility expense (\$0.1 million), an increase in corporate shared services (\$0.2 million), and increased compensation and benefits expense (\$0.6 million).

Edgar Filing: LSI INDUSTRIES INC - Form 10-K

Selling and administrative expenses of \$14,280,000 in fiscal 2016 increased \$1.8 million or 14.0% from fiscal 2015 primarily as a result of increased compensation and benefits expense (\$1.4 million), increased travel and entertainment expense (\$0.2 million), increased convention and show expense (\$0.1 million), and increased commission expense (\$0.1 million). In fiscal 2015, the Graphics Segment recorded a gain on the sale of one of its facilities in Woonsocket, Rhode Island of \$343,000 with no comparable event in fiscal 2016.

Graphics Segment fiscal 2016 operating income of \$5,246,000 increased \$4.3 million or 451% from fiscal 2015 and is the net result of increased net sales, increased gross profit and increased gross profit as a percentage of net sales, increased selling and administrative expenses, and a gain on the sale of a facility in fiscal 2015 with no corresponding event in fiscal 2016.

- 26 -

---

**Technology Segment**

<i>(In thousands)</i>	2016	2015
Net Sales	\$17,339	\$20,744
Gross Profit	\$7,620	\$6,769
Operating Income	\$4,028	\$3,153

Technology Segment net customer sales of \$17,339,000 in fiscal 2016 decreased 16.4% from fiscal 2015 net sales of \$20,744,000. The \$3.4 million decrease in Technology Segment net sales is primarily the net result of a \$2.4 million decrease in sales to the transportation market, a \$0.3 million decrease in sales to original equipment manufacturers, a \$0.8 million decrease in sales to the medical markets, and a \$0.1 million net increase in sales to various other markets. The decrease in sales is due to the cyclic nature of the markets the Company serves in this segment. While net customer sales decreased, the Technology Segment inter-segment sales increased \$6.3 million or 21.5%. The increase in inter-segment sales is the direct result of the Lighting Segment's increase in net sales of light fixtures having solid-state LED technology along with light fixtures with integrated controls. The Technology Segment's intercompany support of electronic circuit boards and lighting control systems to the Lighting Segment is core to the strategic growth of the Company.

Gross profit of \$7,620,000 in fiscal 2016 increased \$0.9 million or 12.6% from fiscal 2015, and increased from 13.5% to 14.4% as a percentage of Technology Segment net sales (customer plus inter-segment net sales). The \$0.9 million increase in amount of gross profit is due to the net effect of decreased customer net sales more than offset by increased inter-segment sales, an improvement in operational efficiencies, decreased employee compensation and benefits expense (\$0.4 million), decreased supplies (\$0.2 million), and increased depreciation expense (\$0.1 million).

Selling and administrative expenses of \$3,592,000 in fiscal 2016 decreased slightly from fiscal 2015 primarily as the net result of decreased research and development expense (\$0.4 million) and increased compensation and benefits expenses (\$0.3 million).

Technology Segment fiscal 2016 operating income of \$4,028,000 increased \$0.9 million or 27.8% from operating income of \$3,153,000 in fiscal 2015. The increase of \$0.9 million was the net result of decreased net customer sales more than offset by increased inter-segment sales, increased gross profit from the net increase in total net sales (customer and intersegment net sales), and decreased selling and administrative expenses.

**All Other Category**

<i>(In thousands)</i>	2016	2015
Net Sales	\$ --	\$41

Gross Profit	\$ --	\$21
Operating (Loss)	\$ --	\$(183)

Due to the sale of LSI Saco on September 30, 2014, there is no longer comparable data for the All Other Category.

**Corporate and Eliminations**

<i>(In thousands)</i>	2016	2015
Gross Profit	\$(149 )	\$(19 )
Operating (Loss)	\$(11,103)	\$(11,164)

The negative gross profit relates to the intercompany profit in inventory elimination.

Selling and administrative expenses of \$10,954,000 in fiscal 2016 increased \$0.3 million or 3.5% from fiscal 2015. The increase in expense is primarily the result of increased employee compensation and benefits expense (\$0.1 million), a decrease in legal fee expense (\$0.3 million), increased outside service expense (\$0.3 million), increased depreciation expense (\$0.2 million), an increase in telephone expense (\$0.2 million), and an increase in repair and maintenance expense (\$0.2 million), an increase in corporate shared service costs allocated to the segments (favorable change of \$2.5 million), and an increase in research and development expense (\$2.0 million). The increase in research and development spending is the result of the creation of a corporate research and development department with its sole purpose to develop leading edge products utilizing: 1) the latest energy saving controls; 2) LED light source technology; and 3) the “internet of things” connectivity. In fiscal 2015, the Company recognized a \$565,000 loss on the sale of its Montreal subsidiary, LSI Saco, with no corresponding event in fiscal 2016.

## **Consolidated Results**

The Company reported net interest income of \$48,000 in fiscal 2016 as compared to net interest expense of \$19,000 in fiscal 2015. Commitment fees related to the unused portions of the Company’s lines of credit and interest income on invested cash are included in the net interest expense amounts in both fiscal 2016 and 2015. The change from net interest expense in fiscal 2015 to net interest income in fiscal 2016 is the result of the growth in invested cash.

The \$4,522,000 income tax expense in fiscal 2016 represents a consolidated effective tax rate of 32.3%, influenced by certain permanent book-tax differences, an \$111,000 tax benefit related to the retroactive reinstatement of the R&D tax credit, and by a tax benefit related to uncertain income tax positions. The \$2,363,000 income tax expense in fiscal 2015 represents a consolidated effective tax rate of 31.4% influenced by certain permanent book-tax differences, by certain U.S. federal tax credits, by a benefit related to uncertain income tax positions, and a \$136,000 tax benefit related to the retroactive reinstatement of the R&D tax credit.

The Company reported net income of \$9,482,000 in fiscal 2016 as compared to net income of \$5,151,000 in fiscal 2015. This represents an 84.1% increase in net income in fiscal 2016 compared to fiscal 2015. The increase in net income is primarily the net result of increased net sales, increased gross profit, increased operating expenses, the gain on the sale of a facility more than offset by the loss on the sale of a subsidiary in fiscal 2015 with no comparable events in fiscal 2016, and increased income tax expense. Diluted earnings per share were \$0.37 in fiscal 2016 as compared to diluted earnings per share of \$ 0.21 in fiscal 2015. The weighted average common shares outstanding for purposes of computing diluted earnings per share in fiscal 2016 were 25,592,000 shares as compared to 24,638,000 shares in fiscal 2015.

## **Liquidity and Capital Resources**

The Company considers its level of cash on hand, borrowing capacity, current ratio and working capital levels to be its most important measures of short-term liquidity. For long-term liquidity indicators, the Company believes its ratio of long-term debt to equity and its historical levels of net cash flows from operating activities to be the most important measures.

At June 30, 2017, the Company had working capital of \$61.7 million, compared to \$88.5 million at June 30, 2016. The large decrease in the Company's working capital is primarily the result of the \$31 million in cash used to acquire Atlas lighting. The ratio of current assets to current liabilities was 2.36 to 1 as compared to a ratio of 3.26 to 1 at June 30, 2016. The \$26.8 million decrease in working capital from June 30, 2016 to June 30, 2017 was primarily related to the net effect of decreased cash and cash equivalents (\$30.8 million), increased net accounts receivable (\$1.9 million), increased net inventory (\$5.9 million), an increase in accrued expenses (\$0.9 million), an increase in other current assets (\$0.2 million), an increase in refundable income taxes (\$0.8 million), an increase in accounts payable (\$5.5 million), and assets held for sale of \$1.5 million at June 30, 2017. The Company has a strategy of aggressively managing working capital, including reduction of the accounts receivable days sales outstanding (DSO) and reduction of inventory levels, without reducing service to its customers.

The Company generated \$21.0 million of cash from operating activities in fiscal 2017 as compared to \$17.8 million in fiscal 2016. This \$3.2 million increase in net cash flows from operating activities is primarily the net result of a decrease rather than an increase in net accounts receivable (unfavorable change of \$8.6 million), an increase rather than a decrease in accounts payable (favorable change of \$3.4 million), an increase rather than a decrease in customer prepayments (favorable change of \$0.3 million), a decrease rather than an increase in net inventory (unfavorable change of \$3.7 million), a decrease rather than an increase in accrued expenses and other (unfavorable change of \$7.3 million), an increase rather than a decrease in refundable income taxes (unfavorable change of \$0.9 million), a smaller increase in net deferred tax assets (favorable change of \$0.3 million), an increase in stock compensation expense (favorable change of \$0.1 million), an increase in the deferred compensation liability (favorable change of \$0.1 million), an increase in depreciation and amortization expense (favorable change of \$1.6 million), fixed asset impairment and accelerated depreciation with no comparable events in the prior year (favorable change of \$0.4 million), intangible asset impairment with no comparable events in the prior year (favorable change of \$0.5 million), a gain on the sale of a building (the Kansas City facility) in fiscal 2017 with no comparable event in fiscal 2016 (unfavorable change of \$1.4 million), a loss compared to a gain on the sale of several fixed assets other than the sale of a building (favorable change of \$0.1 million), and a decrease in net income (unfavorable change of \$6.5 million).

Net accounts receivable were \$48.9 million and \$47.0 million at June 30, 2017 and 2016, respectively. The increase of \$1.9 million in net receivables is primarily due to the net effect of a higher amount of net sales in the fourth quarter of fiscal 2017 as compared to the fourth quarter of fiscal 2016 and higher days sales outstanding (DSO). The DSO increased to 52 days at June 30, 2017 from 47 days at June 30, 2016. The Company believes that its receivables are ultimately collectible or recoverable, net of certain reserves, and that aggregate allowances for doubtful accounts are adequate.

Net inventories of \$50.0 million at June 30, 2017 increased \$5.9 million from June 30, 2016 levels. The increase of \$5.9 million is the result of an increase in gross inventory of \$6.3 million partially offset by an increase in inventory obsolescence reserves of \$0.4 million. Based on a strategy of balancing inventory reductions with customer service and the timing of shipments, net inventory increases occurred in fiscal 2017 in the Lighting Segment of approximately \$3.5 million (fiscal 2017 includes \$9.4 million of net inventory at Atlas for which there was no comparable inventory as of June 30, 2016), in the Graphics Segment of approximately \$0.6 million and in the Technology Segment of approximately \$1.5 million.

Cash generated from operations and borrowing capacity under the Company's line of credit is the Company's primary source of liquidity. The Company has a secured \$100 million revolving line of credit with its bank, with \$49.9 million of the credit line available as of August 25, 2017. This line of credit is a \$100 million five year credit line expiring in the third quarter of fiscal 2022. The Company believes that its \$100 million line of credit plus cash flows from operating activities are adequate for the Company's fiscal 2018 operational and capital expenditure needs. The Company is in compliance with all of its loan covenants.

The Company used cash of \$98.6 million related to investing activities in fiscal 2017 as compared to a use of \$10.1 million in fiscal 2016, resulting in an unfavorable change of \$88.5 million. Capital expenditures for fiscal 2017 decreased \$3.6 million to \$6.6 million from fiscal 2016. The largest components of the fiscal 2017 capital expenditures are equipment and building improvements related to the Company's Lighting and Graphics Segments and computer hardware and software related to Corporate Administration. The Company acquired Atlas Lighting Products in the third quarter of fiscal 2017, which used cash of \$95.1 million of which \$66 million was funded by the Company's line of credit. Proceeds from the sale of fixed assets increased by \$3.0 million due to the sale of the Kansas City manufacturing facility in the third quarter of fiscal 2017.

The Company provided \$46.8 million of cash related to financing activities in fiscal 2017 compared to a use of cash of \$0.2 million in fiscal 2016. The \$47.0 million favorable change in cash flow was primarily the net result of borrowings in excess of payments of long term debt of \$49.5 million, an increase in dividends paid to shareholders (unfavorable change of \$0.8 million), and a decrease in the exercise of stock options in fiscal 2017 (unfavorable change of \$1.4 million).

The Company has, or could have, on its balance sheet financial instruments consisting primarily of cash and cash equivalents, short-term investments, revolving lines of credit, and long-term debt. The fair value of these financial instruments approximates carrying value because of their short-term maturity and/or variable, market-driven interest rates.

### Off-Balance Sheet Arrangements

The Company has no financial instruments with off-balance sheet risk and has no off-balance sheet arrangements except for the operating leases identified in the table below.

Contractual Obligations as of June 30, 2017 (a)(b)	Payments Due by Period Total	Less than			
		1 year	1-3 years	3-5 years	More than 5 years
Operating Lease Obligations	\$14,265	\$1,870	\$5,665	\$6,324	\$ 406
Purchase Obligations	21,234	21,192	42	--	--
Total Contractual Obligations	\$35,499	\$23,062	\$5,707	\$6,324	\$ 406

(a) The liability for uncertain tax positions of \$1.4 million is not included due to the uncertainty of timing of payments.

(b) The \$49.7 borrowed against the revolving line of credit is not included due to the uncertainty of the timing of payments.



## **Cash Dividends**

In August 2017, the Board of Directors declared a regular quarterly cash dividend of \$0.05 per share payable September 6, 2017 to shareholders of record as of August 28, 2017. The indicated annual cash dividend rate for fiscal 2017 was \$0.20 per share. The Board of Directors has adopted a policy regarding dividends which indicates that dividends will be determined by the Board of Directors in its discretion based upon its evaluation of earnings, cash flow requirements, financial condition, debt levels, stock repurchases, future business developments and opportunities, and other factors deemed relevant.

## **Critical Accounting Policies and Estimates**

The Company is required to make estimates and judgments in the preparation of its financial statements that affect the reported amounts of assets, liabilities, revenues and expenses, and related footnote disclosures. The Company bases its estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities. The Company continually reviews these estimates and their underlying assumptions to ensure they remain appropriate. The Company believes the items discussed below are among its most significant accounting policies because they utilize estimates about the effect of matters that are inherently uncertain and therefore are based on management's judgment. Significant changes in the estimates or assumptions related to any of the following critical accounting policies could possibly have a material impact on the financial statements.

### ***Revenue Recognition***

Revenue is recognized when title to goods and risk of loss have passed to the customer, there is persuasive evidence of a purchase arrangement, delivery has occurred or services have been rendered, and collectability is reasonably assured. Sales are recorded net of estimated returns, rebates and discounts. Amounts received from customers prior to the recognition of revenue are accounted for as customer pre-payments and are included in accrued expenses.

The Company has five sources of revenue: revenue from product sales; revenue from installation of products; service revenue generated from providing integrated design, project and construction management, site engineering and site permitting, and commissioning of lighting controls; revenue from the management of media content and digital hardware related to active digital signage; and revenue from shipping and handling.

Product revenue is recognized on product-only orders upon passing of title and risk of loss, generally at time of shipment. In certain arrangements with customers, as is the case with the sale of some of our solid-state LED video screens, revenue is recognized upon customer acceptance of the video screen at the job site. Product revenue related to orders where the customer requires the Company to install the product is recognized when the product is installed. The company provides product warranties and certain post-shipment service, support and maintenance of certain solid state LED video screens and billboards.

Installation revenue is recognized when the products have been fully installed. The Company is not always responsible for installation of products it sells and has no post-installation responsibilities, other than normal warranties.

Service revenue from integrated design, project and construction management, and site permitting is recognized when all products at a customer site have been installed.

Revenue from the management of media content and digital hardware related to active digital signage is recognized evenly over the service period with the customer. Media content service periods with most customers range from 1 month to 1 year.

Shipping and handling revenue coincides with the recognition of revenue from the sale of the product.

In situations where the Company is responsible for re-imaging programs with multiple sites, each site is viewed as a separate unit of accounting and has stand-alone value to the customer. Revenue is recognized upon the Company's complete performance at the location, which may include a site survey, graphics products, lighting products, and installation of products. The selling price assigned to each site is based upon an agreed upon price between the Company and its customer and reflects the estimated selling price for that site relative to the selling price for sites with similar image requirements.

The Company also evaluates the appropriateness of revenue recognition in accordance with the accounting standard on software revenue recognition. Our solid-state LED video screens, billboards and active digital signage contain software elements which the Company has determined are incidental.

### ***Income Taxes***

The Company accounts for income taxes in accordance with the accounting guidance for income taxes. Accordingly, deferred income taxes are provided on items that are reported as either income or expense in different time periods for financial reporting purposes than they are for income tax purposes. Deferred income tax assets and liabilities are reported on the Company's balance sheet. Significant management judgment is required in developing the Company's income tax provision, including the estimation of taxable income and the effective income tax rates in the multiple taxing jurisdictions in which the Company operates, the estimation of the liability for uncertain income tax positions, the determination of deferred tax assets and liabilities, and any valuation allowances that might be required against deferred tax assets. The Company has adopted ASU 2015-17, "Balance Sheet Classification of Deferred Taxes." As a result of early adoption of this accounting guidance, prior periods have been re-classified, which only affected the financial statement presentation and not the measurement of deferred tax liabilities and assets.

The Company operates in multiple taxing jurisdictions and is subject to audit in these jurisdictions. The Internal Revenue Service and other tax authorities routinely review the Company's tax returns. These audits can involve complex issues which may require an extended period of time to resolve. In management's opinion, adequate provision has been made for potential adjustments arising from these audits.

The Company is recording estimated interest and penalties related to potential underpayment of income taxes as a component of tax expense in the Condensed Consolidated Statements of Operations. The reserve for uncertain tax positions is not expected to change significantly in the next twelve months.

### ***Asset Impairment***

Carrying values of goodwill and other intangible assets with indefinite lives are reviewed at least annually for possible impairment in accordance with the accounting guidance on goodwill and intangible assets. The Company may first assess qualitative factors in order to determine if goodwill is impaired. If through the qualitative assessment it is determined that it is more likely than not that goodwill is not impaired, no further testing is required. If it is determined that it is more likely than not that goodwill is impaired, or if the Company elects not to first assess qualitative factors, the Company's impairment testing continues at the reporting unit level with the estimation of the fair value of goodwill and indefinite-lived intangible assets using a combination of a market approach and an income (discounted cash flow) approach. The estimation of the fair value of goodwill and indefinite-lived intangible assets

requires significant management judgment with respect to revenue and expense growth rates, changes in working capital and the selection and use of an appropriate discount rate. The estimates of fair value of reporting units are based on the best information available as of the date of the assessment. The use of different assumptions would increase or decrease estimated discounted future operating cash flows and could increase or decrease an impairment charge. Company management uses its judgment in assessing whether assets may have become impaired between annual impairment tests. Indicators such as adverse business conditions, a sustained drop in the Company's stock price, economic factors and technological change or competitive activities may signal that an asset has become impaired.

Carrying values for long-lived tangible assets and definite-lived intangible assets, excluding goodwill and indefinite-lived intangible assets, are reviewed for possible impairment as circumstances warrant. Impairment reviews are conducted at the judgment of Company management when it believes that a change in circumstances in the business or external factors warrants a review. Circumstances such as the discontinuation of a product or product line, a sudden or consistent decline in the forecast for a product, changes in technology or in the way an asset is being used, a history of negative operating cash flow, or an adverse change in legal factors or in the business climate, among others, may trigger an impairment review. The Company's initial impairment review to determine if a potential impairment charge is required is based on an undiscounted cash flow analysis at the lowest level for which identifiable cash flows exist. The analysis requires judgment with respect to changes in technology, the continued success of product lines and future volume, revenue and expense growth rates, and discount rates.

### ***Credit and Collections***

The Company maintains allowances for doubtful accounts receivable for probable estimated losses resulting from either customer disputes or the inability of its customers to make required payments. If the financial condition of the Company's customers were to deteriorate, resulting in their inability to make the required payments, the Company may be required to record additional allowances or charges against income. The Company determines its allowance for doubtful accounts by first considering all known collectability problems of customers' accounts, and then applying certain percentages against the various aging categories based on the due date of the remaining receivables. The resulting allowance for doubtful accounts receivable is an estimate based upon the Company's knowledge of its business and customer base, and historical trends. The amount ultimately not collected may differ from the reserve established, particularly in the case where percentages are applied against aging categories. In all cases, it is management's goal to carry a reserve against the Company's accounts receivable which is adequate based upon the information available at that time so that net accounts receivable is properly stated. The Company also establishes allowances, at the time revenue is recognized, for returns and allowances, discounts, pricing and other possible customer deductions. These allowances are based upon contractual terms and historical trends.

### ***Warranty Reserves***

The Company offers a limited warranty that its products are free from defects in workmanship and materials. The specific terms and conditions vary somewhat by product line, but generally cover defective products returned within one to five years, with some exceptions where the terms extend to 10 years, from the date of shipment. The Company records warranty liabilities to cover the estimated future costs for repair or replacement of defective returned products as well as products that need to be repaired or replaced in the field after installation. The Company calculates its liability for warranty claims by applying estimates based upon historical claims as a percentage of sales to cover unknown claims, as well as estimating the total amount to be incurred for known warranty issues. The Company periodically assesses the adequacy of its recorded warranty liabilities and adjusts the amounts as necessary.

### ***Inventory Reserves***

The Company maintains an inventory reserve for probable obsolete and excess inventory. The Company first determines its obsolete inventory reserve by considering specific known obsolete items, and then by applying certain percentages to specific inventory categories based upon inventory turns. The Company uses various tools, in addition to inventory turns, to identify which inventory items have the potential to become obsolete. Judgment is used to establish excess and obsolete inventory reserves and management adjusts these reserves as more information becomes available about the ultimate disposition of the inventory item. Management values inventory at lower of cost or market.

### **New Accounting Pronouncements**

In June 2014, the Financial Accounting Standards Board issued ASU 2014-09, "Revenue from Contracts with Customers." This amended guidance supersedes and replaces all existing U.S. GAAP revenue recognition guidance. The guidance established a new revenue recognition model, changes the basis for deciding when revenue is recognized, provides new and more detailed guidance on specific revenue topics, and expands and improves disclosures about revenue. In April 2016, the FASB issued ASU 2016-10, "Revenue from Contracts with Customers: Identifying Performance Obligations and Licensing." In May 2016, the FASB issued ASU 2016-12, "Revenue from Contracts with Customers: Narrow Scope Improvements and Practical Expedients." In December 2016, the FASB issued ASU 2016-20, "Technical Corrections and Improvements to Topic 606, Revenue from Contracts with Customers." These three standards clarify or improve guidance from ASU 2014-09 and are effective for fiscal years and interim periods within those years, beginning after December 15, 2017, or the Company's fiscal year 2019. The Company will adopt these standards no later than July 1, 2018. The Company is reviewing accounting policies and evaluating disclosures in the financial statements related to the new standard. The Company is also assessing potential changes to the business processes, internal controls, and information systems related to the adoption of the new standard. While the Company is currently assessing the impact of the new standard, the Company's revenue is primarily generated from the sale of finished products to customers. Those sales predominantly contain a single delivery element and revenue is recognized at a single point in time when ownership, risks, and rewards transfer. The recognition of revenue from most product sales is largely unaffected by the new standard. However, with respect to certain product sales requiring installation, revenue is currently not recognized until the installation is complete. While the Company does not expect this new guidance to have a material impact on the amount of overall sales recognized, the timing of recognition of revenues from sales on certain projects may be affected. Our initial conclusions may change as we finalize our assessment and select a transition method during the next six to nine months.

In July 2015, the Financial Accounting Standards Board issued ASU 2015-11, "Simplifying the Measurement of Inventory." The amended guidance requires an entity to measure in scope inventory at lower of cost and net realizable value. The amended guidance is effective for fiscal years beginning after December 15, 2016, or the Company's fiscal year 2018, with early adoption permitted. The Company is evaluating the impact the amended guidance will have on its financial statements.

In November 2015, the FASB issued ASU 2015-17, “Balance Sheet Classification of Deferred Taxes,” which eliminates the current requirement to separate deferred income tax liabilities and assets into current and noncurrent amounts in the statement of financial position. This update requires that deferred tax liabilities and assets be classified as noncurrent. This update is effective for financial statements issued for fiscal years beginning April 1, 2017. This update may be applied either prospectively or retrospectively. However, early adoption is permitted and the Company has chosen to adopt the standard retrospectively as of June 30, 2016. As a result, prior periods have been adjusted to reflect this change. This update affected the presentation, but not the measurement of deferred tax liabilities and assets.

In February 2016, the Financial Accounting Standards Board issued ASU 2016-02, “Leases.” The amended guidance requires an entity to recognize assets and liabilities that arise from leases. The amended guidance is effective for financial statements issued for fiscal years and interim periods within those years, beginning after December 15, 2018, or the Company’s fiscal year 2020, with early adoption permitted. The Company has not yet determined the impact the amended guidance will have on its financial statements.

In March 2016, the Financial Accounting Standards Board issued ASU 2016-08, “Principal versus Agent Considerations.” The amendment is intended to improve the operability and understandability of the implementation guidance on principal versus agent considerations. The amended guidance is effective for financial statements issued for fiscal years and interim periods within those years, beginning after December 15, 2017, or the Company’s fiscal year 2019, with early adoption permitted in fiscal years beginning after December 15, 2016. The Company has determined the amended guidance will have an immaterial impact on its financial statements.

In March 2016, the Financial Accounting Standards Board issued ASU 2016-09, “Improvements to Employee Share-Based Payment Accounting.” This amended guidance simplifies several aspects of the accounting for share-based payment award transactions. The amended guidance is effective for financial statements issued for fiscal years and interim periods within those years, beginning after December 15, 2016, or the Company’s fiscal year 2018, with early adoption permitted. The Company has determined the amended guidance will have an immaterial impact on its financial statements.

In June 2016, the Financial Accounting Standards Board issued ASU 2016-13, “Measurement of Credit Losses on Financial Instruments.” This amendment provides additional guidance on the measurement of expected credit losses for financial assets based on historical experience, current conditions, and supportable forecasts. The amended guidance is effective for financial statements issued for fiscal years and interim periods within those years, beginning after December 15, 2019, or the Company’s fiscal year 2021. The Company is evaluating the impact of the amended guidance and the anticipated impact to the financial statements is not material.

In August 2016, the Financial Accounting Standards Board issued ASU 2016-15, “Statement of Cash Flows: Classification of Certain Cash Receipts and Cash Payments,” which provides cash flow classification guidance for

certain cash receipts and cash payments. This standard is effective for financial statements issued for fiscal years beginning after December 15, 2017, or the Company's fiscal year 2019. The Company is evaluating the impact the amended guidance will have on its financial statements.

In January 2017, the Financial Accounting Standards Board issued ASU 2017-04, "Simplifying the Test for Goodwill Impairment", which simplifies the testing for goodwill impairment by eliminating a previously required step. The standard is effective for financial statements issued for fiscal years beginning after December 15, 2019, or the Company's fiscal year 2021. The Company is evaluating the impact the amended guidance will have on its financial statements.



## **MANAGEMENT'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING**

The Management of LSI Industries Inc. and subsidiaries (the "Company" or "LSI") is responsible for the preparation and accuracy of the financial statements and other information included in this report. LSI's Management is also responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Securities Exchange Act Rules 13a-15(f). Under the supervision and with the participation of Management, including LSI's principal executive officer and principal financial officer, the Company conducted an evaluation of the effectiveness of internal control over financial reporting as of June 30, 2017, based on the criteria set forth in "the 2013 Internal Control – Integrated Framework" issued by the Committee of Sponsoring Organizations of the Treadway Commission.

A control system, no matter how well conceived and operated, can provide only reasonable assurance that the objectives of the control system are met. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, have been detected. These inherent limitations include the reality that judgments in decision making can be faulty, the possibility of human error, and the circumvention or overriding of the controls and procedures.

In meeting its responsibility for the reliability of the financial statements, the Company depends upon its system of internal accounting controls. The system is designed to provide reasonable assurance that assets are safeguarded and that transactions are properly authorized and recorded. The system is supported by policies and guidelines, and by careful selection and training of financial management personnel. The Company also has a Disclosure Controls Committee, whose responsibility is to help ensure appropriate disclosures and presentation of the financial statements and notes thereto. Additionally, the Company has an Internal Audit Department to assist in monitoring compliance with financial policies and procedures.

The Board of Directors meets its responsibility for overview of the Company's financial statements through its Audit Committee which is composed entirely of independent Directors who are not employees of the Company. The Audit Committee meets periodically with Management and Internal Audit to review and assess the activities of each in meeting their respective responsibilities. Grant Thornton LLP has full access to the Audit Committee to discuss the results of their audit work, the adequacy of internal accounting controls, and the quality of financial reporting.

The Company acquired Atlas Lighting Products, Inc. ("Atlas") on February 21, 2017. Management excluded Atlas from its evaluation of the effectiveness of internal control over financial reporting as of June 30, 2017. Atlas represented 39% of the Company's total consolidated assets as of June 30, 2017, and 5% of the Company's total consolidated sales for the fiscal year ended June 30, 2017.

Based upon LSI's evaluation, the Company's principal executive officer and principal financial officer concluded that internal control over financial reporting was effective as of June 30, 2017. We reviewed the results of Management's assessment with the Audit Committee of our Board of Directors. Additionally, our independent registered public accounting firm audited and independently assessed the effectiveness of the Company's internal control over financial reporting. Grant Thornton LLP, an independent registered public accounting firm, has issued an attestation report on the effectiveness of the Company's internal control over financial reporting, which is presented in the financial statements.

**Dennis W. Wells**

Chief Executive Officer and President  
(Principal Executive Officer)

**James E. Galeese**

Executive Vice President and Chief Financial Officer  
(Principal Financial Officer)

## REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors and Shareholders

LSI Industries Inc.

We have audited the internal control over financial reporting of LSI Industries Inc. (an Ohio corporation) and subsidiaries (the “Company”) as of June 30, 2017, based on criteria established in the 2013 *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company’s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management’s Report On Internal Control Over Financial Reporting. Our responsibility is to express an opinion on the Company’s internal control over financial reporting based on our audit. Our audit of, and opinion on, the Company’s internal control over financial reporting does not include the internal control over financial reporting of Atlas Lighting Products, Inc. (“Atlas”), a wholly-owned subsidiary, whose financial statements reflect total assets and revenues constituting 39 percent and 5 percent, respectively, of the related consolidated financial statement amounts as of and for the year ended June 30, 2017. As indicated in Management’s Report On Internal Control Over Financial Reporting, Atlas was acquired during fiscal year 2017. Management’s assertion on the effectiveness of the Company’s internal control over financial reporting excluded internal control over financial reporting of Atlas.

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

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

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

In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of June 30, 2017, based on criteria established in the 2013 *Internal Control—Integrated Framework* issued by COSO.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated financial statements of the Company as of and for the year ended June 30, 2017, and our report dated September 8, 2017 expressed an unqualified opinion on those financial statements.

/s/ GRANT THORNTON LLP

Cincinnati, Ohio

September 8, 2017

**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

Board of Directors and Shareholders

LSI Industries Inc.

We have audited the accompanying consolidated balance sheets of LSI Industries Inc. (an Ohio corporation) and subsidiaries (the “Company”) as of June 30, 2017 and 2016, and the related consolidated statements of operations, shareholders’ equity, and cash flows for each of the three years in the period ended June 30, 2017. Our audits of the basic consolidated financial statements included the financial statement schedule appearing under Item 8. These financial statements and financial statement schedule are the responsibility of the Company’s management. Our responsibility is to express an opinion on these financial statements and financial statement schedule based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of LSI Industries Inc. and subsidiaries as of June 30, 2017 and 2016, and the results of their operations and their cash flows for each of the three years in the period ended June 30, 2017 in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, the related financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Company’s internal control over financial reporting as of June 30, 2017, based on criteria established in the 2013 *Internal Control—Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated September 8, 2017 expressed an unqualified opinion.

/s/ GRANT THORNTON LLP

Cincinnati, Ohio

September 8, 2017

- 36 -

---

**LSI INDUSTRIES INC.****CONSOLIDATED STATEMENTS OF OPERATIONS****For the years ended June 30, 2017, 2016, and 2015***(In thousands, except per share data)*

	<b>2017</b>	2016	2015
Net sales	<b>\$331,392</b>	\$322,196	\$307,857
Cost of products and services sold	<b>248,012</b>	238,525	233,408
Restructuring costs	<b>1,503</b>	—	—
Gross profit	<b>81,877</b>	83,671	74,449
Selling and administrative expenses	<b>77,272</b>	69,715	66,694
Impairment of intangible asset	<b>479</b>	—	—
Acquisition deal costs	<b>1,608</b>	—	—
Restructuring costs (gain) (see Note 15)	<b>(1,091 )</b>	—	—
Loss on sale of subsidiary (see Note 17)	—	—	565
Gain on sale of building	—	—	(343 )
Operating income	<b>3,609</b>	13,956	7,533
Interest (income)	<b>(91 )</b>	(84 )	(26 )
Interest expense	<b>620</b>	36	45
Income before income taxes	<b>3,080</b>	14,004	7,514
Income tax expense	<b>80</b>	4,522	2,363
Net income	<b>\$3,000</b>	\$9,482	\$5,151
Earnings per common share (see Note 3)			
Basic	<b>\$0.12</b>	\$0.38	\$0.21

Edgar Filing: LSI INDUSTRIES INC - Form 10-K

Diluted	<b>\$0.12</b>	\$0.37	\$0.21
Weighted average common shares outstanding			
Basic	<b>25,436</b>	24,988	24,496
Diluted	<b>25,988</b>	25,592	24,638

*The accompanying notes are an integral part of these financial statements.*

- 37 -

---



**LSI INDUSTRIES INC.****CONSOLIDATED BALANCE SHEETS****June 30, 2017 and 2016***(In thousands, except shares)*

	<b>2017</b>	2016
<b>ASSETS</b>		
Current Assets		
Cash and cash equivalents	<b>\$3,039</b>	\$33,835
Accounts receivable, less allowance for doubtful accounts of \$506 and \$226, respectively	<b>48,880</b>	46,975
Inventories	<b>50,008</b>	44,141
Refundable income taxes	<b>775</b>	—
Assets held for sale	<b>1,463</b>	—
Other current assets	<b>2,964</b>	2,792
Total current assets	<b>107,129</b>	127,743
Property, Plant and Equipment, at cost		
Land	<b>6,429</b>	6,978
Buildings	<b>35,463</b>	39,317
Machinery and equipment	<b>78,804</b>	82,628
Construction in progress	<b>3,805</b>	838
	<b>124,501</b>	129,761
Less accumulated depreciation	<b>(77,147 )</b>	(82,299 )
Net property, plant and equipment	<b>47,354</b>	47,462
Goodwill	<b>58,538</b>	10,508
Other Intangible Assets, net	<b>38,169</b>	5,586
Other Long-Term Assets, net	<b>5,490</b>	4,261
Total assets	<b>\$256,680</b>	\$195,560

*The accompanying notes are an integral part of these financial statements.*

	2017	2016
<b>LIABILITIES &amp; SHAREHOLDERS' EQUITY</b>		
Current Liabilities		
Accounts payable	<b>\$19,356</b>	\$13,892
Accrued expenses	<b>26,069</b>	25,341
Total current liabilities	<b>45,425</b>	39,233
Long-Term Debt	<b>49,698</b>	—
Other Long-Term Liabilities	<b>1,479</b>	807
Commitments and Contingencies (Note 13)		
Shareholders' Equity		
Preferred shares, without par value; Authorized 1,000,000 shares, none issued	—	—
Common shares, without par value; Authorized 40,000,000 shares; Outstanding 25,429,223 and 24,982,219 shares, respectively	<b>120,259</b>	113,653
Retained earnings	<b>39,819</b>	41,867
Total shareholders' equity	<b>160,078</b>	155,520
Total liabilities & shareholders' equity	<b>\$256,680</b>	\$195,560

*The accompanying notes are an integral part of these financial statements.*

## LSI INDUSTRIES INC.

## CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

For the years ended June 30, 2017, 2016, and 2015

*(In thousands, except per share data)*

	Common Shares		Key Executive Deferred Compensation		Retained Earnings	Total Shareholders' Equity
	Number of Shares	Amount	Number of Shares	Amount		
Balance at June 30, 2014	24,430	\$106,979	(307)	\$(2,915)	\$34,348	\$138,412
Net income	—	—	—	—	5,151	5,151
Stock compensation awards	27	191	—	—	—	191
Distribution of treasury shares, net	—	—	80	770	—	770
Deferred stock compensation	—	(761)	—	—	—	(761)
Stock option expense	—	1,239	—	—	—	1,239
Stock options exercised, net	163	850	—	—	—	850
Dividends — \$0.12 per share	—	—	—	—	(2,900)	(2,900)
Balance at June 30, 2015	24,620	108,498	(227)	(2,145)	36,599	142,952
Net income	—	—	—	—	9,482	9,482
Stock compensation awards	23	248	—	—	—	248
Restricted stock units issued	5	—	—	—	—	—
Purchase of treasury shares, net	—	—	(1)	(23)	—	(23)
Deferred stock compensation	—	151	—	—	—	151
Stock-based compensation expense	—	2,903	—	—	—	2,903
Stock options exercised, net	562	4,021	—	—	—	4,021
Dividends — \$0.17 per share	—	—	—	—	(4,214)	(4,214)
Balance at June 30, 2016	25,210	115,821	(228)	(2,168)	41,867	155,520
<b>Net income</b>	—	—	—	—	<b>3,000</b>	<b>3,000</b>
<b>Stock compensation awards</b>	<b>40</b>	<b>409</b>	—	—	—	<b>409</b>
<b>Restricted stock units issued</b>	<b>25</b>	—	—	—	—	—
<b>Stock Warrants Issued</b>	—	<b>575</b>	—	—	—	<b>575</b>
<b>Purchase of treasury shares, net</b>	—	—	<b>(30)</b>	<b>(276)</b>	—	<b>(276)</b>
<b>Deferred stock compensation</b>	—	<b>237</b>	—	—	—	<b>237</b>

<b>Stock-based compensation expense</b>	—	<b>3,049</b>	—	—	—	<b>3,049</b>
<b>Stock options exercised, net</b>	<b>412</b>	<b>2,612</b>	—	—	—	<b>2,612</b>
<b>Dividends — \$0.20 per share</b>	—	—	—	—	<b>(5,048 )</b>	<b>(5,048 )</b>
<b>Balance at June 30, 2017</b>	<b>25,687</b>	<b>\$122,703</b>	<b>(258)</b>	<b>\$(2,444)</b>	<b>\$39,819</b>	<b>\$ 160,078</b>

*The accompanying notes are an integral part of these financial statements.*

**LSI INDUSTRIES INC.****CONSOLIDATED STATEMENTS OF CASH FLOWS****For the years ended June 30, 2017, 2016, and 2015***(In thousands)*

	<b>2017</b>	2016	2015
<b>Cash Flows From Operating Activities</b>			
Net income	<b>\$3,000</b>	\$9,482	\$5,151
Non-cash items included in net income			
Depreciation and amortization	<b>8,262</b>	6,677	6,331
Intangible asset impairment	<b>479</b>	—	—
Deferred income taxes	<b>(779 )</b>	(1,117 )	(226 )
Deferred compensation plan	<b>237</b>	151	(761 )
Stock based compensation expense	<b>3,049</b>	2,903	1,239
Issuance of common shares as compensation	<b>409</b>	248	191
(Gain) on disposition of building	<b>(1,361 )</b>	—	(343 )
Loss (gain) on disposition of fixed assets	<b>484</b>	(1 )	9
Loss on sale of subsidiary	<b>—</b>	—	565
Allowance for doubtful accounts	<b>349</b>	55	220
Inventory obsolescence reserve	<b>2,088</b>	1,726	1,493
Change in certain assets and liabilities, net of acquisition			
Accounts receivable	<b>4,948</b>	(3,369 )	(1,631 )
Inventories	<b>535</b>	(2,784 )	1
Refundable income taxes	<b>(775 )</b>	99	1,815
Accounts payable	<b>2,278</b>	(1,130 )	910
Accrued expenses and other	<b>(2,180 )</b>	5,116	6,115
Customer prepayments	<b>9</b>	(271 )	(149 )
Net cash flows provided by operating activities	<b>21,032</b>	17,785	20,930
<b>Cash Flows From Investing Activities</b>			
Purchases of property, plant, and equipment	<b>(6,633 )</b>	(10,211)	(4,754 )
Acquisition of business, net of cash received and warrants issued	<b>(95,077)</b>	—	—
Proceeds from sale of subsidiary, net of cash sold	<b>—</b>	—	1,494
Proceeds from sale of fixed assets	<b>3,095</b>	68	1,006
Net cash flows (used in) investing activities	<b>(98,615)</b>	(10,143)	(2,254 )
<b>Cash Flows From Financing Activities</b>			
Payments of long-term debt	<b>(41,282)</b>	—	—
Borrowings of long-term debt	<b>90,781</b>	—	—
Cash dividends paid	<b>(5,048 )</b>	(4,214 )	(2,900 )

Edgar Filing: LSI INDUSTRIES INC - Form 10-K

Purchase of treasury shares	<b>(494 )</b>	(363 )	(205 )
Issuance of treasury shares	<b>218</b>	340	975
Exercise of stock options	<b>2,612</b>	4,021	850
Net cash flows provided by (used in) financing activities	<b>46,787</b>	(216 )	(1,280 )
(Decrease) Increase in cash and cash equivalents	<b>(30,796)</b>	7,426	17,396
Cash and cash equivalents at beginning of year	<b>33,835</b>	26,409	9,013
Cash and cash equivalents at end of year	<b>\$3,039</b>	\$33,835	\$26,409

*The accompanying notes are an integral part of these financial statements.*

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**NOTE 1 — SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

**Consolidation:**

The consolidated financial statements include the accounts of LSI Industries Inc. (an Ohio corporation) and its subsidiaries (collectively, the “Company”), all of which are wholly owned. All intercompany transactions and balances have been eliminated in consolidation.

**Revenue Recognition:**

Revenue is recognized when title to goods and risk of loss have passed to the customer, there is persuasive evidence of a purchase arrangement, delivery has occurred or services have been rendered, and collectability is reasonably assured. Sales are recorded net of estimated returns, rebates and discounts. Amounts received from customers prior to the recognition of revenue are accounted for as customer pre-payments and are included in accrued expenses.

The Company has five sources of revenue: revenue from product sales; revenue from installation of products; service revenue generated from providing integrated design, project and construction management, site engineering and site permitting, and commissioning of lighting controls; revenue from the management of media content and digital hardware related to active digital signage; and revenue from shipping and handling.

Product revenue is recognized on product-only orders upon passing of title and risk of loss, generally at time of shipment. In certain arrangements with customers, as is the case with the sale of some of our solid-state LED (light emitting diode) video screens, revenue is recognized upon customer acceptance of the video screen at the job site. Product revenue related to orders where the customer requires the Company to install the product is recognized when the product is installed. The Company provides product warranties and certain post-shipment service, support and maintenance of certain solid state LED video screens.



Installation revenue is recognized when the products have been fully installed. The Company is not always responsible for installation of products it sells and has no post-installation responsibilities, other than normal warranties.

Service revenue from integrated design, project and construction management, and site permitting is recognized when all products at a customer site have been installed.

Revenue from the management of media content and digital hardware related to active digital signage is recognized evenly over the service period with the customer. Media content service periods with most customers range from one month to one year.

Shipping and handling revenue coincides with the recognition of revenue from sale of the product.

In situations where the Company is responsible for re-imaging programs with multiple sites, each site is viewed as a separate unit of accounting and has stand-alone value to the customer. Revenue is recognized upon the Company's complete performance at the location, which may include a site survey, graphics products, lighting products, and installation of products. The selling price assigned to each site is based upon an agreed upon price between the Company and its customer and reflects the estimated selling price for that site relative to the selling price for sites with similar image requirements.

The Company also evaluates the appropriateness of revenue recognition in accordance with the accounting standards on software revenue recognition. Our solid-state LED video screens and active digital signage contain software elements which the Company has determined are incidental.

**Credit and Collections:**

The Company maintains allowances for doubtful accounts receivable for probable estimated losses resulting from either customer disputes or the inability of its customers to make required payments. If the financial condition of the Company's customers were to deteriorate, resulting in their inability to make the required payments, the Company may be required to record additional allowances or charges against income. The Company determines its allowance for doubtful accounts by first considering all known collectability problems of customers' accounts, and then applying certain percentages against the various aging categories based on the due date of the remaining receivables. The resulting allowance for doubtful accounts receivable is an estimate based upon the Company's knowledge of its business and customer base, and historical trends. Receivables deemed uncollectable are written-off against the allowance for doubtful accounts receivable after all reasonable collection efforts have been exhausted. The Company also establishes allowances, at the time revenue is recognized, for returns, discounts, pricing and other possible customer deductions. These allowances are based upon historical trends.

The following table presents the Company's net accounts receivable at the dates indicated.

<i>(In thousands)</i>	June 30, 2017	June 30, 2016
Accounts receivable	\$49,386	\$47,201
Less: Allowance for doubtful accounts	(506 )	(226 )
Accounts receivable, net	\$48,880	\$46,975

**Cash and Cash Equivalents:**

The cash balance includes cash and cash equivalents which have original maturities of less than three months. Cash and cash equivalents consist primarily of bank deposits and a bank money market account that is stated at cost, which approximates fair value. The Company maintains balances at financial institutions in the United States. In the United States, the FDIC limit for insurance coverage on non-interest bearing accounts is \$250,000. As of June 30, 2017 and June 30, 2016, the Company had bank balances of \$4,488,000 and \$37,883,000, respectively, without insurance coverage.

**Inventories and Inventory Reserves:**

Inventories are stated at the lower of cost or market. Cost of inventories includes the cost of purchased raw materials and components, direct labor, as well as manufacturing overhead which is generally applied to inventory based on direct labor and on material content. Cost is determined on the first-in, first-out basis.

The Company maintains an inventory reserve for obsolete and excess inventory. The Company first determines its obsolete inventory reserve by considering specific known obsolete items, and then by applying certain percentages to specific inventory categories based upon inventory turns. The Company uses various tools, in addition to inventory turns, to identify which inventory items have the potential to become obsolete. Judgment is used to establish excess and obsolete inventory reserves and management adjusts these reserves as more information becomes available about the ultimate disposition of the inventory item.

**Property, Plant and Equipment and Related Depreciation:**

Property, plant and equipment are stated at cost. Major additions and betterments are capitalized while maintenance and repairs are expensed. For financial reporting purposes, depreciation is computed on the straight-line method over the estimated useful lives of the assets as follows:

Buildings (in years)	28-40
Machinery and equipment (in years)	3 - 10
Computer software (in years)	3 - 8

Costs related to the purchase, internal development, and implementation of the Company's fully integrated enterprise resource planning/business operating software system are either capitalized or expensed. Leasehold improvements are depreciated over the shorter of fifteen years or the remaining term of the lease.

The Company sold one of two facilities at its Woonsocket, Rhode Island operation, which is included in the Graphics Segment, in the first quarter of fiscal 2015. The sale of this property was the result of the consolidation of the operations into the remaining facility in order to eliminate redundancies and improve manufacturing efficiencies. The selling price of the building was in excess of its carrying value.

The Company is in the process of selling its second of two facilities in Woonsocket, Rhode Island. This Graphics Segment facility, which is not expected to be sold at a loss, has been separately identified on the balance sheet as an asset held for sale as of June 30, 2017. The Company sold its Kansas City facility and certain manufacturing equipment in the third quarter of fiscal 2017. Refer to Note 15 for more information regarding the closure of these facilities.

The Company recorded \$7,005,000, \$6,171,000 and \$5,804,000 of depreciation expense in the years ended June 30, 2017, 2016 and 2015, respectively.

### **Goodwill and Intangible Assets:**

Intangible assets consisting of customer relationships, trade names and trademarks, patents, technology and software, and non-compete agreements are recorded on the Company's balance sheet. The definite-lived intangible assets are being amortized to expense over periods ranging between seven and twenty years. The Company evaluates definite-lived intangible assets for possible impairment when triggering events are identified. Neither indefinite-lived intangible assets nor the excess of cost over fair value of assets acquired ("goodwill") are amortized, however they are subject to review for impairment. See additional information about goodwill and intangibles in Note 6.

### **Fair Value:**

The Company has financial instruments consisting primarily of cash and cash equivalents, revolving lines of credit, accounts receivable, accounts payable, and long-term debt. The fair value of these financial instruments approximates carrying value because of their short-term maturity and/or variable, market-driven interest rates. The Company has no financial instruments with off-balance sheet risk.

Fair value measurements of nonfinancial assets and nonfinancial liabilities are primarily used in goodwill and other intangible asset impairment analyses, long-lived asset impairment analyses, in the purchase price of acquired companies, and in the valuation of the contingent earn-out. The accounting guidance on fair value measurement was used to measure the fair value of these nonfinancial assets and nonfinancial liabilities.

### **Product Warranties:**

The Company offers a limited warranty that its products are free from defects in workmanship and materials. The specific terms and conditions vary somewhat by product line, but generally cover defective products returned within one to five years, with some exceptions where the terms extend to 10 years, from the date of shipment. The Company records warranty liabilities to cover the estimated future costs for repair or replacement of defective returned products as well as products that need to be repaired or replaced in the field after installation. The Company calculates its liability for warranty claims by applying estimates based upon historical claims as a percentage of sales to cover unknown claims, as well as estimating the total amount to be incurred for known warranty issues. The Company periodically assesses the adequacy of its recorded warranty liabilities and adjusts the amounts as necessary.

Changes in the Company's warranty liabilities, which are included in accrued expenses in the accompanying consolidated balance sheets, during the periods indicated below were as follows:

<i>(In thousands)</i>	June 30, 2017	June 30, 2016
Balance at beginning of the period	\$5,069	\$3,408
Additions charged to expense	4,956	5,069
Addition from acquired company	907	--
Deductions for repairs and replacements	(3,372)	(3,408)
Balance at end of the period	\$7,560	\$5,069

#### **Employee Benefit Plans:**

The Company has a defined contribution retirement plan and a discretionary profit sharing plan covering substantially all of its non-union employees in the United States, and a nonqualified deferred compensation plan covering certain employees. The costs of employee benefit plans are charged to expense and funded annually. Total costs were \$2,373,000 in 2017, \$2,327,000 in 2016, and \$1,880,000 in 2015.

### **Research and Development Costs:**

Research and development costs are directly attributable to new product development, including the development of new technology for both existing and new products, and consist of salaries, payroll taxes, employee benefits, materials, outside legal costs and filing fees related to obtaining patents, supplies, depreciation and other administrative costs. The Company expenses as research and development all costs associated with development of software used in solid-state LED products. All costs are expensed as incurred and are included in selling and administrative expenses. Research and development costs related to both product and software development totaled \$5,700,000, \$5,549,000 and \$5,598,000 for the fiscal years ended June 30, 2017, 2016 and 2015, respectively.

### **Cost of Products and Services Sold:**

Cost of products sold is primarily comprised of direct materials and supplies consumed in the manufacture of products, as well as manufacturing labor, depreciation expense and direct overhead expense necessary to acquire and convert the purchased materials and supplies into finished product. Cost of products sold also includes the cost to distribute products to customers, inbound freight costs, internal transfer costs, warehousing costs and other shipping and handling activity. Cost of services sold is primarily comprised of the internal and external labor costs required to support the Company's service revenue along with the management of media content.

### **Earnings Per Common Share:**

The computation of basic earnings per common share is based on the weighted average common shares outstanding for the period net of treasury shares held in the Company's nonqualified deferred compensation plan. The computation of diluted earnings per share is based on the weighted average common shares outstanding for the period and includes common share equivalents. Common share equivalents include the dilutive effect of stock options, restricted stock units, stock warrants, contingently issuable shares and common shares to be issued under a deferred compensation plan, all of which totaled 844,000 shares in fiscal 2017; 872,000 shares in fiscal 2016; and 451,000 shares in fiscal 2015. See further discussion in Note 3.

### **Income Taxes:**

The Company accounts for income taxes in accordance with the accounting guidance for income taxes. Accordingly, deferred income taxes are provided on items that are reported as either income or expense in different time periods for financial reporting purposes than they are for income tax purposes. Deferred income tax assets are reported on the

Company's balance sheet. Significant management judgment is required in developing the Company's income tax provision, including the estimation of taxable income and the effective income tax rates in the multiple taxing jurisdictions in which the Company operates, the estimation of the liability for uncertain income tax positions, the determination of deferred tax assets and liabilities, and any valuation allowances that might be required against deferred tax assets.

#### **New Accounting Pronouncements:**

In June 2014, the Financial Accounting Standards Board issued ASU 2014-09, "Revenue from Contracts with Customers." This amended guidance supersedes and replaces all existing U.S. GAAP revenue recognition guidance. The guidance established a new revenue recognition model, changes the basis for deciding when revenue is recognized, provides new and more detailed guidance on specific revenue topics, and expands and improves disclosures about revenue. In April 2016, the FASB issued ASU 2016-10, "Revenue from Contracts with Customers: Identifying Performance Obligations and Licensing." In May 2016, the FASB issued ASU 2016-12, "Revenue from Contracts with Customers: Narrow Scope Improvements and Practical Expedients." In December 2016, the FASB issued ASU 2016-20, "Technical Corrections and Improvements to Topic 606, Revenue from Contracts with Customers." These three standards clarify or improve guidance from ASU 2014-09 and are effective for fiscal years and interim periods within those years, beginning after December 15, 2017, or the Company's fiscal year 2019. The Company will adopt these standards no later than July 1, 2018. The Company is reviewing accounting policies and evaluating disclosures in the financial statements related to the new standard. The Company is also assessing potential changes to the business processes, internal controls, and information systems related to the adoption of the new standard. While the Company is currently assessing the impact of the new standard, the Company's revenue is primarily generated from the sale of finished products to customers. Those sales predominantly contain a single delivery element and revenue is recognized at a single point in time when ownership, risks, and rewards transfer. The recognition of revenue from most product sales is largely unaffected by the new standard. However, with respect to certain product sales requiring installation, revenue is currently not recognized until the installation is complete. While the Company does not expect this new guidance to have a material impact on the amount of overall sales recognized, the timing of recognition of revenues from sales on certain projects may be affected. Our initial conclusions may change as we finalize our assessment and select a transition method during the next six to nine months.

In November 2015, the FASB issued ASU 2015-17, “Balance Sheet Classification of Deferred Taxes,” which eliminates the current requirement to separate deferred income tax liabilities and assets into current and noncurrent amounts in the statement of financial position. This update requires that deferred tax liabilities and assets be classified as noncurrent. This update is effective for financial statements issued for fiscal years beginning April 1, 2017. This update may be applied either prospectively or retrospectively. However, early adoption is permitted and the Company has chosen to adopt the standard retrospectively as of June 30, 2016. As a result, prior periods have been adjusted to reflect this change. This update affected the presentation, but not the measurement of deferred tax liabilities and assets.

In February 2016, the Financial Accounting Standards Board issued ASU 2016-02, “Leases.” The amended guidance requires an entity to recognize assets and liabilities that arise from leases. The amended guidance is effective for financial statements issued for fiscal years and interim periods within those years, beginning after December 15, 2018, or the Company’s fiscal year 2020, with early adoption permitted. The Company has not yet determined the impact the amended guidance will have on its financial statements.

#### **Comprehensive Income:**

The Company does not have any comprehensive income items other than net income.

#### **Subsequent Events:**

The Company has evaluated subsequent events for potential recognition and disclosure through the date the consolidated financial statements were filed. No items were identified during this evaluation that required adjustment to or disclosure in the accompanying consolidated financial statements.

#### **Use of Estimates:**

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires the Company to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results could differ from those estimates.



**NOTE 2 — BUSINESS SEGMENT INFORMATION**

The accounting guidance on Segment Reporting establishes standards for reporting information regarding operating segments in annual financial statements and requires selected information of those segments to be presented in financial statements. Operating segments are identified as components of an enterprise for which separate discrete financial information is available for evaluation by the chief operating decision maker (the Company's Chief Executive Officer or "CODM") in making decisions on how to allocate resources and assess performance. The Company's three operating segments are Lighting, Graphics, and Technology, each of which has a president who is responsible for that business and reports to the CODM. Corporate and Eliminations, which captures the Company's corporate administrative activities, is also be reported in the segment information.

The Lighting Segment includes outdoor and indoor lighting utilizing both traditional and LED light sources that have been fabricated and assembled for the commercial, industrial market, the petroleum / convenience store market, the automotive dealership market, the quick service restaurant market, along with other markets the Company serves.

The Graphics Segment designs, manufactures and installs exterior and interior visual image elements such as traditional graphics, active digital signage along with the management of media content related to digital signage, LED video screens, and menu board systems that are either digital or traditional by design. These products are used in visual image programs in several markets including, but not limited to the petroleum / convenience store market, multi-site retail operations, banking, and restaurants. The Graphics Segment implements, installs and provides program management services related to products sold by the Graphics Segment and by the Lighting Segment.

LED video screens that were previously reported in the Technology Segment in prior years' results have been reclassified to the Graphics Segment. The movement of the LED video screen product line was the result of a change in management responsibility of this product line to the Graphics Segment president during the first quarter of fiscal 2017. This movement aligns the product line with other digital visual image elements sold to graphics customers and is consistent with how the Company's CODM manages the business. The movement of the video screen product line resulted in a reclassification of \$183,000 of operating loss from the Technology Segment to the Graphics Segment in fiscal 2016, and \$204,000 of operating loss in fiscal 2015.

The Technology Segment designs, engineers, and manufactures electronic circuit boards, assemblies and sub-assemblies, and various control system products used in other applications (primarily the control of solid-state LED lighting). This operating segment sells its products directly to customers (primarily in the transportation, original equipment manufacturers, sports, and medical markets) and also has significant inter-segment sales to the Lighting Segment.

The Company's corporate administration activities are reported in the Corporate and Eliminations line item. These activities primarily include intercompany profit in inventory eliminations, expense related to certain corporate officers and support staff, the Company's internal audit staff, expense related to the Company's Board of Directors, stock option expense for options granted to corporate administration employees, certain consulting expenses, investor relations activities, and a portion of the Company's legal, auditing and professional fee expenses. Corporate identifiable assets primarily consist of cash, invested cash (if any), refundable income taxes (if any), and deferred income taxes.

There were no customers or customer programs representing a concentration of 10% or more of the Company's net sales in the fiscal years ended June 30, 2017, 2016 and 2015. There was no concentration of accounts receivable at June 30, 2017 or 2016.

Summarized financial information for the Company's reportable business segments is provided for the indicated periods and as of June 30, 2017, June 30, 2016, and June 30, 2015:

<i>(In thousands)</i>	<b>2017</b>	2016	2015
<b>Net Sales:</b>			
Lighting Segment	<b>\$239,005</b>	\$226,889	\$219,920
Graphics Segment	<b>72,395</b>	77,968	67,152
Technology Segment	<b>19,992</b>	17,339	20,744
All Other Category	—	—	41
Total Net Sales	<b>331,392</b>	\$322,196	\$307,857

**Operating Income (Loss):**

Lighting Segment	<b>\$10,566</b>	\$15,785	\$14,775
Graphics Segment	<b>2,439</b>	5,246	952
Technology Segment	<b>3,885</b>	4,028	3,153
All Other Category	<b>—</b>	—	(183 )
Corporate and Eliminations	<b>(13,281 )</b>	(11,103 )	(11,164 )
Total Operating Income	<b>\$3,609</b>	\$13,956	\$7,533

**Capital Expenditures:**

Lighting Segment	<b>\$4,010</b>	\$4,255	\$1,905
Graphics Segment	<b>1,748</b>	3,688	1,105
Technology Segment	<b>239</b>	1,852	1,141
All Other Category	<b>—</b>	—	4
Corporate and Eliminations	<b>636</b>	416	599
Total Capital Expenditures	<b>\$6,633</b>	\$10,211	\$4,754

**Depreciation and Amortization:**

Lighting Segment	<b>\$4,337</b>	\$2,930	\$2,965
Graphics Segment	<b>1,474</b>	1,104	1,042
Technology Segment	<b>1,312</b>	1,429	1,278
All Other Category	<b>—</b>	—	31
Corporate and Eliminations	<b>1,139</b>	1,214	1,015
Total Depreciation and Amortization	<b>\$8,262</b>	\$6,677	\$6,331

	<b>June 30, 2017</b>	June 30, 2016
<b>Identifiable Assets:</b>		
Lighting Segment	<b>\$186,111</b>	\$95,168
Graphics Segment	<b>33,144</b>	33,490
Technology Segment	<b>28,294</b>	28,348
Corporate and Eliminations	<b>9,131</b>	38,554
Total Identifiable Assets	<b>\$256,680</b>	\$195,560

The segment net sales reported above represent sales to external customers. Segment operating income, which is used in management's evaluation of segment performance, represents net sales less all operating expenses. Identifiable assets are those assets used by each segment in its operations. Corporate identifiable assets primarily consist of cash, invested cash (if any), refundable income taxes, and deferred income tax assets.

The Company records a 10% mark-up on intersegment revenues. Any intersegment profit in inventory is eliminated in consolidation. Intersegment revenues were eliminated in consolidation as follows:

<i>(In thousands)</i>	<b>2017</b>	2016	2015
Lighting Segment intersegment net sales	<b>\$2,559</b>	\$2,935	\$2,752
Graphics Segment intersegment net sales	<b>\$1,135</b>	\$1,760	\$559
Technology Segment intersegment net sales	<b>\$33,981</b>	\$35,733	\$29,412
All Other Category intersegment net sales	<b>\$—</b>	\$—	\$308

The Company's operations are located solely within the United States due to the sale of a subsidiary on September 30, 2014, the Company no longer has a presence in Canada (See Note 17). As a result, the geographic distribution of the Company's net sales and long-lived assets originate within the United States.

<i>(In thousands)</i>	<b>2017</b>	2016	2015
<b>Net Sales (a):</b>			
United States	<b>\$331,392</b>	\$322,196	\$307,816
Canada	<b>—</b>	—	41
Total Net Sales	<b>\$331,392</b>	\$322,196	\$307,857

June 30, June 30,

	<b>June 30, 2017</b>	2016	2015
<b>Long-Lived Assets (b):</b>			
United States	<b>\$52,844</b>	\$51,723	\$46,430
Canada	—	—	—
Total Long-Lived Assets	<b>\$52,844</b>	\$51,723	\$46,430

a. Net sales are attributed to geographic areas based upon the location of the operation making the sale.

b. Long-lived assets include property, plant and equipment, and other long term assets. Goodwill and intangible assets are not included in long-lived assets.

**NOTE 3 — EARNINGS PER COMMON SHARE**

The following table presents the amounts used to compute basic and diluted earnings per common share, as well as the effect of dilutive potential common shares on weighted average shares outstanding (in thousands, except per share data):

<i>(In thousands, except per share data)</i>	<b>2017</b>	2016	2015
<b>BASIC EARNINGS PER SHARE</b>			
Net income	<b>\$3,000</b>	\$9,482	\$5,151
Weighted average shares outstanding during the period, net of treasury shares (a)	<b>25,144</b>	24,720	24,187
Weighted average vested restricted stock units outstanding	<b>37</b>	24	—
Weighted average shares outstanding in the Deferred Compensation Plan	<b>255</b>	244	309
Weighted average shares outstanding	<b>25,436</b>	24,988	24,496
Basic earnings per share	<b>\$0.12</b>	\$0.38	\$0.21
<b>DILUTED EARNINGS PER SHARE</b>			
Net income	<b>\$3,000</b>	\$9,482	\$5,151
Weighted average shares outstanding - Basic	<b>25,436</b>	24,988	24,496
Effect of dilutive securities (b):			
Impact of common shares to be issued under stock option plans, and contingently issuable shares, if any	<b>552</b>	604	142
Weighted average shares outstanding (c)	<b>25,988</b>	25,592	24,638
Diluted earnings per share	<b>\$0.12</b>	\$0.37	\$0.21

(a) Includes shares accounted for like treasury stock.

(b) Calculated using the “Treasury Stock” method as if dilutive securities were exercised and the funds were used to purchase common shares at the average market price during the period.

(c) Options to purchase 1,698,883 common shares, 1,331,300 common shares, and 1,882,722 common shares at June 30, 2017, 2016, and 2015, respectively, were not included in the computation of diluted earnings per share because the exercise price was greater than the average fair market value of the common shares.



**NOTE 4 — INVENTORIES**

The following information is provided as of the dates indicated:

<i>(In thousands)</i>	<b>June 30, 2017</b>	June 30, 2016
Inventories:		
Raw materials	<b>\$32,421</b>	\$28,979
Work-in-process	<b>3,527</b>	4,418
Finished goods	<b>14,060</b>	10,744
Total Inventories	<b>\$50,008</b>	\$44,141

**NOTE 5 — ACCRUED EXPENSES**

The following information is provided as of the dates indicated:

<i>(In thousands)</i>	<b>June 30, 2017</b>	June 30, 2016
Accrued Expenses:		
Compensation and benefits	<b>\$9,759</b>	\$11,983
Customer prepayments	<b>1,061</b>	1,053
Accrued sales commissions	<b>2,314</b>	2,792
Accrued warranty	<b>7,560</b>	5,069
Other accrued expenses	<b>5,375</b>	4,444
Total Accrued Expenses	<b>\$26,069</b>	\$25,341

**NOTE 6 — GOODWILL AND OTHER INTANGIBLE ASSETS**



Carrying values of goodwill and other intangible assets with indefinite lives are reviewed at least annually for possible impairment. The Company may first assess qualitative factors in order to determine if goodwill and indefinite-lived intangible assets are impaired. If through the qualitative assessment it is determined that it is more likely than not that goodwill and indefinite-lived assets are not impaired, no further testing is required. If it is determined more likely than not that goodwill and indefinite-lived assets are impaired, or if the Company elects not to first assess qualitative factors, the Company's impairment testing continues with the estimation of the fair value of reporting units and indefinite-lived intangible assets using a combination of a market approach and an income (discounted cash flow) approach, at the reporting unit level. The estimation of the fair value of reporting units and intangible assets requires significant management judgment with respect to revenue and expense growth rates, changes in working capital and the selection and use of an appropriate discount rate. The estimates of fair value of reporting units are based on the best information available as of the date of the assessment. The use of different assumptions would increase or decrease estimated discounted future operating cash flows and could increase or decrease an impairment charge. Company management uses its judgment in assessing whether assets may have become impaired between annual impairment tests. Indicators such as adverse business conditions, a sustained significant drop in the Company's stock price, economic factors, technological change, or competitive activities may signal that an asset has become impaired.

The Company identified its reporting units in conjunction with its annual goodwill impairment testing. The Company relies upon a number of factors, judgments and estimates when conducting its impairment testing including, but not limited to, the Company's stock price, operating results, forecasts, anticipated future cash flows and marketplace data. There are inherent uncertainties related to these factors and judgments in applying them to the analysis of goodwill impairment.

As of March 1, 2017, the Company performed its annual goodwill impairment test on the three reporting units that contain goodwill (excluding Atlas Lighting Products). The goodwill impairment test on one reporting unit in the Lighting Segment passed with a business enterprise value that was \$60.0 million or 80% above the carrying value of this reporting unit including goodwill. The goodwill impairment test of the one reporting unit with goodwill in the Graphics Segment passed with an estimated business enterprise value that was \$4.2 million or 424% above the carrying value of the reporting unit including goodwill. The goodwill impairment test of the reporting unit in the Technology Segment that contains goodwill passed with an estimated business enterprise value that was \$23.2 million or 95% above the carrying value of this reporting unit including goodwill. The Company has performed an assessment of goodwill from the date of the annual test through the balance sheet date for possible triggering events and has concluded that there were no triggering events that would indicate the assets are impaired. There were no changes to the qualitative factors from the date of the Atlas acquisition that would indicate the goodwill is impaired.

As of March 1, 2016, the Company performed its annual goodwill impairment test on the three reporting units that contain goodwill. The goodwill impairment test in the Lighting Segment passed with a business enterprise value that was \$89.0 million or 112% above the carrying value of this reporting unit including goodwill. The goodwill impairment test of the one reporting unit with goodwill in the Graphics Segment passed with an estimated business enterprise value that was \$1.7 million or 183% above the carrying value of the reporting unit including goodwill. The goodwill impairment test of the reporting unit in the Technology Segment that contains goodwill passed with an estimated business enterprise value that was \$15.4 million or 59% above the carrying value of this reporting unit including goodwill.

The Company acquired all of the capital stock of Atlas Lighting Products, Inc., on February 21, 2017 (see Note 16). The total purchase price exceeded the estimated fair value of net assets by approximately \$48.0million, which was allocated to goodwill. The Company completed its valuation of the goodwill and intangible assets in March 2017 and purchase price allocations have been made at February 21, 2017. While identified intangible assets related to the Atlas acquisition are being amortized effective February 21, 2017 over appropriate lives, goodwill will not be amortized on the Company's financial statements. Goodwill and intangible assets related to Atlas Lighting Products are included in the assets of the Lighting Segment. Refer to Note 16 for additional information on the intangible assets of Atlas Lighting Products.

The following table presents information about the Company's goodwill on the dates or for the periods indicated:

Goodwill (In thousands)	Lighting Segment	Graphics Segment	Technology Segment	Total
Balance as of June 30, 2016				
Goodwill	\$34,913	\$28,690	\$ 11,621	\$75,224
Accumulated impairment losses	(34,778)	(27,525)	(2,413 )	(64,716 )
Goodwill, net as of June 30, 2016	\$135	\$1,165	\$ 9,208	\$10,508
Goodwill acquired	\$48,030	\$--	\$ --	\$48,030
Balance as of June 30, 2017				
Goodwill	\$82,943	28,690	11,621	123,254
Accumulated impairment losses	(34,778)	(27,525)	(2,413 )	(64,716 )
Goodwill, net as of June 30, 2017	\$48,165	\$1,165	\$ 9,208	\$58,538

The Company performed its annual review of indefinite-lived intangible assets as of March 1, 2017 and determined there was no impairment. The indefinite-lived intangible impairment test passed with a fair market value that was \$15.2 million or 445% above its carrying value. The Company has performed an assessment of its intangible assets from the date of the annual test through the balance sheet date for possible triggering events and has concluded that there were no triggering events that would indicate the assets are impaired.

In March 2017, a customer relationship intangible asset with a net book value of \$479,000 related to the LED video screen product line in the Graphics Segment was determined to be fully impaired. The Company deemed that distribution channels and corresponding projected future cash flows that support the customer list intangible asset are not adequate to support the asset.

As of March 1, 2016, the Company performed its annual review of indefinite-lived intangible assets and determined there was no impairment. The indefinite-lived intangible asset impairment test passed with a fair market value that was \$ 8.4 million or 245% above its carrying value.

In the first quarter of fiscal 2015, the Company sold LSI Saco Technologies Inc. A customer relationship intangible asset with a gross carrying amount of \$1,306,000 and accumulated amortization of \$428,000 was sold as a result of the sale of LSI Saco Technologies (See Note 17).

The gross carrying amount and accumulated amortization by major other intangible asset class is as follows:

Other Intangible Assets (In thousands)	June 30, 2017		
	Gross Carrying Amount	Accumulated Amortization	Net Amount
Amortized Intangible Assets			
Customer relationships	\$35,563	\$ 7,956	\$27,607
Patents	338	186	152
LED technology firmware, software	16,066	11,237	4,829
Trade name	2,658	499	2,159
Non-compete agreements	710	710	-
Total Amortized Intangible Assets	55,335	20,588	34,747
Indefinite-lived Intangible Assets			
Trademarks and trade names	3,422	--	3,422
Total Indefinite-lived Intangible Assets	3,422	--	3,422
Total Other Intangible Assets	\$58,757	\$ 20,588	\$38,169

Other Intangible Assets (In thousands)	June 30, 2016		
	Gross Carrying Amount	Accumulated Amortization	Net Amount
Amortized Intangible Assets			
Customer relationships	\$9,316	\$ 7,581	\$ 1,735
Patents	338	154	184
LED technology firmware, software	11,228	10,989	239
Trade name	460	460	--
Non-compete agreements	710	704	6
Total Amortized Intangible Assets	22,052	19,888	2,164
Indefinite-lived Intangible Assets			
Trademarks and trade names	3,422	--	3,422
Total Indefinite-lived Intangible Assets	3,422	--	3,422
Total Other Intangible Assets	\$25,474	\$ 19,888	\$ 5,586

Amortization  
Expense of Other

	Intangible Assets		
<i>(In thousands)</i>	2017	2016	2015
Amortization Expense	\$ 1,257	\$ 506	\$ 527

- 52 -

---

The Company expects to record annual amortization expense as follows:

*(In thousands)*

2018	\$2,760
2019	\$2,760
2020	\$2,687
2021	\$2,682
2022	\$2,461
After 2022	\$21,397

#### **NOTE 7 — REVOLVING LINES OF CREDIT AND LONG-TERM DEBT**

In February, 2017 the Company amended its line of credit to a \$100 million secured revolving line of credit, increased from the \$30 million line of credit that was previously in place. The increased credit line was required for the funding of the acquisition of Atlas Lighting Products, Inc. The line of credit expires in the third quarter of fiscal 2022. Interest on the revolving line of credit is charged based upon an increment over the LIBOR rate as periodically determined, or at the bank's base lending rate, at the Company's option. The increment over the LIBOR borrowing rate, as periodically determined, fluctuates between 125 and 250 basis points depending upon the ratio of indebtedness to earnings before interest, taxes, depreciation and amortization ("EBITDA"), as defined in the line of credit agreement. The increment over LIBOR borrowing rate will remain at 175 basis points for the next twelve months. The fee on the unused balance of the \$100 million committed line of credit is 15 basis points. Under the terms of this line of credit, the Company has agreed to a negative pledge of real estate assets and is required to comply with financial covenants that limit the ratio of indebtedness to EBITDA and require a minimum fixed charge coverage ratio. As of June 30, 2017, there was \$49.7 million borrowed against the line of credit, and \$50.3 million was available as of that date. Based on the terms of the line of credit and the final principal due date, the debt has been classified as long term. The line of credit closing fees and legal fees of \$199,000 have been recorded as a long term asset and are being amortized over the term of the line of credit.

The Company is in compliance with all of its loan covenants as of June 30, 2017.

#### **NOTE 8 — CASH DIVIDENDS**

The Company paid cash dividends of \$5,048,000, \$4,214,000 and \$2,900,000 in fiscal years 2017, 2016 and 2015, respectively. Dividends on restricted stock units in the amount of \$30,067 and \$10,625 were accrued as of June 30, 2017 and 2016, respectively. These dividends are paid upon the vesting of the restricted stock units when shares are issued to the award recipients. In August 2017, the Board of Directors declared a regular quarterly cash dividend of

\$0.05 per share payable September 6, 2017 to shareholders of record August 28, 2017.

## NOTE 9 — EQUITY COMPENSATION

### Stock Options

The Company has an equity compensation plan that was approved by shareholders in November 2012 and that covers all of its full-time employees, outside directors and certain advisors. This 2012 Stock Incentive Plan replaced all previous equity compensation plans. The options granted and stock awards made pursuant to this plan are granted at fair market value at the date of grant or award. Service-based options granted to non-employee directors become exercisable 25% every ninety days (cumulative) from the date of grant and options granted to employees generally become exercisable 25% per year (cumulative) beginning one year after the date of grant. Performance-based options granted to employees become exercisable 33.3% per year (cumulative) beginning one year after the date of grant. The maximum contractual term of the Company's stock options is ten years. If a stock option holder's employment with the Company terminates by reason of death, disability or retirement, as defined in the Plan, the Plan generally provides for acceleration of vesting. The number of shares reserved for issuance is 2,188,509 shares, all of which were available for future grant or award as of June 30, 2017. This plan allows for the grant of incentive stock options, nonqualified stock options, stock appreciation rights, restricted and unrestricted stock awards, performance stock awards, and other stock awards. Service based and performance based stock options were granted and restricted stock units ("RSUs") were awarded in fiscal 2017.

*Stock Warrants*

The Company issued 200,000 fully vested stock warrants in the third quarter of fiscal 2017 in conjunction with the acquisition of Atlas Lighting Products, Inc., with the fair value of the warrants being included in the purchase price of that company rather than being expensed. See further discussion in Note 16. These 200,000 stock warrants were outstanding as of June 30, 2017. The fair value of the warrants on the date of grant was estimated using the Black-Scholes option pricing model. The below listed weighted average assumptions were used for the warrants.

	February	
	21,	
	2017	
Dividend yield	2.01	%
Expected volatility	39	%
Risk-free interest rate	1.80	%
Expected life (in years)	4.5	

The stock warrants issued during the quarter ended March 31, 2017 had an exercise price of \$9.95, and a fair value of \$2.87. As of June 30, 2017, the warrants had a remaining contractual life of 4.7 years.

*Stock Options*

As of June 30, 2017, a total of 3,119,688 options for common shares were outstanding from this plan as well as one previous stock option plan (both of which have been approved by shareholders), and of these, a total of 1,277,561 options for common shares were vested and exercisable. As of June 30, 2017, the approximate unvested stock option expense that will be recorded as expense in future periods is \$3,065,300. The weighted average time over which this expense will be recorded is approximately 2 years.

The fair value of each option on the date of grant was estimated using the Black-Scholes option pricing model. The below listed weighted average assumptions were used for grants in the periods indicated.

2017	2016	2015
------	------	------



Edgar Filing: LSI INDUSTRIES INC - Form 10-K

Dividend yield	1.9 %	1.3 %	1.1 %
Expected volatility	42 %	44 %	55 %
Risk-free interest rate	1.3 %	1.7 %	1.6 %
Expected life (in years)	6.0	6.0	6.0

At June 30, 2017, the 1,332,623 options granted during fiscal 2017 to employees had exercise prices ranging from \$9.15 to \$11.06 per share, fair values ranging from \$3.01 to \$3.83 per share, and remaining contractual lives of between 9 years and 10 years. The performance metric for the 425,000 performance based stock options granted in fiscal 2017 was not achieved; therefore these stock options were forfeited in fiscal 2017.

At June 30, 2016, the 1,026,800 options granted during fiscal 2016 to employees had exercise prices ranging from \$8.84 to \$11.87 per share, fair values ranging from \$3.28 to \$4.52 per share, and remaining contractual lives of between 9 years and 9.7 years.

At June 30, 2015, the 734,323 options granted to employees during fiscal 2015 had exercise prices ranging from \$5.96 to \$8.23 per share, fair values ranging from \$2.19 to \$3.89 per share, and remaining contractual lives of between nine years five months and 9.8 years.

The Company calculates stock option expense using the Black-Scholes model. Stock option expense is recorded on a straight line basis, or sooner if the grantee is retirement eligible as defined in the 2012 Stock Incentive Plan, with an estimated 3.1% forfeiture rate effective April 1, 2017. Previous estimated forfeiture rates were between 2.0% and 3.3% over the period January 1, 2013 through March 31, 2017. The expected volatility of the Company's stock was calculated based upon the historic monthly fluctuation in stock price for a period approximating the expected life of option grants. The risk-free interest rate is the rate of a five year Treasury security at constant, fixed maturity on the approximate date of the stock option grant. The expected life of outstanding options is determined to be less than the contractual term for a period equal to the aggregate group of option holders' estimated weighted average time within which options will be exercised. It is the Company's policy that when stock options are exercised, new common shares shall be issued.

Edgar Filing: LSI INDUSTRIES INC - Form 10-K

The Company recorded \$2,478,861, \$2,519,092 and \$1,238,897 of expense related to stock options in fiscal years 2017, 2016 and 2015, respectively. As of June 30, 2017, the Company had 3,067,295 stock options that were vested and that were expected to vest, with a weighted average exercise price of \$9.11 per share, an aggregate intrinsic value of \$2,322,190 and weighted average remaining contractual terms of 7.1 years.

Information related to all stock options for the years ended June 30, 2017, 2016 and 2015 is shown in the following tables:

	Twelve Months Ended June 30, 2017			
	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value
Outstanding at 6/30/16	2,976,490	\$ 8.97	6.6	\$8,338,974
Granted	1,332,623	\$ 10.59		
Forfeitures	(702,979 )	\$ 12.46		
Exercised	(486,446 )	\$ 7.37		
Outstanding at 6/30/17	3,119,688	\$ 9.12	7.4	\$2,332,324
Exercisable at 6/30/17	1,277,561	\$ 8.75	5.0	\$1,592,653

	Twelve Months Ended June 30, 2016			
	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value
Outstanding at 6/30/15	2,677,436	\$ 8.85	6.1	\$4,914,601
Granted	1,026,800	\$ 9.39		
Forfeitures	(165,800 )	\$ 15.15		
Exercised	(561,946 )	\$ 7.34		
Outstanding at 6/30/16	2,976,490	\$ 8.97	6.6	\$8,338,974

Edgar Filing: LSI INDUSTRIES INC - Form 10-K

Exercisable at 6/30/16	1,312,985	\$ 9.75	4.0	\$3,819,127
------------------------	-----------	---------	-----	-------------

- 55 -

---

## Twelve Months Ended June 30, 2015

	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value
Outstanding at 6/30/14	2,677,464	\$ 9.57	5.4	\$1,674,010
Granted	734,323	\$ 6.83		
Forfeitures	(571,275 )	\$ 10.26		
Exercised	(163,076 )	\$ 6.70		
Outstanding at 6/30/15	2,677,436	\$ 8.8.5	6.1	\$4,914,601
Exercisable at 6/30/15	1,597,238	\$ 10.18	4.3	\$2,250,093

The following table presents information related to unvested stock options:

	Shares	Weighted-Average Grant Date Fair Value
Unvested at June 30, 2016	1,663,505	\$ 3.39
Granted	1,332,623	\$ 3.67
Vested	(696,501 )	\$ 3.30
Forfeited	(457,500 )	\$ 3.81
Unvested at June 30, 2017	1,842,127	\$ 3.52

The weighted average grant date fair value of options granted was \$3.67, \$3.64 and \$3.27 per share in fiscal years 2017, 2016 and 2015, respectively. The aggregate intrinsic value of options exercised during the years ended June 30, 2017, 2016 and 2015 were \$1,189,414, \$1,695,213 and \$212,106, respectively. The aggregate grant date fair value of options that vested during 2017, 2016 and 2015 was \$2,298,114, \$1,168,192 and \$822,827, respectively. The Company received \$2,945,946, \$4,124,047 and \$1,092,002 of cash from employees who exercised options in fiscal years 2017, 2016 and 2015, respectively. For the twelve months ended June 30, 2017, the \$2,945,986 cash received from stock options was partially offset by \$138,722 related to the tax effect of disqualifying dispositions of stock options. For the twelve months ended June 30, 2016, the \$4,170,997 cash received from stock options was partially offset by \$141,394 related to the tax effect of disqualifying dispositions of stock options. In the fiscal 2017 the

Company recorded \$505,879 as a reduction of federal income taxes payable, \$261,694 as a decrease in common stock, \$138,722 as a reduction of income tax expense, and \$628,852 as a reduction of the deferred tax asset related to the issuance of RSUs and the exercises of stock options in which the employees sold the common shares prior to the passage of twelve months from the date of exercise. In fiscal 2016 the Company recorded \$595,483 as a reduction of federal income taxes payable, \$102,010 as a decrease in common stock, \$141,349 as a reduction of income tax expense, and \$556,144 as a reduction of the deferred tax asset related to the exercises of stock options in which the employees sold the common shares prior to the passage of twelve months from the date of exercise.

### *Restricted Stock Units*

A total of 96,210 RSUs with a weighted average fair value of \$10.84 per share were awarded to employees during the twelve months ended June 30, 2017. A total of 72,000 RSUs with a fair value of \$9.39 per share were awarded to employees during the twelve months ended June 30, 2016. The Company determined the fair value of the awards based on the closing price of the Company stock on the date the RSUs were awarded. The RSUs have a four year ratable vesting period. The RSUs are non-voting, but accrue cash dividends at the same per share rate as those cash dividends declared and paid on LSI's common stock. Dividends on RSUs in the amount of \$30,067 and \$10,625 were accrued as of June 30, 2017 and 2016, respectively. Accrued dividends are paid to the holder upon vesting of the RSUs and issuance of shares. The following table presents information related to RSUs:

	Shares	Weighted-Average Grant Date Fair Value
Unvested at June 30, 2016	62,500	\$ 9.39
Awarded	96,210	\$ 10.84
Shares Issued	(25,375 )	\$ 9.69
Unvested at June 30, 2017	133,335	\$ 10.38

As of June 30, 2017, the 133,335 outstanding RSUs had a remaining weighted average contractual life of 6.0 years. The Company recorded \$570,178 of expense related to RSUs during fiscal year 2017. Of the 133,335 RSUs outstanding as of June 30, 2017, 128,859 are vested or expected to vest in the future. The approximate unvested stock compensation expense that will be recorded as expense in future periods for the RSUs is \$234,320. The weighted average time over which this expense will be recorded is approximately 32 months. An estimated forfeiture rate of 3.4% was used in the calculation of expense related to the RSUs.

As of June 30, 2016, the 62,500 outstanding RSUs had a remaining weighted average contractual life of 3.0 years. The Company recorded \$383,483 of expense related to RSUs during fiscal year 2016. Of the 62,500 RSUs outstanding as of June 30, 2016, 60,794 were vested or expected to vest in the future. An estimated forfeiture rate of 3.3% was used in the calculation of expense related to the RSUs.

### **Director and Employee Stock Compensation Awards**

The Company awarded a total of 40,092 common shares in fiscal 2017, a total of 23,838 common shares in fiscal 2016, and a total of 26,850 common shares in fiscal 2015 as stock compensation awards. These common shares were valued at their approximate \$409,000, \$248,000 and \$191,000 fair market values based on their stock price at dates of issuance multiplied by the number of common shares awarded, respectively, pursuant to the compensation programs for non-employee directors who receive a portion of their compensation as an award of Company stock and for employees who receive a nominal recognition award in the form of common stock. Stock compensation awards are made in the form of newly issued common shares of the Company.

### **Deferred Compensation Plan**

The Company has a non-qualified deferred compensation plan providing for both Company contributions and participant deferrals of compensation. This plan is fully funded in a Rabbi Trust. All plan investments are in common shares of the Company. As of June 30, 2017, there were 33 participants, all with fully vested account balances. A total of 257,898 common shares with a cost of \$2,456,875, and 228,100 common shares with a cost of \$2,167,717 were held in the plan as of June 30, 2017 and 2016, respectively, and, accordingly, have been recorded as treasury shares. The change in the number of shares held by this plan is the net result of share purchases and sales on the open stock market for compensation deferred into the plan and for distributions to terminated employees. The Company does not issue new common shares for purposes of the nonqualified deferred compensation plan. The Company used approximately \$492,400 and \$363,400 to purchase 50,579 and 36,685 common shares of the Company in the open stock market during fiscal years 2017 and 2016, respectively, for either employee salary deferrals or Company contributions into the nonqualified deferred compensation plan. For fiscal year 2018, the Company estimates the Rabbi Trust for the Nonqualified Deferred Compensation Plan will make net repurchases, deposits of newly issues shares, and issuances in the range of 85,000 to 95,000 common shares of the Company. The Company does not currently repurchase its own common shares for any other purpose.

**NOTE 10 — LEASES AND PURCHASE COMMITMENTS**

Purchase commitments, including minimum annual rental commitments, of the Company totaled \$21,973,000 and \$20,824,000 as of June 30, 2017 and June 30, 2016, respectively. The Company leases certain of its facilities and equipment under operating lease arrangements. The facility leases contain the option to renew for periods ranging from one to five years. Rental expense was \$2,439,000 in 2017, \$2,027,000 in 2016, and \$1,876,000 in 2015. Minimum annual rental commitments under non-cancelable operating leases are indicated in the table below:

2018	2019	2020	2021	2022	2023 & Beyond
\$1,869,943	\$1,907,756	\$1,865,341	\$1,891,698	\$1,893,083	\$4,837,364

- 57 -

---

**NOTE 11 — INCOME TAXES**

The following information is provided for the years ended June 30:

<i>(In thousands)</i>	<b>2017</b>	2016	2015
<b>Components of income before income taxes:</b>			
United States	<b>\$3,080</b>	\$14,004	\$7,697
Foreign	—	—	(183 )
Income before income taxes	<b>\$3,080</b>	\$14,004	\$7,514
<b>Provision for income taxes:</b>			
Current			
U.S. federal	<b>\$800</b>	\$5,056	\$2,364
State and local	<b>59</b>	582	237
Foreign	—	—	(12 )
Total current	<b>859</b>	5,638	2,589
Deferred	<b>(779 )</b>	(1,116)	(226 )
Total provision for income taxes	<b>\$80</b>	\$4,522	\$2,363

<i>(In thousands)</i>	<b>2017</b>	2016	2015
<b>Reconciliation to federal statutory rate:</b>			
Federal statutory tax rate	<b>34.0 %</b>	35.0%	34.0%
State and local taxes, net of federal benefit	<b>2.4</b>	2.2	2.4
Impact of foreign operations	—	—	0.7
Federal and state tax credits	<b>(5.3 )</b>	(2.6 )	(3.7 )
Valuation allowance	<b>(18.9)</b>	—	(3.8 )
Domestic production activities deduction	<b>(4.1 )</b>	(4.2 )	(4.0 )
Uncertain tax position activity	<b>(5.5 )</b>	(0.6 )	(1.3 )
Other	<b>0.0</b>	2.5	2.1
Sale of subsidiary	—	—	5.0
Effective tax rate	<b>2.6 %</b>	32.3%	31.4%

The components of deferred income tax assets and (liabilities) at June 30, 2017 and 2016 are as follows:

<i>(In thousands)</i>	<b>2017</b>	2016
Uncertain tax positions	<b>\$281</b>	\$—



Edgar Filing: LSI INDUSTRIES INC - Form 10-K

Reserves against current assets	<b>584</b>	679
Accrued expenses	<b>3,357</b>	3,690
Deferred compensation	<b>925</b>	842
Stock-based compensation	<b>1,824</b>	1,473
State net operating loss carryover and credits	<b>1,853</b>	1,878
Long term capital loss carryforward	<b>3,703</b>	4,272
U.S. Federal net operating loss carryover and credits	<b>406</b>	456
Deferred income tax asset before valuation reserve	<b>12,933</b>	13,290
Valuation reserve	<b>(5,556 )</b>	(6,150 )
Deferred income tax asset	<b>7,377</b>	7,140
Depreciation	<b>(3,515 )</b>	(4,270 )
Goodwill, acquisition costs and intangible assets	<b>(502 )</b>	(289 )
Deferred income tax liability	<b>(4,017 )</b>	(4,559 )
Net deferred income tax asset	<b>\$3,360</b>	\$2,581

- 58 -

---

As of June 30, 2017 and 2016, the Company has recorded a deferred tax asset in the amount of \$406,000 and \$456,000, respectively, related to U.S. Federal net operating loss and research and development credit carryovers acquired in the acquisition of Virticus Corporation. The net operating losses will expire over a period of 3 years, beginning in June 30, 2029. The research and development credits will expire over a period of 2 years, beginning in June 30, 2029. The annual utilization is limited by Internal Revenue Code Section 382. However, the Company has determined these assets, more likely than not, will be realized.

As of June 30, 2017 and 2016, the Company has recorded a deferred state income tax asset in the amount of \$1,716,000, net of federal tax benefits, related to non-refundable New York state tax credits. These credits do not expire, but pursuant to New York state legislation enacted in fiscal 2014, the Company has determined that this asset, more likely than not, will not be realized. As of June 30, 2017 and 2016, the Company has recorded a full valuation reserve in the amount of \$1,716,000. There was no change in the deferred state income tax asset or related valuation reserve in fiscal 2017.

As of June 30, 2017 and 2016, the Company has recorded a deferred state income tax asset in the amount of \$137,000 and \$162,000, respectively, related to a state net operating loss carryover and a state research and development credit in Oregon acquired during the acquisition of Virticus Corporation. The Company has determined this asset more likely than not, will not be realized and that a full valuation reserve is required. The Oregon net operating loss will expire over a period of 4 years, beginning in June 30, 2027. Related to the Oregon research and development credit, \$11,000 expired during fiscal 2016 and the remaining balance of \$25,000 expired during fiscal 2017.

During fiscal 2015, the Company recorded a deferred tax asset related to the sale of its Canadian subsidiary creating a long term capital loss carryforward totaling \$4,272,000. The Company previously determined that this asset, more likely than not, will not be realized within the 5 year carryforward period and that a full valuation reserve was required. In fiscal 2017 the Company sold its Kansas City facility that generated a long term capital gain. The capital loss carryforward related to the sale of the Canadian subsidiary will offset the long term gain from the sale of the Kansas City facility. The utilization of the capital loss carryforward will reduce the deferred tax asset with its corresponding full valuation allowance to \$3,703,000. The long term capital loss carryforward will expire in June 30, 2020.

Considering all issues discussed above, the Company has recorded valuation reserves of \$5,556,000 and \$6,150,000 as of June 30, 2017 and 2016, respectively.

The Company accounts for uncertain tax positions in accordance with accounting standards. At June 30, 2017, tax, interest, and penalties, net of potential federal tax benefits, were \$657,000, \$268,000, and \$194,000, respectively, of the total reserve for uncertain tax positions of \$1,119,000. Of the \$1,119,000 reserve for uncertain tax positions, \$925,000 would have an unfavorable impact on the effective tax rate if recognized. During fiscal 2017, the Company added uncertain tax positions as a result of the acquisition of Atlas totaling \$483,000, which is included in the

\$1,119,000 above. Tax, interest, and penalties, net of potential federal tax benefits were \$314,000, \$79,000, and \$90,000, respectively. At June 30, 2016, tax, interest, and penalties, net of potential federal tax benefits, were \$421,000, \$244,000, and \$142,000 respectively, of the total reserve for uncertain tax positions of \$807,000. Of the \$807,000 reserve for uncertain tax positions, \$665,000 would have an unfavorable impact on the effective tax rate if recognized. The liability for uncertain tax positions is included in Other Long-Term Liabilities.

The Company recognized a \$78,000 net tax benefit in fiscal 2017, a \$26,000 net tax benefit in fiscal 2016, and a \$40,000 net tax benefit in fiscal 2015 related to the change in reserves for uncertain tax positions. The Company recognized interest net of federal benefit and penalties of \$66,000 and \$27,000, respectively, in fiscal 2017, \$48,000 and \$10,000, respectively, in fiscal 2016, and \$41,000 and \$17,000, respectively in fiscal 2015. The Company is recording estimated interest and penalties related to potential underpayment of income taxes as a component of tax expense in the Consolidated Statements of Operations. The reserve for uncertain tax positions is not expected to change significantly in the next twelve months.

The fiscal 2017, 2016 and 2015 tax activity in the liability for uncertain tax positions was as follows:

<i>(in thousands)</i>	<b>2017</b>	2016	2015
Balance at beginning of the fiscal year	<b>\$648</b>	\$687	\$746
Decreases — tax positions in prior period	<b>(170)</b>	(161)	(134)
Increases — tax positions in current period	<b>50</b>	122	75
Increases — tax positions in prior period	<b>314</b>	—	—
Settlements and payments	—	—	—
Lapse of statute of limitations	—	—	—
Balance at end of the fiscal year	<b>\$842</b>	\$648	\$687

The Company files a consolidated federal income tax return in the United States, and files various combined and separate tax returns in several state and local jurisdictions. With limited exceptions, the Company is no longer subject to U.S. Federal, state and local tax examinations by tax authorities for fiscal years ending prior to June 30, 2014.

#### **NOTE 12 — SUPPLEMENTAL CASH FLOW INFORMATION**

<i>(In thousands)</i>	<b>2017</b>	2016	2015
Cash payments for:			
Interest	<b>\$529</b>	\$50	\$48
Income taxes	<b>\$2,618</b>	\$5,079	\$1,078
Issuance of common shares as compensation	<b>\$409</b>	\$248	\$191

#### **NOTE 13 — COMMITMENTS AND CONTINGENCIES**

The Company is party to various negotiations, customer bankruptcies, and legal proceedings arising in the normal course of business. The Company provides reserves for these matters when a loss is probable and reasonably estimable. The Company does not disclose a range of potential loss because the likelihood of such a loss is remote. In the opinion of management, the ultimate disposition of these matters will not have a material adverse effect on the Company's financial position, results of operations, cash flows or liquidity.

The Company may occasionally issue a standby letter of credit in favor of third parties. As of June 30, 2017, there were no such standby letters of credit issued.

**NOTE 14 -- SEVERANCE COSTS**

The Company recorded severance charges of \$523,000 and \$469,000 in fiscal 2017 and 2016, respectively. This severance expense was related to reductions in staffing not related to plant restructuring. See further discussion of restructuring expenses in Note 15.

- 60 -

---

The activity in the Company's accrued severance liability was as follows for the twelve months ended June 30, 2017 and 2016:

<i>(In thousands)</i>	Fiscal Year Ended June 30, 2017	Fiscal Year Ended June 30, 2016
Balance at beginning of the period	\$ 39	\$ 379
Accrual of expense	523	469
Payments	(313 )	(742 )
Adjustments	(14 )	(67 )
Balance at end of the period	\$ 235	\$ 39

#### **NOTE 15 -- RESTRUCTURING COSTS**

On September 22, 2016, the Company announced plans to close its lighting facility in Kansas City, Kansas. The decision was based upon the market shift away from fluorescent and other technologies and the rapid movement to LED lighting which is produced at other LSI facilities. The Company expects to continue to meet the demand for products containing fluorescent light sources as long as these products are commercially viable. All operations at the Kansas City facility ceased prior to December 31, 2016. Total restructuring costs related to the closure of the Kansas City facility were \$944,000. These costs primarily included employee-related costs (primarily severance), the impairment of manufacturing equipment, plant shut down costs, costs related to the preparation of the facility for sale, legal costs, and other related costs. In addition, there was also an inventory write-down of \$485,000 recorded in fiscal 2017. The write-down was related to inventory that was previously realizable until the decision in the first quarter of fiscal 2017 to shut down the Kansas City plant due to the planned curtailment of the manufacturing of fluorescent light fixtures. The Company owned the facility in Kansas City and realized a \$1,361,000 gain when the facility was sold.

The Company also announced the consolidation of the Beaverton, Oregon facility into other LSI facilities. The light assembly of products in the Beaverton facility was moved to the Company's Columbus, Ohio facility, and administration and engineering functions were moved to the Company's Cincinnati, Ohio facility. This consolidation was completed September 30, 2016. As a result of this consolidation, restructuring charges of \$377,000 were recorded in fiscal 2017, with the majority of this representing the costs related to the remaining period of the facility's lease and severance costs for employees who formerly worked in the Beaverton facility.

In November 2016, the Company announced the consolidation of the Woonsocket, Rhode Island manufacturing operation into its North Canton, Ohio operation. The manufacturing operations in Woonsocket ceased prior to

Edgar Filing: LSI INDUSTRIES INC - Form 10-K

December 31, 2016. The Company owns the facility in Woonsocket and expects to realize a gain when the facility is sold. The facility is presented on the balance sheet as an asset held for sale of \$1,463,000. Total restructuring costs related to the consolidation of the Woonsocket facility are expected to be approximately \$500,000. These costs primarily include employee-related costs (severance), plant shut down costs, costs related to the preparation of the facility for sale, legal costs, and other related costs.

The following table presents information about restructuring costs recorded in fiscal 2017:

<i>(In thousands)</i>	Total Fiscal 2017 Restructuring Costs
Severance and other termination benefits	\$ 811
Lease obligation	213
Impairment of fixed assets and accelerated depreciation	354
Gain on sale of facility	(1,361 )
Other	395
Total	\$ 412

- 61 -

---

Impairment and accelerated depreciation expense of \$354,000 was recorded in fiscal 2017 related to machinery and equipment at the Kansas City and Beaverton facilities. There was no impairment expense related to the closure of the Woonsocket facility. Of the \$354,000 of impairment and accelerated depreciation expense, \$322,000 was recorded in the Lighting Segment and \$32,000 was recorded in the Technology Segment. The fair value of the equipment evaluated for impairment was determined by comparing the future undiscounted cash flows to the carrying value of the assets. The future cash flows are from the remaining use of the assets as well as the cash flows expected to result from the future sale of the assets.

The following table presents restructuring costs incurred by line item in the consolidated statement of operations in which the costs are included:

<i>(In thousands)</i>	Total Fiscal 2017 Restructuring Costs
Cost of Goods Sold	\$ 1,503
Operating Expenses	(1,091 )
Total	\$ 412

The following table presents information about restructuring costs by segment for the periods indicated:

<i>(In thousands)</i>	Total Fiscal 2017 Restructuring Expenses
Lighting Segment	\$ (417 )
Graphics Segment	452
Technology Segment	252
Corporate and Eliminations	125
Total	\$ 412

The above tables include the gain on the sale of the Kansas City facility, and exclude the expected gain on the Woonsocket facility. Additionally, the above tables do not include expense of \$485,000 recorded during fiscal 2017 related to the write-down of inventory included as cost of sales as part of the Kansas City facility closure.



The following table presents a roll forward of the beginning and ending liability balances related to the restructuring costs:

*(In thousands)*

	Balance as of	Restructuring Expense	Payments	Adjustments	Balance as of
	June 30, 2016				June 30, 2017
Severance and termination benefits	\$ --	\$ 811	\$ (804 )	\$ (7 )	\$ --
Lease obligation	--	213	(128 )	--	85
Other	--	395	(395 )	--	--
Total	\$ --	\$ 1,419	\$ (1,327 )	\$ (7 )	\$ 85

The above table does not include fixed asset impairment and accelerated depreciation expense of \$354,000 or the \$1,361,000 gain on the sale of the Kansas City facility recorded in fiscal 2017.

Refer to Note 14 for information regarding additional severance expenses that are not included in the restructuring costs identified in this footnote.

**NOTE 16 – ACQUISITION**

On February 21, 2017, the Company acquired all the capital stock of Atlas Lighting Products, Inc. (Atlas), a Burlington North Carolina manufacturer of high-quality LED lighting products sold into the electrical distribution market. The purchase price of \$97.5 million included a cash payment of \$96.9 million and 200,000 five year warrants valued at \$0.6 million. The Company funded the acquisition with a combination of cash on hand and \$66 million from a new \$100 million revolving line of credit (See Note 7).

The Company has accounted for this transaction as a business combination. Under business combination accounting, the preliminary allocation of the purchase consideration to the fair value of the assets acquired and liabilities assumed as of February 21, 2017 is as follows:

	February 21, 2017	Measurement Period	February 21, 2017
<i>(amounts in thousands)</i>	(Initially Reported)	Adjustments	(As Adjusted)
Cash and Cash Equivalents	\$ 1,815		\$ 1,815
Accounts Receivable	7,202		7,202
Inventories	8,490		8,490
Property, Plant, and Equipment	3,631	(85 )	3,546
Other Assets	248		248
Intangible Assets	34,319		34,319
Liabilities Assumed	(6,106 )	(77 )	(6,183 )
Identifiable net assets acquired	49,599	(162 )	49,437
Goodwill	47,868	162	48,030
Net Purchase Consideration	\$ 97,467	\$ --	\$ 97,467

Goodwill recorded from the acquisition of Atlas is attributable to the impact of the positive cash flow from Atlas in addition to the expected synergies from the business combination. The goodwill resulting from the acquisition is deductible for tax purposes. The intangible assets include amounts recognized for the fair value of the trade name, customer relationships, and technology-related assets. The fair value of the intangible assets was determined based upon a combination of the market and income (discounted cash flow) approach. The following table present the details of the identified intangible assets acquired at the date of acquisition (in thousands):

<b>Estimated Fair Value</b>	<b>Estimate Useful Life (Years)</b>
-------------------------------------	-------------------------------------------------

Edgar Filing: LSI INDUSTRIES INC - Form 10-K

Tradename	\$ 2,198	20
Technology asset	4,838	10
Customer relationship	27,283	15
Total	\$ 34,319	

The fair market value write-up of the inventory totaled \$228,000, and the fair market value write-up of the property, plant, and equipment totaled \$526,000. Transaction costs related to the acquisition totaled \$1.48 million in fiscal 2017 and are recorded as an operating expense.

Atlas's post-acquisition results of operations for the period from February 21, 2017 through June 30, 2017 are included in the Company's Consolidated Statements of Operations. Since the acquisition date, net sales of Atlas for the period from February 21, 2017 through June 30, 2017 were \$17.8 million and operating income was \$1.8 million. The operating results of Atlas are included in the Lighting Segment.

Pro Forma Impact of the Acquisition of Atlas Lighting Products, Inc. (unaudited)

The following table represents pro forma results of operations and gives effect to the acquisition of Atlas as if the transaction had occurred on July 1, 2015. The unaudited pro forma results of operations have been prepared for comparative purposes only and are not necessarily indicative of what would have occurred had the business combination been completed at the beginning of the period or the results that may occur in the future. Furthermore, the pro forma financial information does not reflect the impact of any synergies or operating efficiencies resulting from the acquisition of Atlas.

<i>(In thousands, unaudited)</i>	Twelve Months Ended	
	June 30 2017	2016
Net Sales	\$366,541	\$381,650
Gross Profit	\$95,038	\$105,592
Operating Income	\$6,857	\$18,010

The unaudited pro forma financial information for the twelve months ended June 30, 2017 and June 30, 2016 is prepared using the acquisition method of accounting and has been adjusted to effect to the pro forma events that are: (1) directly attributable to the acquisition; (2) factually supportable; and (3) expected to have a continuing impact on the combined results. The pro forma operating income of \$6.9 million excludes acquisition-related expenses of \$1.61 million.

**NOTE 17 — SALE OF SUBSIDIARY**

On September 30, 2014, the Company sold the stock of its wholly owned subsidiary LSI Saco Technologies Inc., located in Montreal, Canada, for \$1.9 million cash. The sale resulted in a pre-tax loss of \$565,000. As a result of the sale, the Company terminated the \$5 million unsecured revolving line of credit for this Canadian operation. LSI Saco reported \$41,000 of net customer sales and a \$(183,000) operating loss in the first quarter of fiscal 2015 prior to the sale. The sale of LSI Saco was not considered the sale of a discontinued operation because the Company migrated most of its manufacturing, research and development, and selling activities from LSI Saco to the Company's Cincinnati, Ohio location.

**NOTE 18 — RELATED PARTY TRANSACTIONS**

The Company has recorded expense for the following related party transactions in the fiscal years indicated:

<i>(In thousands)</i>	<b>2017</b>	2016	2015
Keating Muething & Klekamp PLL	<b>\$526</b>	\$207	\$500
American Engineering and Metal Working	<b>\$—</b>	\$522	\$300
3970957 Canada Inc.	<b>\$—</b>	\$—	\$42
Synergy Electronic LTD	<b>\$—</b>	\$—	\$7
Atlas Melbane Street Properties, LLC	<b>\$314</b>	\$—	\$—

The Company has recognized revenue related to the following related party transactions in the fiscal years indicated:

<i>(In thousands)</i>	<b>2017</b>	2016	2015
Wesco International	<b>\$2,121</b>	\$2,450	\$2,726
American Engineering and Metal Working	<b>\$—</b>	\$27	\$4

As of the balance sheet date indicated, the Company had the following liabilities recorded with respect to related party transactions:

<i>(In thousands)</i>	<b>June 30, 2017</b>	June 30, 2016
Keating Muething & Klekamp PLL	<b>\$ 28</b>	\$ 12
American Engineering and Metal Working	<b>\$ —</b>	\$ 6

The law firm of Keating Muething & Klekamp PLL, of which the son of one of the Company's independent outside directors is a partner, is the Company's primary outside law firm providing legal services in most areas required other than patents and intellectual property. Wesco International, of which one of the Company's independent outside directors is a director, purchases lighting fixtures from the Company. The manufacturing firm of American Engineering and Metal Working, which is owned and operated by the son of the former president of the Company's Graphics Segment, provides metal fabricated components. 3970957 Canada Inc., which is owned by the former president and another executive of the Company's former LSI Saco Technologies subsidiary, owns the building that the former Canadian operation occupied and rented. Synergy Electronic LTD, which is owned and operated by the brother of an executive at the Company's former LSI Saco Technologies, manufactures molds and materials used in video screens and research and development projects. The Company leases its Burlington, North Carolina facility from Atlas Melbane Street Properties, LLC which is partially owned by an executive of the Company.



**NOTE 19 — SUMMARY OF QUARTERLY RESULTS (UNAUDITED)**

<i>(In thousands except per share data)</i>	Quarter Ended				Fiscal
	Sept. 30	Dec. 31	March 31	June 30	Year
<b>2017</b>					
Net sales	\$84,159	\$85,658	\$78,156	\$83,419	\$331,392
Gross profit	20,835	21,407	18,399	21,236	81,877
Net income	829	2,006	(531 )	696	3,000
Earnings per share					
Basic	\$0.03	\$0.08	\$(0.02 )	\$0.03	\$0.12
Diluted	\$0.03	\$0.08	\$(0.02 )	\$0.03	\$0.12
Range of share prices					
High	\$11.64	\$11.23	\$10.68	\$10.21	\$11.64
Low	\$9.41	\$8.12	\$8.31	\$8.26	\$8.12
<b>2016</b>					
Net sales	\$85,925	\$84,687	\$70,740	\$80,844	\$322,196
Gross profit	23,349	23,926	16,549	19,847	83,671
Net income	3,750	3,782	522	1,428	9,482
Earnings per share					
Basic	\$0.15	\$0.15	\$0.02	\$0.06	\$0.38
Diluted	\$0.15	\$0.15	\$0.02	\$0.06	\$0.37 (a)
Range of share prices					
High	\$10.48	\$12.80	\$12.22	\$13.45	\$13.45
Low	\$8.33	\$7.89	\$9.85	\$10.29	\$7.89
<b>2015</b>					
Net sales	\$78,466	\$84,715	\$68,603	\$76,073	\$307,857
Gross profit	18,608	20,555	16,305	18,981	74,449
Net income (loss)	1,527	1,588	393	1,643	5,151
Earnings (loss) per share					
Basic	\$0.06	\$0.06	\$0.02	\$0.07	\$0.21
Diluted	\$0.06	\$0.06	\$0.02	\$0.07	\$0.21
Range of share prices					
High	\$8.49	\$7.70	\$9.17	\$10.24	\$10.24
Low	\$6.00	\$5.61	\$5.84	\$8.02	\$5.61

The total of the earnings per share for each of the four quarters does not equal the total earnings per share for the (a) full year because the calculations are based on the average shares outstanding during each of the individual periods.

At August 30, 2017, there were approximately 630 shareholders of record. The Company believes this represents approximately 3,000 beneficial shareholders.

- 65 -

---



**LSI INDUSTRIES INC.**  
**SELECTED FINANCIAL DATA**

(In thousands except per share data)

The following data has been selected from the Consolidated Financial Statements of the Company for the periods and dates indicated:

**Statement of Operations Data:**

	<b>2017</b>	2016	2015	2014	2013
Net sales	<b>\$331,392</b>	\$322,196	\$307,857	\$299,463	\$280,790
Cost of products and services sold	<b>248,012</b>	238,525	233,408	234,165	220,380
Restructuring costs (in cost of sales)	<b>1,503</b>	—	—	—	—
Loss on sale of a subsidiary	—	—	565	—	—
(Gain) loss on sale of a building	—	—	(343 )	—	—
Acquisition deal costs	<b>1,608</b>	—	—	—	—
Restructuring costs (in SG&A)	<b>(1,091 )</b>	—	—	—	—
Selling and administrative expenses	<b>77,272</b>	69,715	66,694	62,175	57,367
Goodwill and intangible asset impairment	<b>479</b>	—	—	805	2,413
Operating income	<b>3,609</b>	13,956	7,533	2,318	630
Interest (income)	<b>(91 )</b>	(84 )	(26 )	(17 )	(47 )
Interest expense	<b>620</b>	36	45	68	62
Income before income taxes	<b>3,080</b>	14,004	7,514	2,267	615
Income taxes	<b>80</b>	4,522	2,363	1,337	738
Net income (loss)	<b>\$3,000</b>	\$9,482	\$5,151	\$930	\$(123 )
Earnings (loss) per common share					
Basic	<b>\$0.12</b>	\$0.38	\$0.21	\$0.04	\$(0.01 )
Diluted	<b>\$0.12</b>	\$0.37	\$0.21	\$0.04	\$(0.01 )
Cash dividends paid per share	<b>\$0.20</b>	\$0.17	\$0.12	\$0.24	\$0.36
Weighted average common shares					
Basic	<b>25,436</b>	24,988	24,496	24,388	24,313
Diluted	<b>25,988</b>	25,592	24,638	24,546	24,313

**Balance Sheet Data:**

(At June 30)

Edgar Filing: LSI INDUSTRIES INC - Form 10-K

	<b>2017</b>	2016	2015	2014	2013
Working capital	<b>\$61,704</b>	\$88,510	\$80,813	\$74,349	\$74,647
Total assets	<b>256,680</b>	195,560	180,690	168,688	169,179
Long-term debt	<b>49,698</b>	—	—	—	—
Shareholders' equity	<b>160,078</b>	155,520	142,952	138,412	141,690

- 66 -

---

## LSI INDUSTRIES INC. AND SUBSIDIARIES

SCHEDULE II — VALUATION AND QUALIFYING ACCOUNTS  
FOR THE YEARS ENDED JUNE 30, 2017, 2016, AND 2015

(In Thousands)

COLUMN A	COLUMN B	COLUMN C	COLUMN D	COLUMN E	COLUMN F
Description	Balance Beginning of Period	Additions Charged to Costs and Expenses	Additions (Deductions) From Company Acquired (Sold)	(a) Deductions	Balance End of Period
<b>Allowance for Doubtful Accounts:</b>					
Year Ended June 30, 2017	\$ 226	\$ 339	\$ 10	\$ (69)	) \$ 506
Year Ended June 30, 2016	\$ 317	\$ 55	\$ —	\$ (146)	) \$ 226
Year Ended June 30, 2015	\$ 294	\$ 220	\$ —	\$ (197)	) \$ 317
<b>Inventory Obsolescence Reserve:</b>					
Year Ended June 30, 2017	\$ 2,394	\$ 1,495	\$ 600	\$ (1,674)	) \$ 2,815
Year Ended June 30, 2016	\$ 2,197	\$ 1,726	\$ —	\$ (1,529)	) \$ 2,394
Year Ended June 30, 2015	\$ 2,298	\$ 1,493	\$ (417)	) \$ (1,177)	) \$ 2,197
<b>Deferred Tax Asset Valuation Reserve:</b>					
Year Ended June 30, 2017	\$ 6,150	\$ —	\$ (569)	) \$ (25)	) \$ 5,556
Year Ended June 30, 2016	\$ 6,161	\$ —	\$ —	\$ (11)	) \$ 6,150
Year Ended June 30, 2015	\$ 6,450	\$ —	\$ (283)	) \$ (6)	) \$ 6,161

(a) For Allowance for Doubtful Accounts, deductions are uncollectible accounts charged off, less recoveries.