SIGMATRON INTERNATIONAL INC
Form 10-Q
December 13, 2012
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

(Mark One)

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

For the quarterly period ended October 31, 2012

OR

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

For the transition period from to

Commission File Number 0-23248

SIGMATRON INTERNATIONAL, INC.

(Exact name of registrant as specified in its charter)

Delaware	**36-3918470**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**
2201 Landmeier Road Elk Grove Village, Illinois	**60007**
(Address of principal executive offices)	**(Zip Code)**

Registrant s telephone number, including area code: (847) 956-8000

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 x No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files. Yes x No ¨

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

Large accelerated filer ¨	Accelerated filer ¨
Non-accelerated filer ¨ (Do not check if a smaller reporting company)	Smaller reporting company x

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

Indicate the number of shares outstanding of the registrant s common stock, $0.01 par value, as of December 13, 2012: 3,930,402

Table of Contents

SigmaTron International, Inc.

Index

Table of Contents

SigmaTron International, Inc.

Consolidated Balance Sheets

	October 31, 2012 (Unaudited)	April 30, 2012
Current assets:		
Cash	$ 7,591,585	$ 4,668,931
Accounts receivable, less allowance for doubtful accounts of $150,000 and $164,103 at October 31, 2012 and April 30, 2012	18,739,228	27,916,288
Inventories, net	48,541,540	37,838,378
Prepaid expenses and other assets	1,077,419	1,170,537
Refundable income taxes	615,404	465,653
Deferred income taxes	1,852,361	1,840,751
Other receivables	376,222	238,592
Total current assets	78,793,759	74,139,130
Property, machinery and equipment, net	25,595,807	24,373,494
Intangible assets, net of amortization of $2,816,490 and $2,683,075 at October 31, 2012 and April 30, 2012	6,095,510	86,925
Goodwill	3,611,960	
Other assets	882,826	547,334
Total other long-term assets	10,590,296	634,259
Total assets	$ 114,979,862	$ 99,146,883
Liabilities and stockholders equity:		
Current liabilities:		
Trade accounts payable	$ 27,061,589	$ 20,233,521
Accrued expenses	1,840,529	1,012,549
Accrued wages	3,489,225	2,974,607
Current portion of long-term debt	99,996	126,828
Current portion of capital lease obligations	224,501	219,457
Current portion of contingent consideration	331,429	
Total current liabilities	33,047,269	24,566,962
Long-term debt, less current portion	22,125,015	18,175,013
Capital lease obligations, less current portion	693,356	806,882
Contingent consideration, less current portion	1,923,571	
Other long-term debt	934,085	363,520
Deferred rent	1,015,896	735,616
Deferred income taxes	3,486,153	3,477,819
Total long-term liabilities	30,178,076	23,558,850
Total liabilities	63,225,345	48,125,812
Commitments and contingencies:		
Stockholders equity:		

Preferred stock, $.01 par value; 500,000 shares authorized, none issued or outstanding		
Common stock, $.01 par value; 12,000,000 shares authorized, 3,930,402 and 3,909,572 shares issued and outstanding at October 31, 2012 and April 30, 2012	39,679	39,096
Capital in excess of par value	20,235,168	19,891,996
Retained earnings	31,479,670	31,089,979
Total stockholders equity	51,754,517	51,021,071
Total liabilities and stockholders equity	$ 114,979,862	$ 99,146,883

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

Table of Contents

SigmaTron International, Inc.

Consolidated Statements Of Operations

	Three Months Ended October 31, 2012 (Unaudited)	Three Months Ended October 31, 2011 (Unaudited)	Six Months Ended October 31, 2012 (Unaudited)	Six Months Ended October 31, 2011 (Unaudited)
Net sales	$ 52,729,395	$ 39,902,653	$ 100,358,624	$ 78,794,664
Cost of products sold	47,326,225	36,331,246	90,249,556	71,680,749
Gross profit	5,403,170	3,571,407	10,109,068	7,113,915
Selling and administrative expenses	4,679,755	3,032,310	9,345,160	5,941,446
Operating income	723,415	539,097	763,908	1,172,469
Other income (expense)	8,255	(8,149)	8,255	(26,580)
Interest expense	208,615	296,118	396,952	565,434
Income from operations before income tax expense	506,545	251,128	358,701	633,615
Income tax expense (benefit)	23,711	92,861	(30,989)	234,387
Net income	$ 482,834	$ 158,267	$ 389,690	$ 399,228
Earnings per share basic	$ 0.12	$ 0.04	$ 0.10	$ 0.10
Earnings per share diluted	$ 0.12	$ 0.04	$ 0.10	$ 0.10
Weighted average shares of common stock outstanding Basic	3,930,402	3,864,412	3,926,440	3,864,343
Weighted average shares of common stock outstanding Diluted	4,002,264	3,883,683	3,989,180	3,887,380

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

4

Table of Contents

SigmaTron International, Inc.

Consolidated Statements of Cash Flows

	Six Months Ended October 31, 2012 (Unaudited)	Six Months Ended October 31, 2011 (Unaudited)
Operating activities:		
Net income	$ 389,690	$ 399,228
Adjustments to reconcile net income to net cash used in operating activities:		
Depreciation and amortization	2,221,992	2,007,173
Stock-based compensation	135,838	2,414
Restricted stock expense	38,907	
Provision for inventory obsolescence		31,500
Deferred income taxes	(3,276)	(942)
Amortization of intangibles	133,415	60,196
Loss from disposal or sale of machinery and equipment		1,143
Changes in operating assets and liabilities, net of assets and liabilities acquired		
Accounts receivable	(4,560,840)	(4,147,764)
Inventories	(3,512,547)	4,347,162
Prepaid expenses and other assets	(213,848)	567,523
Refundable Income taxes	(149,751)	218,016
Trade accounts payable	4,968,907	(6,209,216)
Deferred rent	280,280	7,160
Accrued expenses and wages	280,657	(521,126)
Net cash provided by (used in) operating activities	9,424	(3,237,533)
Investing activities:		
Purchases of machinery and equipment	(2,044,055)	(1,452,473)
Cash received in conjunction with acquisition	1,142,597	
Net cash used in investing activities	(901,458)	(1,452,473)
Financing activities:		
Proceeds from exercise of common stock options		9,310
Payments under capital lease obligations	(108,482)	(620,879)
Payments under other notes payable	(26,832)	(80,497)
Net proceeds under lines of credit	4,000,000	4,586,619
Change in bank overdraft		165,277
Payments under building notes payable	(49,998)	(49,998)
Net cash provided by financing activities	3,814,688	4,009,832
Change in cash	2,922,654	(680,174)
Cash at beginning of period	4,668,931	4,138,102
Cash at end of period	$ 7,591,585	$ 3,457,928
Supplementary disclosures of cash flow information		
Cash paid for interest	$ 385,336	$ 497,929
Cash paid for income taxes, net of (refunds)	24,310	(96,016)

Non-Cash Transaction - Acquisition of Spitfire Control, Inc.		
SigmaTron International, Inc. A/R Trade forgiven	$ 15,312,904	$
SigmaTron International, Inc. Foreign A/R Trade forgiven	1,142,392	
Contingent consideration	2,320,000	
Issuance of Restricted stock	169,011	
Total Cost of Acquisition	$ 18,944,307	$

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

5

Table of Contents

SigmaTron International, Inc.

October 31, 2012

Notes to Consolidated Financial Statements

(Unaudited)

Note A Basis of Presentation

The accompanying unaudited consolidated financial statements of SigmaTron International, Inc. (SigmaTron), SigmaTron s wholly-owned subsidiaries Standard Components de Mexico S.A., AbleMex, S.A. de C.V., Digital Appliance Controls de Mexico, S.A. de C.V., Spitfire Controls (Vietnam) Co. Ltd., Spitfire Controls (Cayman) Co. Ltd. and SigmaTron International Trading Co., wholly-owned foreign enterprises Wujiang SigmaTron Electronics Co., Ltd. and SigmaTron Electronic Technology Co., Ltd. (SigmaTron China) and international procurement office SigmaTron Taiwan branch (collectively, the Company) have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X.

Accordingly, the consolidated financial statements do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring adjustments) considered necessary for a fair presentation have been included. Operating results for the three and six month periods ended October 31, 2012 are not necessarily indicative of the results that may be expected for the year ending April 30, 2013. For further information, refer to the consolidated financial statements and footnotes thereto included in the Company s Annual Report on Form 10-K for the year ended April 30, 2012.

On May 31, 2012, SigmaTron acquired certain assets and assumed certain liabilities of Spitfire Control, Inc. (Spitfire). Spitfire was a privately held Illinois corporation headquartered in Carpentersville, Illinois with captive manufacturing sites in Chihuahua, Mexico and suburban Ho Chi Minh City, Vietnam. Both manufacturing sites were among the assets acquired by the Company.

Certain reclassifications have been made to the previously reported financial statements in order to conform to the current period presentation.

Note B Inventories

The components of inventory consist of the following:

	October 31, 2012	April 30, 2012
Finished products	$ 14,297,879	$ 10,271,703
Work-in-process	2,444,192	2,101,342
Raw materials	33,644,569	27,343,433
	50,386,640	39,716,478
Less obsolescence reserve	1,845,100	1,878,100
	$ 48,541,540	$ 37,838,378

Table of Contents

SigmaTron International, Inc.

October 31, 2012

Notes to Consolidated Financial Statements - Continued

(Unaudited)

Note C Earnings Per Share

The following table sets forth the computation of basic and diluted earnings per share:

	Three Months Ended October 31, 2012	Three Months Ended October 31, 2011	Six Months Ended October 31, 2012	Six Months Ended October 31, 2011
Net income	$ 482,834	$ 158,267	$ 389,690	$ 399,228
Weighted-average shares				
Basic	3,930,402	3,864,412	3,926,440	3,864,343
Effect of dilutive stock options	71,862	19,271	62,740	23,037
Diluted	4,002,264	3,883,683	3,989,180	3,887,380
Basic earnings per share	$ 0.12	$ 0.04	$ 0.10	$ 0.10
Diluted earnings per share	$ 0.12	$ 0.04	$ 0.10	$ 0.10

Options to purchase 525,192 and 455,357 shares of common stock were outstanding at October 31, 2012 and 2011, respectively. There were no options granted during the quarters ended October 31, 2012 and 2011. The Company recognized approximately $32,160 and $2,400 in stock option expense during the quarters ended October 31, 2012 and 2011, respectively. The balance of unrecognized compensation cost related to the Company s stock options plans was approximately $134,000 and $0 at October 31, 2012 and 2011, respectively.

The Company issued 25,000 shares of restricted stock, of which 8,333 vested in June 2012. The Company recognized approximately $39,000 and $11,000 in compensation expense during the quarter ended July 31, 2012 and October 31, 2012, respectively. There was no issuance of restricted stock during the quarters ended October 2012 and 2011. The balance of unrecognized compensation expense related to the Company s restricted stock award was approximately $39,000 and $0 at October 31, 2012 and 2011, respectively.

SigmaTron International, Inc.

October 31, 2012

Notes to Consolidated Financial Statements - Continued

(Unaudited)

Note D Long-term Debt

The Company has a senior secured credit facility with Wells Fargo Bank (Wells Fargo), with a credit limit up to $30 million. The term of the credit facility initially extended through September 30, 2013, and allows the Company to choose among interest rates at which it may borrow funds. The interest rate is the prime rate plus one half percent (effectively, 3.75% at October 31, 2012) or LIBOR plus two and three quarter percent (effectively, 3.1% at October 31, 2012), which is paid monthly. The credit facility is collateralized by substantially all of the domestically located assets of the Company and requires the Company to be in compliance with several financial covenants. In conjunction with the Spitfire acquisition, two of the financial covenants required by terms of the Company s senior secured credit facility were amended as of May 31, 2012. The Company was in violation of certain of its financial covenants at July 31, 2012 and received a waiver for the financial covenant violations. The Company renegotiated its financial covenants prior to October 31, 2012 with its bank and extended the credit facility through September 30, 2014. At October 31, 2012 the Company was in compliance with its financial covenants. As of October 31, 2012, there was a $20,000,000 outstanding balance under the credit facility and $10,000,000 of unused availability.

Note E Tijuana, MX Operation Move

During the first quarter of fiscal year 2013, the Company relocated its Tijuana, MX operation to a new facility within Tijuana, MX. The Company incurred a total of approximately $423,000 in relocation expenses as a result of the move. During the first quarter ended July 31, 2012, relocation expenses of $391,750 were included in cost of products sold and consist primarily of moving expenses related to equipment, the write-off of leasehold improvements and the restoration of the prior Tijuana facility. There was $5,880 of additional costs incurred during the quarter ended October 31, 2012. The Company does not anticipate any additional costs as a result of the move in future periods.

Note F Acquisition

Spitfire Control, Inc.

The Purchase Agreement

SigmaTron entered into a Purchase Agreement on May 31, 2012 with Spitfire Control, Inc., an Illinois corporation (Seller), regarding the acquisition of certain assets of the Seller by the Company. Prior to the date of the Purchase Agreement, the Seller and its affiliates were customers and strategic partners of SigmaTron, with such relationships dating back to 1994.

Seller, on its own and through its subsidiaries Digital Appliance Controls de Mexico, S.A. de C.V., a Mexico corporation (DAC), and Spitfire Controls (Cayman) Co. Ltd., a Cayman Islands exempted company (Cayman), their subsidiaries and Seller s affiliated entities, is engaged in the business of the design, manufacture, sale and distribution of electrical or electronic controls for appliances (the Business).

SigmaTron International, Inc.

October 31, 2012

Notes to Consolidated Financial Statements - Continued

(Unaudited)

Note F Acquisition Continued

Spitfire Control, Inc.

The Purchase Agreement Continued

Pursuant to the terms of the Purchase Agreement, SigmaTron acquired on May 31, 2012 certain Acquired Assets from or at the direction of the Seller (the Transaction). The Acquired Assets, which are listed in greater detail in the Purchase Agreement, consist of (i) all of the equity securities of DAC and Cayman and (ii) all of the assets used by or useful in the conduct of the Business. In addition to acquiring the Acquired Assets, SigmaTron also obtained an agreement not to compete against the Business as it is operated by the Company after the closing of the Transaction from each of the Sellers and the sole owner of Seller.

In exchange for the Acquired Assets, the Company agreed to pay a purchase price consisting of: (i) the satisfaction and release of the account payable of approximately $16,000,000 owed by Seller to the Company; (ii) future payments, which are based upon the annual post-closing performance of the Business during each of the Company s fiscal years 2013 through 2019; and (iii) the issuance of 50,000 shares of restricted common stock of SigmaTron, 12,500 of which vested upon the closing of the Transaction and 12,500 of which will vest on each of the first, second and third anniversaries of the closing of the Transaction.

In addition to the foregoing, SigmaTron agreed to assume (i) the Seller s obligations under certain specified contracts and Governmental Authorizations (as defined in the Purchase Agreement), (ii) specified trade accounts payable and accrued expenses of the Seller as agreed upon by the parties and (iii) specified inter-company payables involving the Seller, DAC, Cayman and/or their subsidiaries and associated companies. Further, each of DAC and Cayman has retained the liabilities associated with its respective operations, which is customary in transactions involving the purchase or sale of all of the equity securities of an entity. As a result, SigmaTron indirectly acquired such liabilities through the Transaction.

The Credit Amendment

Concurrent with the Transaction, the Company entered into amendments of its credit facility with Wells Fargo (the Credit Amendment). The Credit Amendment modified certain financial covenant thresholds applicable to the Company, added property acquired in the Transaction as collateral for the loan to the Company, permitted the Company to acquire certain inter-company payables involving the Seller, DAC, Cayman or the subsidiaries and associated companies and permitted the Company to discharge and release the account payable owed by the Seller to the Company in partial consideration for the Transaction.

Table of Contents

SigmaTron International, Inc.

October 31, 2012

Notes to Consolidated Financial Statements - Continued

(Unaudited)

Note F Acquisition Continued

Spitfire Control, Inc.

Reasons for the Transaction

The Company believes its acquisition of Spitfire will allow a comprehensive approach to solving major appliance producers issues with integrating electronics into their platforms. The acquisition also added two manufacturing operations in locations that the Company believes will augment the Company s international footprint. In addition, the acquisition of Spitfire will allow the Company to offer design services for the first time in specific markets. In conjunction with the Spitfire acquisition, the Company incurred a total of approximately $1,300,000 in professional fees. The professional fees incurred for the three and six month periods ended October 31, 2012 were $179,156 and $767,755, respectively. The professional fees were recorded as selling and administrative expenses.

Accounting

The acquisition of Spitfire was accounted for in accordance with ASC Topic No. 805, Business Combinations . The acquisition was recorded using the purchase method of accounting, and on the date of the acquisition, the Company assessed the fair value of the acquired assets and assumed liabilities (primarily using level 3 measurement inputs) and an allocated purchase price of $18,944,307. The allocation of the purchase considerations based upon estimates made by the Company with the assistance of independent valuation specialists. The purchase price allocation as of October 31, 2012, was as follows:

	Estimated Fair Value
Cash	$ 1,142,597
Current assets	10,074,168
Property, plant and equipment	1,400,250
Liabilities assumed	(3,426,668)
Non-contractual customer relationships	4,690,000
Backlog	22,000
Trade names	980,000
Non-compete agreements	50,000
Patents	400,000
Goodwill	3,611,960
Total Net Assets	$ 18,944,307

Table of Contents

SigmaTron International, Inc.

October 31, 2012

Notes to Consolidated Financial Statements - Continued

(Unaudited)

Note F Acquisition Continued

Spitfire Control, Inc.

Accounting Continued

The amounts allocated to non-contractual customer relationships, backlog, trade names, non-compete agreements and patents are estimated by the Company based on the work performed by independent valuation specialists, primarily through the use of discounted cash flow techniques. Appraisal assumptions utilized under these methods include a forecast of estimated future net cash flows, as well as discounting the future net cash flows to their present value. Acquired intangible assets are being amortized over the estimated useful lives as set forth in the following table:

	Method	Life
Non-contractual customer relationships	Accelerated	15 Years
Backlog	Straight-line	1 Year
Trade names	Straight-line	20 Years
Non-compete agreements	Straight-line	7 Years
Patents	Straight-line	5 Years
Goodwill	N/A	Indefinite

The estimated asset lives are determined based on projected future economic benefits and expected life cycles of the acquired intangible assets. The amount assigned to goodwill is not being amortized, but will be tested for impairment annually or under circumstances that may indicate a potential impairment. Goodwill is deductible for federal income tax purposes over a period of 15 years.

The Company s estimate of the fair value of the contingent consideration ($2,320,000 as of the acquisition date) was based on expected operating results of the Business through fiscal 2019 and the specific terms of when such consideration would be earned. Those terms provide for additional consideration to be paid to Seller or its owner based on a percentage of sales and pre-tax profits over those years in excess of certain minimums. Payments are to be made quarterly each year and adjusted after each year end audit. The Company discounted expected payments by its weighted average cost of capital of 11.5%. The value of the 50,000 shares of restricted stock issued as part of the purchase price was based on the trading price of the Company s common stock on the acquisition date discounted by 15% to account for the restrictions associated with that issuance.

Due to the acquisition of Spitfire, effective June 1, 2012, the Company discontinued selling to Spitfire. The Company instead began selling directly to Spitfire s former customers.

Table of Contents

SigmaTron International, Inc.

October 31, 2012

Notes to Consolidated Financial Statements - Continued

(Unaudited)

Note F Acquisition Continued

Spitfire Control, Inc.

Pro forma Results

The results of Spitfire for the period August 1, 2012 through October 31, 2012, which includes sales of $7,312,160 and a net loss of $887,533 have been included in our consolidated financial statements for the three month period ended October 31, 2012. In addition the results of Spitfire for the period June 1, 2012 through October 31, 2012 have been included in our consolidated financial statement for the six month period ended October 31, 2012, which includes sales of $11,278,681 and a net loss of $1,456,117.

While the results of Spitfire have been included in the condensed consolidated financial statements of the Company for the period subsequent to the acquisition, the following unaudited pro forma condensed combined results of operations for the three and six month periods ended October 31, 2012 and 2011 are based on the historical financial statements of the Company and Spitfire giving effect to the business combination as if it had occurred on May 1, 2011. Therefore, this pro forma data includes adjustments to sales, amortization, depreciation, compensation expense and tax expense. This data is not necessarily indicative of the results of operations that would have been generated if the transaction had occurred on May 1, 2011. Moreover, this data is not intended to be indicative of future results of operations.

	Three Months Ended October 31,		Six Months Ended October 31,	
	2012	2011	2012	2011
Net sales	$ 52,729,395	$ 43,615,516	$ 101,138,686	$ 85,757,696
Net income (loss)	482,834	(526,047)	554,342	(1,401,035)
Income (loss) per share:				
Basic	$ 0.12	$ (0.14)	$ 0.14	$ (0.36)
Diluted	$ 0.12	$ (0.14)	$ 0.14	$ (0.36)

Note G Goodwill and Other Intangible Assets

Goodwill

The changes in carrying amount of goodwill for the three months ended October 31, 2012, are as follows:

	Total
Balance at April 30, 2012	$
Goodwill due to Spitfire acquisition July 31, 2012	3,611,960

Balance at October 31, 2012	$ 3,611,960

Table of Contents

SigmaTron International, Inc.

October 31, 2012

Notes to Consolidated Financial Statements - Continued

(Unaudited)

Note G Goodwill and Other Intangible Assets Continued

Other Intangible Assets

Intangible assets subject to amortization are summarized as of October 31, 2012 as follows:

	Weighted Average Remaining Amortization Period (Years)	Gross Carrying Amount	Accumulated Amortization
Other intangible assets Able		$ 375,000	$ 375,000
Customer relationships Able	.7	2,395,000	2,348,925
Spitfire:			
Non-contractual customer relationships	14.6	4,690,000	26,675
Backlog	.6	22,000	9,165
Trade names	19.6	980,000	20,415
Non-compete agreements	6.6	50,000	2,975
Patents	4.6	400,000	33,335
Total		$ 8,912,000	$ 2,816,490

Estimated aggregate amortization expense for our intangible assets, which become fully amortized in 2032, for the remaining periods is as follows:

For the remaining 6 months of the fiscal year ending April 30:	2013	$ 146,076
For the year fiscal ended April 30:	2014	346,680
	2015	428,610
	2016	470,899
	2017	490,010
	Thereafter	4,213,235
		$ 6,095,510

Table of Contents

SigmaTron International, Inc.

October 31, 2012

Notes to Consolidated Financial Statements - Continued

(Unaudited)

Note H Critical Accounting Policies

Management Estimates and Uncertainties The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America (U.S. GAAP) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Significant estimates made in preparing the consolidated financial statements include depreciation and amortization periods, the allowance for doubtful accounts, reserves for inventory and valuation of long-lived assets. Actual results could materially differ from these estimates.

Revenue Recognition Revenues from sales of the Company s electronic manufacturing services business are recognized when the finished good product is shipped to the customer. In general, and except for consignment inventory, it is the Company s policy to recognize revenue and related costs when the finished goods have been shipped from our facilities, which is also the same point that title passes under the terms of the purchase order. Finished goods inventory for certain customers is shipped from the Company to an independent warehouse for storage or shipped directly to the customer and stored in a segregated part of the customer s own facility. Upon the customer s request for finished goods inventory, the inventory is shipped to the customer if the inventory was stored off-site, or transferred from the segregated part of the customer s facility for consumption or use by the customer. The Company recognizes revenue upon such shipment or transfer. The Company does not earn a fee for such arrangements. The Company from time to time may ship finished goods from its facilities, which is also the same point that title passes under the terms of the purchase order, and invoice the customer at the end of the calendar month. This is done only in special circumstances to accommodate a specific customer. Further, from time to time customers request the Company hold finished goods after they have been invoiced to consolidate finished goods for shipping purposes. The Company generally provides a 90 day warranty for workmanship only and does not have any installation, acceptance or sales incentives (although the Company has negotiated longer warranty terms in certain instances). The Company assembles and tests assemblies based on customers specifications. Historically, the amount of returns for workmanship issues has been de minimis under the Company s standard or extended warranties.

Inventories Inventories are valued at the lower of cost or market. Cost is determined by the first-in, first-out method. In the event of an inventory write-down, the Company records expense to state the inventory at lower of cost or market. The Company establishes inventory reserves for valuation, shrinkage, and excess and obsolete inventory. The Company records provisions for inventory shrinkage based on historical experience to account for unmeasured usage or loss. Actual results differing from these estimates could significantly affect the Company s inventories and cost of products sold. The Company records provisions for excess and obsolete inventories for the difference between the cost of inventory and its estimated realizable value based on assumptions about future product demand and market conditions. Actual product demand or market conditions could be different than that projected by management.

Table of Contents

SigmaTron International, Inc.

October 31, 2012

Notes to Consolidated Financial Statements - Continued

(Unaudited)

Note H Critical Accounting Policies Continued

Goodwill Goodwill represents the purchase price in excess of the fair value of assets acquired in business combinations. Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 350, Goodwill and other Intangible Assets, requires the Company to assess goodwill and other indefinite-lived intangible assets for impairment at least annually in the absence of an indicator of possible impairment and immediately upon an indicator of possible impairment. There were no indicators identified during the quarter ended October 31, 2012.

Impairment of Long-Lived Assets The Company reviews long-lived assets, including amortizable intangible assets for impairment. The Company is permitted the option to first assess qualitative factors to determine whether the existence of events and circumstances indicates that it is more likely than not that the indefinite-lived intangible asset is impaired. If, after assessing the totality of events and circumstances, the Company concludes that it is not more likely than not that the indefinite-lived intangible asset is impaired, then the Company is not required to take further action. However, if the Company concludes otherwise, then it is required to determine the fair value of the indefinite-lived intangible asset and perform the quantitative impairment test by comparing the fair value with the carrying amount. The Company also has the option to bypass the qualitative assessment for any indefinite-lived intangible asset in any period and proceed directly to performing the quantitative impairment test. The Company will be able to resume performing the qualitative assessment in any subsequent period.

Income Tax The Company accounts for income taxes in accordance with FASB ASC 740, Income Taxes . Our income tax expense, deferred tax assets and liabilities and reserves for unrecognized tax benefits reflect management s best assessment of estimated future taxes to be paid. The Company is subject to income taxes in both the U.S. and several foreign jurisdictions. Significant judgments and estimates by management are required in determining the consolidated income tax expense assessment.

Deferred income taxes arise from temporary differences between the tax and financial statement recognition of revenue and expense. In evaluating our ability to recover our deferred tax assets within the jurisdiction from which they arise, the Company considers all available positive and negative evidence, including scheduled reversals of deferred tax liabilities, projected future taxable income, tax planning strategies and recent financial operations. In projecting future taxable income, the Company begins with historical results adjusted for the results of discontinued operations and changes in accounting policies, and incorporates assumptions including the amount of future state, federal and foreign pretax operating income, the reversal of temporary differences, and the implementation of feasible and prudent tax planning strategies. These assumptions require significant judgment and estimates by management about the forecasts of future taxable income and are consistent with the plans and estimates the Company uses to manage the underlying businesses. In evaluating the objective evidence that historical results provide, the Company considers three years of cumulative operating income and/or loss.

SigmaTron International, Inc.

October 31, 2012

Notes to Consolidated Financial Statements - Continued

(Unaudited)

Note H Critical Accounting Policies Continued

The calculation of our tax liabilities involves dealing with uncertainties in the application of complex tax laws and regulations in a multitude of jurisdictions across our global operations. Changes in tax laws and rates could also affect recorded deferred tax assets and liabilities in the future. Management is not aware of any such changes that would have a material effect on the Company s results of operations, cash flows or financial position.

FASB ASC Topic 740, Income Taxes provides that a tax benefit from an uncertain tax position may be recognized when it is more likely than not that the position will be sustained upon examination, including resolutions of any related appeals or litigation processes, based on the technical merits. FASB ASC Topic 740 also provides guidance on measurement, derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition.

The Company recognizes tax liabilities in accordance with FASB ASC Topic 740 and adjusts these liabilities when its judgment changes as a result of the evaluation of new information not previously available. Due to the complexity of some of these uncertainties, the ultimate resolution may result in a payment that is materially different from our current estimate of the tax liabilities. These differences will be reflected as increases or decreases to income tax expense in the period in which they are determined.

New Accounting Standards:

In June 2011, the FASB issued ASU 2011-05, Comprehensive Income (ASC Topic 220), Presentation of Comprehensive Income, which requires disclosure of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. ASU 2011-05 eliminates the option to present the components of other comprehensive income as part of the statement of changes in shareholders equity. ASU 2011-05 became effective for fiscal years, and interim periods within those years, beginning after December 15, 2011. In December, the FASB issued ASU 2011-12, Comprehensive Income (Topic 220), that deferred the requirement to separately present within net income reclassification adjustments of items out of accumulated other comprehensive income. The Company adopted this guidance beginning February 1, 2012. The adoption of this guidance did not have a material impact on the Company s consolidated results of operations and financial condition.

In September 2011, the FASB issued ASU 2011-08, Intangibles, Goodwill and Other (ASC Topic 350), Testing Goodwill for impairment (revised topic). The revised standard is intended to reduce the cost and complexity of the annual goodwill impairment test by providing entities an option to perform a qualitative assessment to determine whether further impairment testing is necessary. The revised standard is effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011. The Company adopted this guidance beginning February 1, 2012. The adoption of this guidance did not have a material impact on the Company s consolidated results of operations and financial condition.

Table of Contents