

James

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**SPARTON**  
**SPARTON CORPORATION**

December 19, 2001



Mr. Gregg A. Cooke  
Regional Administrator  
Environmental Protection Agency  
Region 6  
1445 Ross Avenue  
Dallas, Texas 75202

Mr. Peter Maggiore  
Secretary of New Mexico Environment Department  
Harold S. Runnels Building  
1190 St. Francis Drive  
P.O. Drawer 26110  
Santa Fe, New Mexico 87502-6110

Dear Mr. Cooke and Mr. Maggiore:

I am the chief financial officer of Sparton Corporation, 2400 E. Ganson Street, Jackson, Michigan 49202. This letter is in support of Sparton Corporation's use of the financial test to demonstrate financial assurance for corrective action and any post-closure care, as specified in subparts G and H of 40 C.F.R. parts 264 and 265.

1. Sparton Corporation is the owner or operator of the following facilities -for which financial assurance for closure, post-closure care, or corrective action is demonstrated through the financial test specified in subpart H of 40 C.F.R. parts 264 and 265. The current closure, post-closure care, and/or corrective action cost estimates covered by the test are shown for each facility: None.
2. Sparton Corporation guarantees, through the guarantee specified in subpart H of 40 C.F.R. parts 264 and 265, the corrective action and any post-closure care of the following facilities owned or operated by the guaranteed party. The current cost estimates for the corrective action and post-closure care so guaranteed are shown for each facility: Sparton Technology, Inc., 9621 Coors Rd., N.E., Albuquerque, New Mexico 87114: corrective action and post-closure care cost estimate = \$4,183,526. Sparton Corporation is the direct parent corporation of Sparton Technology, Inc.
3. In States where EPA is not administering the financial requirements of subpart H of 40 C.F.R. part 264 or 265, Sparton Corporation, as guarantor, is demonstrating financial assurance for the closure, post-closure care, or corrective action of the following facilities through the use of test equivalent or substantially equivalent to the financial test specified in subpart H of 40 C.F.R. parts 264 and 265. The current closure, post-closure care, and corrective action cost estimates covered by such a test are shown for each facility: Except for the Sparton Technology, Inc. facility listed under number 2 above, none.

# SPARTON

4. Sparton Corporation is the owner or operator of the following hazardous waste management facilities for which financial assurance for closure, post-closure care, or corrective action is not demonstrated either to EPA or a State through the financial test of any other financial assurance mechanism specified in subpart H of 40 C.F.R. parts 264 and 265 or equivalent or substantially equivalent State mechanisms. The current closure, post-closure care, and corrective action cost estimates not covered by such financial assurance are shown for each facility: None.

5. Sparton Corporation is the owner or operator of the following UIC facilities for which financial assurance for plugging and abandonment is required under part 144. The current closure cost estimates as required by 40 C.F.R. 144.62 are shown for each facility: None.

Sparton Corporation is required to file a Form 10K with the Securities and Exchange Commission (SEC) for the latest fiscal year.

The fiscal year of this firm ends on June 30. The figures for the following items marked with an asterisk are derived from this firm's independently audited, year-end financial statements for the latest completed fiscal year, ended June 30, 2001.

## ALTERNATIVE I

1. Sum of current corrective action and post-closure care cost estimates:

\$4,183,526

\*2. Total liabilities: \$28,272,054

\*3. Tangible net worth: \$79,522,450

\*4. Net worth: \$79,522,451

\*5. Current assets: \$86,513,361

\*6. Current liabilities \$20,536,181

\*7. Net working capital: \$65,977,180:

\*8. The sum of net income plus depreciation, depletion, and amortization:

\$3,532,800

\*9. Total assets in U.S. (required only if less than 90% of firm's assets are located in the U.S.): Not Applicable

10. Is line 3 at least \$10 million? (Yes/No) Yes

11. Is line 3 at least 6 times line 1 ? (Yes/No) Yes

# SPARTON

12. Is line 7 at least 6 times line 1? (Yes/No) Yes

\*13. Are at least 90% of firm's assets located in the U.S.? If not, complete line 14  
(Yes/No) Yes

14. Is line 9 at least 6 times line 1? (Yes/No) Not Applicable

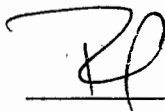
15. Is line 2 divided by line 4 less than 2.0? (Yes/No) Yes

16. Is line 8 divided by line 2 greater than 0.1? (Yes/No) Yes

17. Is line 5 divided by line 6 greater than 1.5? (Yes/No) Yes

I hereby certify that the wording of this letter is substantially identical to the wording specified in 40 C.F.R. 264.151(f) as such regulations were constituted on the date shown immediately below, except as modified to reflect financial assurances of corrective action and except where "this firm" is replaced with "Sparton Corporation."

[Signature]



[Name]

Richard Langley

[Title]

Vice President, Chief Financial Officer, Treasurer

[Date]

December 19, 2001

Enclosure: Sparton's 2001 Annual Report to Shareholders

Real People. Real Solutions.

**SPARTON**  
CORPORATION



2001 ANNUAL REPORT



## THE SPARTON WAY

Dedicated to the conduct of our business at the highest ethical level.

Dedicated to the manufacture of superior quality products in the most efficient manner possible and at the lowest possible cost.

Dedicated to loyally serving our customers to the utmost of our ability by making continuing contributions that support their progress.

Dedicated to constantly improving our Company's technological base to better serve our customers.

Dedicated to the creation of new ideas and new processes in order to remain the low cost producer in our chosen marketplaces.

Dedicated to making our Company grow faster than the economy.

Dedicated to the maximization of shareowner value.

Dedicated to providing a work environment that is safe, modern and clean and one where our employees can achieve their highest potential during their working years.

## PEOPLE ON THE COVER:



**Annette Sobolewski**  
Customer Business Manager



**Lorrie Durwin**  
Manufacturing Cell Manager



**Erik Fabricius-Olsen**  
Customer Business Manager



**Alan J. Houghtaling**  
Vice President,  
Director Business Development  
&

**Cynthia Goeckel**  
Materials Manager



**Vivian Dognard**  
Customer Business  
Manager



**Stephanie Martin**  
Vice President,  
Corporate Materials  
Acquisitions & Logistics

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## FINANCIAL HIGHLIGHTS

### SPARTON CORPORATION & SUBSIDIARIES FOR YEARS ENDED JUNE 30

	2001	2000	1999
Net sales	\$187,620,426	\$161,914,446	\$131,900,489
Net income (loss):			
Continuing operations	\$1,619,037	\$(8,407,734)	\$ 1,759,081
Discontinued operations	-	-	(2,520,000)
	<u>\$1,619,037</u>	<u>\$(8,407,734)</u>	<u>\$ (760,919)</u>
Working capital	\$65,977,180	\$64,778,574	\$68,578,975
Working capital ratio	4.21:1	4.00:1	4.85:1
Common shares outstanding at June 30	7,570,090	7,828,090	7,828,090
Basic and diluted earnings per share:			
Income (loss):			
Continuing operations	\$0.21	\$(1.07)	\$ 0.22
Discontinued operations	-	-	(0.32)
	<u>\$0.21</u>	<u>\$(1.07)</u>	<u>\$(0.10)</u>
Additional per share information:			
Working capital	\$8.72	\$8.28	\$8.76
Shareowners' equity	10.50	10.10	11.18

#### MARKET DATA

Price range  
New York Stock Exchange

#### Years Ended June 30

	2001		2000		1999	
	High	Low	High	Low	High	Low
Quarter ended:						
September 30	\$4 1/4	\$3 5/8	\$6 5/8	\$5 5/8	\$8 7/8	\$5 3/4
December 31	6	4	5 5/8	4 5/8	6 3/8	5 5/8
March 31	6 1/4	4	6 1/8	4 1/2	7 1/2	6
June 30	7 1/4	6 1/8	4 3/4	3 3/4	6 3/8	5 7/8

Recent Price as of August 31, 2001.....\$7.20

Shareowners of record.....684



## LETTER TO SHAREOWNERS

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To our Shareowners:

This year we have chosen to present a review of some of the highlights and initiatives through the introduction of a few of our Sparton associates. They were difficult to choose, as there was ample evidence that while those chosen were certainly worthy, there were many more that could have been featured as well. This small insight into our staff is but a sample of the great people of Sparton. We trust that you find this format as informative and exciting as we did during its preparation.

Our 101<sup>st</sup> business year was interesting, challenging and rewarding, all within the confines of only 12 months. It was interesting in that we had the opportunity to involve ourselves in several technology leading products and programs which will create significant value for the Company going forward. It was challenging from the standpoint of having to staff growth in one of the toughest employment markets in history. It was rewarding in that all of us at Sparton were able to see real evidence of progress in the maturing of a single business process and single information system which efforts had begun only six years ago. We are well on our way toward an "electronic everything" business environment where the information is live, real time and available to all.

At the close of the year, we were able to post financial results, which gives a true measurement of our progress.

Sales for the year ended June 30, 2001, were \$187,620,000, an increase of \$25,706,000 (16%) from the previous year's \$161,914,000. Net profit for the year was \$1,619,000 (\$0.21 per share) compared to a net loss of \$8,408,000 (\$1.07 per share) last year. Results for the year were in line with our expectations.

Tier 1 Electronics Manufacturing Services (EMS) providers continued to consolidate amidst plant closings and layoffs due to the downturn in the economy, particularly in the telecommunications related sectors of the market. Inventory shortages of critical components were somewhat mitigated by year-end due to this downturn. The Tier 2 sector of EMS providers, in which Sparton resides, is still largely unconsolidated. Many such providers with the wrong customer orientations are experiencing difficulties.

Key value drivers and the growing trend toward increased outsourcing, will continue to help propel business growth for EMS providers, including Sparton, in the future. This will occur despite the continuing downturn in manufacturing demand.

We remain short-term cautious and long-term bullish on outsourcing, which is still in its infancy. Currently, less than 13 percent of all Original Equipment Manufacturer (OEM) manufacturing is outsourced. Industry projections are that this percentage could increase to as high as 80 percent in the future. Our focus remains in the high mix, low to medium volume arena of the regulated EMS markets. The Sparton business model speaks specifically to this orientation and accordingly is unique in the industry.

Those outsourcing companies who are able to provide the most compelling mix of cost savings, quality, and technical expertise will continue to grow. Sparton is committed to be a leading deliverer of value to our targeted customers.

We are continuing to address cost control measures on customer programs, which have adversely affected our operational results in the past. These measures resulted in the recovery of \$1.9 million this past year and the repricing of certain products. During this past year, the entire EMS market encountered serious availability and extended lead-time issues on some electronic components. Shortages on certain key electronic



**BRADLEY O. SMITH**  
CHAIRMAN OF THE BOARD



components resulted in higher prices and late deliveries. Sparton's cost control programs enabled an additional \$2.3 million of cost increases to be recovered from our customers. These tightened supply conditions now appear to be easing somewhat due to the general economic downturn.

Total EPA related costs for the year were \$1.8 million versus \$10.8 million last year. This year's costs were principally legal services expended in litigation to recover EPA costs previously incurred. The net loss for fiscal 2000 was in part the result of the \$10.0 million charge against operations recorded in the second quarter. This charge was a direct result of the settlement of Sparton's 17-year effort and resulting litigation with the United States EPA and others, concerning environmental cleanup at our Coors Road facility in Albuquerque, New Mexico.

The proposed Hobbs, New Mexico, plant facility, announced earlier in the year, continues in the planning stages. A construction start date has not been established due to the current state of the general economy and the lack of customer demand for added manufacturing capacity.

During the year, Sparton was awarded \$21.3 million of the \$40.8 million for the development and production of sonobuoys for the U.S. Navy. The U.S. Navy has also awarded an additional \$12 million to ERAPSCO, Sparton's joint venture with U.S.S.I., based in Ft. Wayne, Indiana. Sparton should realize about 50% of the ERAPSCO awarded revenues.

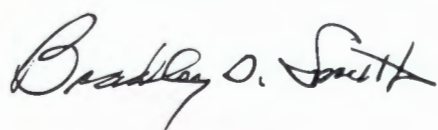
Sparton's Alliance Partner network continues to expand and become a potentially significant part of Sparton's business future. In September, Preco, Inc. – Morton Division became the newest addition to our Alliance Partner network. Preco, Inc. – Morton Division provides design and manufacturing capabilities in the midwestern region of the United States. Members of the Alliance Partner network share customers and resources through cooperation with each other. All of the partners are listed on the inside back cover of this report.

At June 30, 2001, total shareowners' equity was \$79,522,000. The Company continues to have no outstanding bank debt and cash equivalents and investment securities totaled \$14,210,000. Informal bank credit lines are in place to provide additional resources if needed, to fund future growth.

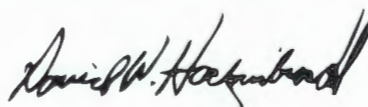
We do invite you to visit our website [www.sparton.com](http://www.sparton.com) often for the latest information on your Company.

Our personal thanks to each of you for your continuing interest and support of Sparton.

Cordially,



Bradley O. Smith  
Chairman of the Board



David W. Hockenbrocht  
Chief Executive Officer & President



**DAVID W. HOCKENBROCHT**  
CHIEF EXECUTIVE OFFICER  
&  
PRESIDENT



## SPARTON BOARD OF DIRECTORS

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**The Sparton Board of Directors**

Standing from left to right: Robert J. Kirk, W. Peter Slusser, James N. DeBoer, Bradley O. Smith, David P. Molfetter  
Seated from left to right: William L. Noecker, Richard L. Langley, David W. Hockenbrocht

### TO THE SHAREOWNERS OF SPARTON CORPORATION:

AS WE EMBARK UPON SPARTON CORPORATION'S SECOND CENTURY OF BUSINESS OPERATIONS, THE BOARD INVITES YOU TO REVIEW OUR FINANCIAL PERFORMANCE FOR THE PAST FISCAL YEAR. THROUGHOUT ITS HISTORY, SPARTON HAS EMPLOYED COUNTLESS TALENTED INDIVIDUALS. THIS YEAR WE WISH TO INTRODUCE A SMALL REPRESENTATION OF SPARTON ASSOCIATES AND THE PROGRAMS WHICH ARE SHAPING OUR FUTURE.

THANK YOU FOR YOUR CONTINUING INTEREST AND SUPPORT.

*Richard L. Langley*

*Bradley O. Smith*

*Peter Slusser*

*Robert J. Kirk*

*David P. Molfetter*

*David W. Hockenbrocht*

*James N. DeBoer*

*William L. Noecker*



## MICHAEL D. SOBOLEWSKI

### SPARTON CENTRAL ENGINEERING SERVICES

Sparton's engineering organization may be considered one of the most experienced and versatile engineering groups in the Electronics Manufacturing Services (EMS) industry today. Sparton has a long history of engineering design and manufacturing experience. As Sparton's EMS business continues to grow, there has been an increasing need to provide a centralized design service organization. This group facilitates a coordinated and efficient execution of engineering activities and improves Sparton's focus to each customer. Sparton's new design organization enhances its ability to deliver customer products and services faster. The new central engineering group also strengthens the Company's commitment to implementing new and expanding technologies.

Michael Sobolewski, formerly a regional Director of Engineering for Sparton Electronics, was selected to manage the new Corporate engineering group. Sparton began bringing local engineering teams together to collaborate on various projects. This introduction of different personnel and skill sets immediately demonstrated an improvement in the quality of current projects. Engineers were able to share their knowledge and experiences, benefitting customer projects.

The transition from independent design groups to a central unit was a success due to the Sparton culture. Sparton's culture facilitates open communication and cooperation between organizations. Each location contributed to making the centralization and development of the new engineering organization an easy process. Michael credits the support of the General Managers, the accounting personnel and the engineering personnel.

The primary focus for the future of the Sparton Engineering Group is to build upon the current customer base and become a source of revenue for Sparton. The majority of the design engineering work that the group is currently doing should eventually lead to ongoing manufacturing work. Sparton believes this is the key to long-term growth for the engineering group.

Sparton continues to focus on new technologies in the marketplace in order to better serve its customers. The Sparton Engineering Group offers a complete range of engineering services that is believed to be unsurpassed by its competition. This unique breadth and depth of design experience is what sets Sparton apart.

Sparton Engineering specializes in full service design from early concept development, research design, development, test and manufacturing to a fully documented manufacturable design. The specific skills and services Sparton Corporate EMS Engineering provides in accomplishing these tasks include: electrical circuit design, RF and wireless design, mechanical design, enclosures and packaging, IPC certified PCB design and layout, power electronics design, software and firmware development, systems design and packaging, safety and regulatory qualification, Design for Manufacturing (DFM), Design for Assembly (DFA), Design for Test (DFT), Design of Experiments (DOE) Analysis, Design Optimization, value engineering and product cost reduction, material obsolescence analysis and reporting, product design maintenance and product improvement.



**MICHAEL D. SOBOLEWSKI**  
**DIRECTOR, CORPORATE EMS**  
**ENGINEERING**

*Michael Sobolewski began working at Sparton in July 1990. Prior to that time, he was a project engineer for a tier-one automotive design and manufacturing company. Initially, Michael was a design engineer and then a project engineer. He later worked as a program manager and a Customer Business Manager. After transitioning back into engineering, Michael was promoted to Director of Engineering for Sparton Electronics in Florida. In 2001, Michael was again promoted to Director of Corporate EMS Engineering.*

*Michael holds a Bachelors of Science in both Mechanical Engineering and Aerospace Engineering, along with a Masters of Science in Mechanical Engineering and a Masters of Business Administration.*



## STEPHANIE A. MARTIN

### STRATEGIC MATERIALS LOGISTICS MANAGEMENT



**STEPHANIE A. MARTIN**  
**VICE PRESIDENT, CORPORATE MATERIALS**  
**ACQUISITIONS & LOGISTICS**

In early 1997, under the guidance of Stephanie Martin, the foundation of the new Corporate Materials Logistics team and a multifaceted supplier managed inventory process began. Sparton would do business with a small group of distributors based on the breadth of their line card, history, pricing, performance and growth capabilities. Sparton sought strategic account status with these suppliers to be recognized as one corporation rather than individual buying locations. From this point, Sparton negotiated for component contract pricing on approximately 60-70% of procured components. Sparton could then stabilize pricing, reduce the transaction costs and quoting time, and obtain improved pricing. The next undertaking was the reduction of material overhead. Stephanie and her team determined that a substantial decrease in material overhead costs would be achieved by processing component transactions with Sparton's strategic suppliers electronically. A supplier managed inventory program known as FlexLink was created.

The Corporate Materials Logistics team operates under the guidelines of "electronic everything." To make the concept a reality, Sparton needed to standardize the data contained in Sparton's Enterprise Resource Planning system. In the fall of 1999, Sparton began trading its first piece of electronic demand data with the supply base. Gradually, more parts were added to the program. Today, approximately 40% of all components that Sparton purchases are traded electronically and the number continues to grow daily. As the system matures and more data is traded electronically, Sparton is able to reduce inventory and material overhead rates and gain greater flexibility for its customers.

FlexLink's creation and implementation was possible because of many people throughout Sparton. Information Technology: Constance McMahon, David Korp; Component Engineering: Robert Neuhausen; Commodities Management: Jennifer Radder, Cheryl Edmonds, Kathy Beliveau, David Walters; Plant Materials Management: Cynthia Goeckel, Patricia Webb, Gerald Vanneste, Rudy Jiron; Quality Management: Verne Wright; Advanced Manufacturing: Richard Merrill. Additionally, Planners/Buyers, at each facility, along with management were very supportive through beta testing and continuing development of the tool.

Under the current FlexLink model, Sparton can trade up to about 60% of its component needs. To manage the remaining 40%, Sparton will be implementing FlexLink II. FlexLink II is a simulated electronic data interchange (EDI) program that will operate across the internet and allow small or nonelectronic suppliers to trade information with Sparton electronically. Sparton is also developing methods of electronic invoicing and payments.

Another successful project Sparton has implemented is the Material Win Transition program. This process takes a customer's bill of material, approved manufacturer list and product demands and drives the output through Sparton's Materials Resource Planning (MRP) system. The Win Transition team utilizes the MRP output to set the supply line in place before the planned production run. Sparton buyers set the components up to trade electronically through FlexLink from the start of the project. The implementation of this new process has provided numerous benefits which allow Sparton to be more responsive to its customers. Approximately 55% of all new components are traded electronically from start-up.

*Stephanie Martin is Vice President, Corporate Materials Acquisition and Logistics. Stephanie is responsible for developing a centralized team for strategic supplier management and reducing the total acquisition cost of material procurement and execution. The materials team forms strategic alliances with suppliers, drives commodity management and global procurement as well as corporate quoting, value-add program identification/facilitation, EDI exchanges and component engineering. Stephanie has been in the acquisitions and logistics field for 18 years and employed with Sparton since 1996.*

*Stephanie holds a Masters of Business Administration from Spring Hill College and a Bachelors of Arts from Glenville State College. She has achieved CPIM and CIRM certifications from APICS and CPM and APP certifications from NAPM. She has had articles published in various trade publications. Stephanie also authored the CPMPrep software training program for a software company.*



## ALAN J. HOUGHTALING

### CUSTOMER RELATIONSHIP MANAGEMENT

Sparton began participating in the Electronic Manufacturing Services (EMS) industry in 1986 looking to develop a more diverse customer base. Alan Houghtaling's responsibility has been to facilitate and organize Sparton around a high mix of potential customers and regulated markets. As the Vice President and Director of Business Development, Alan and Sparton Business Development Managers look for ways to bring in selected new customers and successfully manage existing client relationships.

Under Alan's guidance, Sparton has developed and continues to refine and manage the critical customer relationship process. Sparton's internal organization develops a team with counterparts within its customers' organization. Customer relationship management centers on making the daily communications operate more efficiently. With a strong communication channel among team members, Sparton's customers can concentrate on other critical aspects of the business such as R&D and Marketing. Sparton's numerous customer services allow them to focus on other tasks necessary to stay competitive.

With the implementation of a new sales contact software program, the Business Development Manager and support staff have the tools to keep track and write reports on each contact/customer on a day-to-day, month-to-month and year-to-year basis. Sparton is in the process of executing and refining this software tool along with training all sales personnel to utilize this program. Alan's department expects to utilize this software tool as a real-time customer relationship manager, maintaining all contact data related to the total management of any given customer or contact.

Sparton is also making great advances in data access. Business Development Managers along with Customer Business Managers are equipped with the latest technologies and communication devices. This provides customers with instant access to Sparton team members. With the aid of the Information Technology department, Sparton plans to expand its technological infrastructure: Virtual Private Network (VPN) for a safe and immediate connection to Sparton's data; on-line presentation and proposal composition tools; on-line pricing and parts availability.

Sparton's commitment to Customer Relationship Management was acknowledged when Sparton recently won the **2001 Service Excellence Award** for highest overall customer rating for medium-sized EMS companies. This year marks the third time in four attempts Sparton has won this award. The criteria is based upon a third party conducting an independent audit of Sparton customers. The results were well received among Sparton's associates and the scores are scrutinized to see where the process can be improved.



**ALAN J. HOUGHTALING**  
VICE PRESIDENT, DIRECTOR BUSINESS  
DEVELOPMENT

*Alan Houghtaling attended Western Michigan University and thereafter began his career with Sparton in 1977. He has worked in various positions in the materials organization, mostly as senior buyer for electronic components. His scope of experience was broadened by working at a component distribution company as a product/sales manager before rejoining Sparton.*

*Alan's specific responsibility at Sparton is to build a foundation for Sparton's embryonic EMS business. Currently, Alan manages corporate business development and oversees the efforts of six locations within Sparton, along with the Sparton Alliance Network - a collaboration of EMS companies committed to improving customer service through local resources.*

*In addition, Alan is an active participant in the Surface Mount Technology Association (SMTA), and the IPC / TMRC.*



## CONSTANCE E. MCMAHON

### ENTERPRISE RESOURCE PLANNING SYSTEMS MANAGEMENT



**CONSTANCE E. MCMAHON**  
**CORPORATE APPLICATIONS MANAGER**

Constance McMahon was the project leader for creating a system backup and "fail over" process for Sparton's Enterprise Resource Planning (ERP) System. Before this method was in effect, if a network or application went down, a paper process was initiated to keep Sparton operational. The goal was to eliminate a paper solution and introduce an electronic fail over process, eliminating both lost productivity and errors. The biggest challenge the team faced was the communication systems within each facility. Sparton immediately upgraded the communications and other systems to support the electronic fail over process.

In order to achieve a successful system fail over transition, the Information Technology (IT) department had to migrate Sparton's current software and data to a new computer. The staff transferred its current data to the new hardware along with the latest version of its data management software and operating system. The scope of this project utilized all resources within the IT department and required extensive coordination between the IT staff and the Sparton user community. Constance and her team identified the points of failure and prepared for each scenario. The planning and testing process was so successful that zero down time to the computer network was incurred during this project. The focus of the Information Technology staff is teamwork. Each member has ownership into the migration of Sparton's Enterprise Resource Planning System.

The migration team consisted of the Data Base Administrator, Earl Young; Unix Administrator, Jay Rivera; Application Programmer, David Korp; Telecommunications, Donald Gustafson; and other members of Sparton's IT staff: Dennis Beach, Robert Hines and Michael Duryea.

*Constance McMahon began at Sparton in 1985, and has held many positions within the organization. These include experience in the Configuration, Engineering and Information Technology departments. Constance was a critical player in the first ISO9000 certification. Constance is responsible for the EDI project and the ERP administration and development. Constance is the Corporate Applications Manager and is responsible for all applications and application integration.*

*Constance began her education at Ohio State University. She completed her Associates of Computer Science at Pasco Hernando Community College. Constance is pursuing her Bachelors and Masters degrees concurrently.*

*Constance is a certified MTMS administrator as well as a Microsoft Certified Professional (MCP).*

The growing strength of Sparton's IT department is the result of a consolidation of processes and resources. This centralization immediately reduced the department's operating costs, allowing it to be more proficient at resolving issues.

Currently, the IT department is focused on reducing costs through electronic solutions. A recent example is the implementation of electronic time and attendance, allowing for more accurate and inexpensive tracking of labor hours. As the process matures, Sparton will seek to identify the employee's current work cell assignment along with the customer assembly they are working on at any given moment. Sparton will be deploying a Virtual Private Network (VPN) to allow better access for customers and the internal user community. This solution offers an easy and efficient connection to Sparton's data at a minimal cost.

The Information Technology department's "Solution Center" will continue to focus on internal customer service. The high level of service will enable Sparton associates to become more efficient in their respective work responsibilities. The "Solution Center" will become the focal point of all IT projects, allowing for proper testing, documentation and deployment. Considerations are also being given to an electronic shop floor.



## MICHAEL L. CHILDRESS

### OPERATIONS TRAINING MANAGEMENT

Michael Childress joined Sparton in 1999. Michael's priorities were to create a formalized and structured training process. Historically, Sparton associates were trained by individual departments and the manufacturing personnel received a great deal of 'On-The-Job' training. Michael has made great advances in documenting the knowledge base of the manufacturing department personnel and supervisory staff and distributing this information throughout each facility.

Sparton's goal is to provide a constructive learning environment that constantly challenges our employees. Training and the opportunity for continuing education are highly valued at Sparton. Employees benefit from in-house training activities and tuition reimbursement programs.

Sparton has begun implementing the technology available for production floor training. Currently, the Jackson, Michigan facility has access to on-line training for the complete Surface Mount Technology (SMT) process. This course provides both audio and video for actual demonstrations of equipment usage. Manufacturing personnel are able to utilize these training courses whenever a question arises. Future goals include a stationary kiosk at various work stations, minimizing down time when accessing the necessary information.

Supervisor training has been standardized in four of the six locations. Sparton has also set aside equipment and space for training centers. Each of Sparton six facilities has a permanent area for training and knowledge storage.

Michael has made significant strides in obtaining training that is funded by governmental sources. As a significant taxpayer, Sparton's approach to training is to align its training needs with government funding for that specific discipline. Sparton has benefitted from funding programs from local, state, and federal agencies created to assist corporations in training their incumbent work force. This funding has been designated to assist corporations with limited funds for training.

In Jackson, Michigan, Sparton has been granted \$500,000 in training funds. The Brooksville, Florida, facility has acquired \$15,000 in grant money for its location. The DeLeon Springs, Florida, facility is one of six companies sharing a \$1.8 million grant.

Sparton personnel have also been encouraged to utilize local colleges as much as possible. Partnerships with local community colleges have been formed at each of Sparton's six locations. Associates of Sparton have training available to them for the latest software programs and technologies. These local colleges tend to attract top professionals who are not only educators but practitioners of their trade.

Future possibilities for standardized training throughout the Sparton facilities include offering the training programs and initiatives to members of the Sparton Alliance Network and providing machine-specific training accessible through a corporate intranet.



**MICHAEL L. CHILDRESS**  
**CORPORATE MANAGER, TRAINING &  
ORGANIZATIONAL DEVELOPMENT**

*Michael graduated with a Bachelor of Science from the University of Dubuque with a triple major in Industrial Psychology, Business Administration and Sociology.*

*Michael spent 12 years at an Original Equipment Manufacturer (OEM) as a Production Supervisor, Production Manager and Training Coordinator.*

*Michael was a Training Manager and a Training Project Manager with two world-renowned OEMs as well as being a Technical Instructor.*

*Michael designed and taught electronic vocational training to immigrant refugees on a volunteer basis in Chicago, Illinois and placed 450 workers with electronic companies in the Chicago area.*



## CYNTHIA GOECKEL

### STRATEGIC INVENTORY MANAGEMENT



**CYNTHIA GOECKEL**  
**MATERIALS MANAGER**

Prior to 1995, inventory management at Sparton Electronics in Jackson, Michigan, was verified by performing an annual physical inventory. Typically, Sparton's manufacturing operations would shut down for two days and most support functions would be involved with the physical inventory process. Operations personnel would assist the Materials Department in a wall-to-wall physical count of all finished goods, work-in-process (WIP), and raw materials. Clerical staff would process and input data and the Accounting Department performed various administrative functions.

Since the Jackson, Michigan, facility began cycle counting on a daily basis, levels of accuracy have improved substantially. Both industry literature and expert sources agree that cycle counting is the preferred method of inventory management. Accurate records in conjunction with a good cycle counting program saves time, money and preserves the accuracy of the data.

Since the change from physical inventory counts to cycle counts, the Jackson location has maintained an average level of 99.5% accuracy for several years using a standard cycle counting program. Sparton's level of accuracy under the guidelines of American Production and Inventory Control Society (APICS) is considered to be excellent.

The accuracy level is made possible through extensive training and discipline. Donald Whitaker, Stockroom Traffic Supervisor, concentrates daily on this concept with his personnel. The importance of inventory accuracy is stressed during employee orientation. Sparton requires that all material handlers understand the importance of inventory accuracy.

At the beginning of each day, all stockroom personnel cycle count the parts in their area. A cycle count coordinator then resolves any issues that arise due to this count. Due to the growth of the materials department, Sparton has been challenged with the training of individuals for materials handling, demanding a commitment to accuracy. Donald Whitaker has been outstanding in cultivating a strong core group of Sparton associates.

The Sparton Materials Department continues to work with production personnel and strongly emphasizes good material handling techniques for point-of-use stock. For Sparton's First-In, First-Out (FIFO) inventory method to work, lot integrity must be continually stressed and practiced. Jackson's inventory method has become the model for all of Sparton Corporation, and is in the process of being implemented at all Sparton facilities.

Sparton's material management consists of personnel throughout its facilities. These include Gerald Vanneste, Sparton of Canada; Howard Bessonette, DeLeon Springs, Florida; Rudy Jiron, Rio Rancho, New Mexico; and the Corporate Materials Logistics Manager, Bruce Perry. They communicate weekly and meet on a quarterly basis to continue to bolster our materials management. Cycle count accuracy is one of the areas Sparton continues to focus on at every site.

*Cynthia Goeckel, C.P.M., CPIM, has worked at Sparton Electronics for the last ten years in the Materials Department and has been the Materials Manager for the department for the last eight years. Prior to working at Sparton, she was employed in inventory management and transportation.*

*Cynthia earned her Bachelors of Arts from the Supply Chain Management program at Michigan State University and graduated Summa Cum Laude, majoring in Purchasing and Operations. She is certified in Transportation Management, is a Certified Purchasing Manager (CPM) by the National Association of Purchasing Managers (NAPM) and a Certified Production and Inventory Management (CPIM) by the American Production and Inventory Control Society (APICS). Cynthia is also a member of both NAPM and APICS.*



## ROYAL DEVRIES

### OPERATIONS MANAGEMENT FOR PROGRAM STARTUP

Sparton's experience with quality systems was the key to a major aerospace manufacturer's interest in Sparton. This particular aerospace customer quickly recognized how easily Sparton's military product culture would translate to their own commercial and military aircraft products.

Sparton's quality systems are mature, comprehensive and fully certified to Quality Standard ISO 9001. These systems are tailored to provide assurance to our customers that all of the important processes affecting quality from the initial review of contracts received, to the packaging and delivery of the finished product are strictly monitored.

Sparton's team management approach focuses primarily upon reliable internal and external communications. Customer requirements are translated into clear goals and objectives and are communicated to the project team. Project status feedback to the customer provides performance visibility. Secondly, Sparton proactively seeks process improvement opportunities to improve product manufacturability, while practicing "real-time" corrective actions followed by documentation of all changes.

The project support team consists of key customer service, materials, quality, test, manufacturing team lead / coordinator and supervision personnel.

The team leader is responsible for communicating customer requirements to manufacturing and coordinating the manufacturing activities of eight (8) strategic work cells. The team leader establishes daily goals for each work cell. The work cell leader oversees and reports daily work performed within their work cell to the team leader who in turn then reports product shipment status to the customer. This cycle is repeated on a daily basis. Each work cell team contains a group of skilled employees. The cell has ownership of all aspects of the products they produce. Cell performance measurements are the acceptability of products produced in parts per million (PPM), quantity of units completed by category against plan and rework (defects and defectives tracked by part number) against plan.

Sparton's experience includes the design and manufacture of high reliability products for the United States Navy. These programs require Sparton to adhere strictly to military specification requirements to properly fabricate and test products. Customer confidence depends heavily upon certified procedures and manufacturing support control systems to produce acceptable highly reliable products. On-site customer surveillance validates both process and product fabrication conformance. Customer requirements mandate a precisely detailed paper trail, validating complete process and product conformance for each individually serialized product manufactured. Employees are trained and certified to the high reliability solder and workmanship requirements of military standards.

In the future, Sparton will attract new business by demonstrating what we have learned from a major aerospace customer project: improved internal and external communications, manufacturing efficiency, excellent product quality and highly predictable on-time product delivery.



**ROYAL DEVRIES**  
DIRECTOR OF OPERATIONS

*Royal DeVries began his career at Sparton, in Jackson, Michigan, 31 years ago. He has two years of education from Jackson Community College and is the Director of Operations.*

*During his association with Sparton, Royal has worked on many R&D programs in different capacities.*

*As a Quality Assurance Engineer, Royal was Sparton's first certified high-reliability soldering instructor working on a defense program. Together with manufacturing engineering, Sparton developed many special and custom fabrication processes employing military specifications.*



## RHONDA E. ALDRICH

### ELECTRONIC COMMERCE MANAGEMENT



**RHONDA E. ALDRICH**  
DIRECTOR, CORPORATE COMMUNICATIONS,  
MARKETING INFORMATION & E-COMMERCE

*Rhonda Aldrich began her career at Sparton in 1998. She is responsible for all public and customer access websites, electronic business, creation of advertising and marketing materials such as the Annual and Quarterly Reports, advertisements, brochures, multimedia presentations and other graphical elements. Rhonda is also the creator and administrator of "The Circuit" - the customer access website to Sparton's ERP system.*

*Before joining Sparton, Rhonda was a Marketing Manager for a Construction Management Firm. Rhonda's first employer was a power supply and electronics contract manufacturer in which she was a Marketing Communications Coordinator. During this tenure, Rhonda created her first website in 1996.*

*Rhonda earned a Bachelors of Arts - with Honor in Advertising from Michigan State University and a Masters of Business Administration from Eastern Michigan University.*

Since 1998, Sparton has been experimenting with various technologies related to the Internet and electronic commerce. An initial investment in electronic commerce produced a website consisting of static documents containing some customer data. The concept did address Sparton's goal to provide an electronic solution for business processes. However, due to the dynamic nature of technology and software, the project was not suited to bring about accurate, real-time information in a consistent manner.

After careful research, Sparton realized it could reduce costs and improve customer service by providing instant access to its ERP system. Sparton's philosophy is to provide accurate and instant access to the data critical to the customer and supplier's success. Customers and suppliers no longer need to rely solely on communications with their customer service team. An electronic solution allows the customer access to the information they need when they need it. The Customer Business Manager can then focus their efforts on value-added services rather than tracking information.

The current system was developed, tested and is now being deployed to select customers. The application known as "The Circuit" is an on-line tool used to access customer-specific information. The customer is able to retrieve various data: purchase orders, sales orders, shipping information, sales order backlog, invoices, assembly information, bill of material specifications, cross reference searches. Within moments after a transaction is placed in the Sparton ERP system, the data is available to the customer. Throughout the development, Sparton has taken various steps to ensure that each customer's proprietary data is secure as it is transmitted across the Internet.

The next phase of "The Circuit" will offer an electronic submission of a sales order. A customer will be able to add a line to an existing sales order or possibly begin a new sales order.

Sparton is also in the process of developing an on-line supplier fulfillment application. This program, FlexLink II, is a method where a supplier can view Sparton's current MRP requirements, select the items they wish to fulfill and accept an electronic purchase order from Sparton. The information the supplier inputs will be instantly updated to the database. Another service which will be provided to suppliers is access to materials data. Certain components have a default supplier; the default supplier will be able to view a Qualified Manufacturers List for those components.

During the various stages of the project, numerous people throughout Sparton have been catalysts for deployment: Constance McMahon, Michael Duhlstine, John Evans, Ronald Wolf, Aquanita Johnson, David Korp and Douglas Johnson. Their commitment and insight produced a product which has been well received by customers.

Future possibilities for electronic commerce are endless. As the process matures, Sparton customers may have access to their manufacturing and quality data as the assemblies are being produced. Non-manufacturing vendors will soon be able to view accounts receivable or accounts payable transaction on-line as well.



## **FINANCIAL PERFORMANCE**

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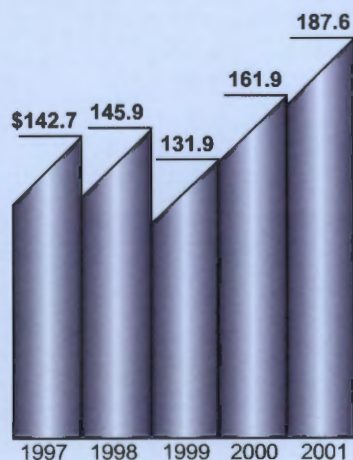
## CONSOLIDATED BALANCE SHEETS

### SPARTON CORPORATION & SUBSIDIARIES FOR YEARS ENDED JUNE 30

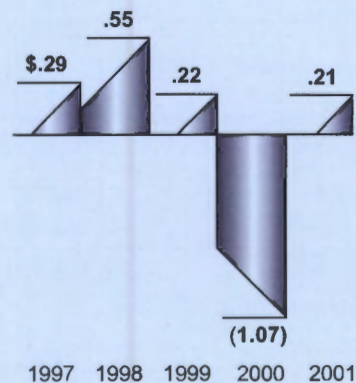
	2001	2000
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 13,034,790	\$ 5,052,405
Investment securities (Notes 1 and 3)	1,175,000	4,643,704
Income taxes recoverable	-	483,598
Accounts receivable:		
Trade, less allowance of \$615,000 (\$365,000 in 2000)	21,477,330	14,937,185
U.S. and foreign governments	2,227,524	5,740,096
Inventories (Notes 1 and 4)	44,912,886	51,189,623
Prepaid expenses (Note 8)	3,685,831	4,295,496
Total current assets	86,513,361	86,342,107
Deferred income taxes (Note 8)	-	304,800
Other assets (Notes 3 and 7)	11,170,575	10,922,299
Property, plant and equipment, at cost (Note 1):		
Land and land improvements	1,590,797	1,515,856
Buildings and building equipment	11,965,497	11,822,327
Machinery and equipment	19,098,641	18,719,312
	32,654,935	32,057,495
Less accumulated depreciation	(22,544,366)	(20,650,465)
Net property, plant and equipment	10,110,569	11,407,030
	<u>\$107,794,505</u>	<u>\$108,976,236</u>

### FINANCIAL TRENDS AT A GLANCE

NET SALES (IN MILLIONS OF DOLLARS)



INCOME (LOSS) PER COMMON SHARE-CONTINUING OPERATIONS





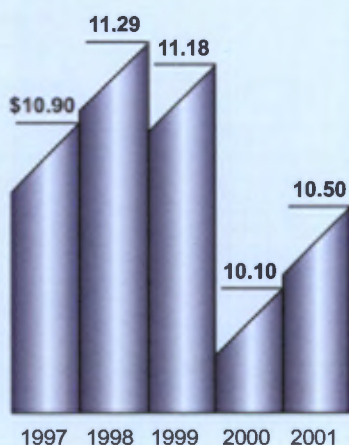
# SPARTON CORPORATION & SUBSIDIARIES FOR YEARS ENDED JUNE 30

	2001	2000
<b>LIABILITIES AND SHAREOWNERS' EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 13,329,356	\$ 14,251,023
Salaries and wages	2,902,324	3,145,222
Accrued liabilities	4,187,044	4,167,288
Income taxes payable	117,457	-
Total current liabilities	20,536,181	21,563,533
Deferred Income taxes (Note 8)	127,200	-
Environmental remediation (Note 9)	7,608,673	8,335,553
Commitments and contingencies (Note 9)	-	-
Shareowners' equity (Notes 1 and 6):		
Preferred stock, no par value; 200,000 shares authorized, none outstanding	-	-
Common stock, \$1.25 par value; 8,500,000 shares authorized, 7,570,090 shares outstanding (7,828,090 at June 30, 2000) after deducting 364,622 shares (106,622 at June 30, 2000) in treasury (Note 1)	9,462,613	9,785,113
Retained earnings	478,144	494,427
Accumulated other comprehensive loss	-	(108,014)
Capital in excess of par value	69,581,694	68,905,624
Total shareowners' equity	79,522,451	79,077,150
	<b>\$107,794,505</b>	<b>\$108,976,236</b>

SEE ACCOMPANYING NOTES

## FINANCIAL TRENDS AT A GLANCE (CONTINUED)

EQUITY PER COMMON SHARE



WORKING CAPITAL (IN MILLIONS OF DOLLARS)





# CONSOLIDATED STATEMENTS OF OPERATIONS

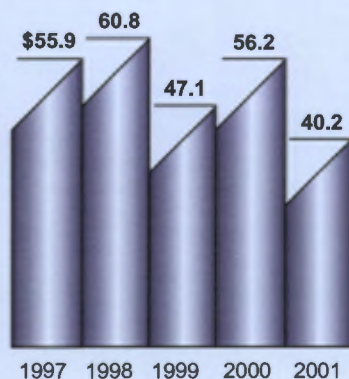
## SPARTON CORPORATION & SUBSIDIARIES FOR YEARS ENDED JUNE 30

	2001	2000	1999
Net sales	\$187,620,426	\$161,914,446	\$131,900,489
Costs and expenses:			
Costs of goods sold	169,153,517	150,368,886	112,092,367
Selling and administrative	16,333,066	25,197,716	17,758,382
	185,486,583	175,566,602	129,850,749
	2,133,843	(13,652,156)	2,049,740
Other income (expense):			
Interest and investment income (Note 3)	355,626	666,253	1,503,982
Other - net	159,568	713,169	23,359
	515,194	1,379,422	1,527,341
Income (loss) from continuing operations before income taxes	2,649,037	(12,272,734)	3,577,081
Provision (credit) for income taxes (Note 8)	1,030,000	(3,865,000)	1,818,000
Income (loss) from continuing operations	1,619,037	(8,407,734)	1,759,081
Discontinued operations:			
Loss on disposal of discontinued automotive operations, net of applicable income tax credits of \$1,480,000	-	-	(2,520,000)
Net income (loss)	\$ 1,619,037	\$ (8,407,734)	\$ (760,919)
Basic and diluted earnings per share:			
Continuing operations	\$0.21	\$(1.07)	\$ 0.22
Discontinued operations	-	-	(0.32)
Net income (loss)	\$0.21	\$(1.07)	\$(0.10)

SEE ACCOMPANYING NOTES

## FINANCIAL TRENDS AT A GLANCE (CONTINUED)

GOVERNMENT SALES (IN MILLIONS OF DOLLARS)



COMMERCIAL SALES (IN MILLIONS OF DOLLARS)





# CONSOLIDATED STATEMENTS OF CASH FLOWS

## SPARTON CORPORATION & SUBSIDIARIES FOR YEARS ENDED JUNE 30

	2001	2000	1999
<b>OPERATING ACTIVITIES:</b>			
Income (loss) from continuing operations	\$ 1,619,037	\$(8,407,734)	\$1,759,081
Add (deduct) noncash items affecting continuing operations:			
Depreciation	1,913,763	2,371,871	2,101,262
Pension	(685,681)	(623,593)	(665,564)
Deferred income taxes	195,000	(3,430,000)	513,000
Environmental charge	-	10,000,000	-
Other	114,088	(60,735)	(34,259)
Add (deduct) changes in operating assets and liabilities:			
Accounts receivable	(3,027,573)	(4,451,038)	7,275,926
Inventories and prepaid expenses	7,123,402	(11,179,926)	(8,140,631)
Income taxes recoverable	-	138,485	(622,083)
Accounts payable, salaries and wages, accrued liabilities and income taxes	(1,270,634)	2,887,232	(2,386,883)
Net cash provided (used) by continuing operations	5,981,402	(12,755,438)	(200,151)
Cash flow provided by discontinued operations	-	-	2,077,788
<b>NET CASH PROVIDED (USED) BY OPERATING ACTIVITIES</b>	<b>5,981,402</b>	<b>(12,755,438)</b>	<b>1,877,637</b>
<b>INVESTING ACTIVITIES:</b>			
Proceeds from investment securities - net	3,468,704	15,479,198	3,530,227
Purchases of property, plant and equipment	(623,376)	(2,398,139)	(2,908,852)
Other, principally noncurrent other assets	437,405	416,443	(3,470,645)
Proceeds from sale of property, plant and equipment	-	144,583	-
Proceeds from sale of assets of discontinued operations	-	-	1,216,890
Discontinued operations, principally purchases of property, plant and equipment	-	-	(39,772)
<b>NET CASH PROVIDED (USED) BY INVESTING ACTIVITIES</b>	<b>3,282,733</b>	<b>13,642,085</b>	<b>(1,672,152)</b>
<b>FINANCING ACTIVITIES:</b>			
Purchase of common stock for treasury	(1,281,750)	-	-
Principal payments on long-term borrowings, discontinued operations	-	-	(123,000)
<b>NET CASH USED BY FINANCING ACTIVITIES</b>	<b>(1,281,750)</b>	<b>-</b>	<b>(123,000)</b>
<b>INCREASE IN CASH</b>	<b>7,982,385</b>	<b>886,647</b>	<b>82,485</b>
Cash at beginning of year	5,052,405	4,165,758	4,083,273
<b>CASH AT END OF YEAR</b>	<b>\$13,034,790</b>	<b>\$ 5,052,405</b>	<b>\$4,165,758</b>
 Supplemental disclosures of cash paid (refunded) during the year:			
Income taxes - net	\$ 198,000	\$ (564,000)	\$ 350,000

SEE ACCOMPANYING NOTES



# CONSOLIDATED STATEMENTS OF SHAREOWNERS' EQUITY

## SPARTON CORPORATION & SUBSIDIARIES FOR YEARS ENDED JUNE 30

	Common stock, \$1.25 par value		Capital in excess of par value	Accumulated other comprehensive income (loss)	Retained earnings	Total
	Shares	Amount				
Balance June 30, 1998	7,828,090	\$9,785,113	\$494,427	\$15,000	\$78,074,277	\$88,368,817
Net loss					(760,919)	(760,919)
Other comprehensive income:						
Net unrealized losses in marketable securities (Note 3)				(86,000)		(86,000)
Comprehensive net loss						(846,919)
Balance June 30, 1999	7,828,090	9,785,113	494,427	(71,000)	77,313,358	87,521,898
Net loss					(8,407,734)	(8,407,734)
Other comprehensive income:						
Net unrealized losses in marketable securities (Note 3)				(37,014)		(37,014)
Comprehensive net loss						(8,444,748)
Balance June 30, 2000	7,828,090	9,785,113	494,427	(108,014)	68,905,624	79,077,150
Net income					1,619,037	1,619,037
Other comprehensive income:						
Net unrealized losses in marketable securities (Note 3)				(1,986)		(1,986)
Plus: net reclassification adjustment for losses realized and reported in net income				110,000		110,000
Comprehensive net income						1,727,051
Purchase of common stock for treasury	(258,000)	(322,500)	(16,283)	-	(942,967)	(1,281,750)
<b>Balance June 30, 2001</b>	<b>7,570,090</b>	<b>\$9,462,613</b>	<b>\$478,144</b>	<b>-</b>	<b>\$69,581,694</b>	<b>\$79,522,451</b>

SEE ACCOMPANYING NOTES

### REPORT OF INDEPENDENT AUDITORS

#### The Board of Directors and Shareowners Sparton Corporation

We have audited the accompanying consolidated balance sheets of Sparton Corporation and subsidiaries as of June 30, 2001 and 2000, and the related consolidated statements of operations, shareowners' equity, and cash flows for each of the three years in the period ended June 30, 2001. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the 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 financial statements referred to above present fairly, in all material respects, the consolidated financial position of Sparton Corporation and subsidiaries at June 30, 2001 and 2000, and the consolidated results of their operations and their cash flows for each of the three years in the period ended June 30, 2001, in conformity with accounting principles generally accepted in the United States.

Toledo, Ohio  
August 17, 2001

*Ernst & Young LLP*



## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### 1. STATEMENT OF SIGNIFICANT ACCOUNTING POLICIES

**Basis of presentation** - The consolidated financial statements include the accounts of Sparton Corporation and all active subsidiaries. All significant intercompany transactions and accounts have been eliminated.

**Operations** - The Company's operations are in one line of business, electronic manufacturing services (EMS). Products and services include complete "Box Build" products for Original Equipment Manufacturers, microprocessor-based systems, transducers, printed circuit boards and assemblies, sensors and electromechanical devices for the telecommunications, medical, electronics, avionics, and other industries. The Company also develops and manufactures sonobuoys, anti-submarine warfare (ASW) devices, used by the U.S. Navy and other free-world countries.

**Use of estimates** - The preparation of the financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the disclosure of assets and liabilities and the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

**Revenue recognition** - The Company's net sales are comprised of product sales and revenue earned from engineering and design services. Revenue from product sales is recognized upon shipment of the goods and transfer of title; service revenue is recognized as the service is performed or under the percentage of completion method, depending on the nature of the arrangement. Long-term contracts relate to government defense contracts. Contracts are accounted for based on completed units shipped and their estimated average cost per unit. Development contracts are accounted for based on percentage of completion. Costs and fees billed under cost-reimbursement-type contracts are recorded as sales. A provision for the entire amount of a loss on a contract is charged to operations as soon as the loss is determinable.

**Credit practices** - The Company sells products principally in the commercial and governmental electronics manufacturing markets. Credit terms are granted and periodically revised based on evaluations of the customers' financial condition, with collateral generally not required. Receivables from foreign customers are generally secured by letters of credit or cash advances.

**Cash and cash equivalents** - Cash and cash equivalents consist of demand deposits and other highly liquid investments.

**Investment securities** - Investments in debt securities that are not cash equivalents and marketable equity securities have been designated as available for sale. Those securities are reported at fair value, with net unrealized gains and losses included in equity, net of applicable taxes. Unrealized losses that are other than temporary are recognized in earnings.

Realized gains and losses on investments are determined using the specific identification method.

In June 1999, the Company acquired a 12% interest, on a fully diluted basis, in Cybernet Systems Corporation, a privately held company headquartered in Ann Arbor, Michigan. This investment is carried at cost and is included on the balance sheet in other assets.

**New Accounting Standard** - In June 1998, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 133, "Accounting for Derivative Instruments and Hedging Activities" (SFAS No. 133). This accounting standard, which is effective for all fiscal quarters of fiscal years beginning after June 15, 2000, requires that all derivatives be recognized as either assets or liabilities at estimated fair value. The adoption of SFAS No. 133 did not have any effect on the Company's financial position or results of operations.

**Market risk exposure** - The Company manufactures its products in the United States and Canada. Sales of the Company's products are made in the U.S. and Canada, as well as other foreign markets. The Company is potentially subject to foreign currency exchange rate risk relating to receipts from customers and payments to suppliers in foreign currencies. As a result, the Company's financial results could be affected by factors such as changes in foreign currency exchange rates or weak economic conditions in the foreign markets in which the Company operates. However, minimal receivables and payables are denominated in foreign currency. The Company does not consider the market risk exposure relating to currency exchange to be material.

The Company has financial instruments that are subject to interest rate risk, principally short-term investments. Historically, the Company has not experienced material gains or losses due to such interest rate changes. Based on the current holdings of short-term investments, the interest rate risk is not considered to be material.

**Inventories** - Inventories are valued at the lower of cost (first-in, first-out basis) or market and include costs related to long-term contracts as disclosed in Note 4. Inventories, other than contract costs, are principally raw materials and supplies.

The following are the major classifications of inventory:

	2001	2000
Raw materials	\$30,122,000	\$42,419,000
Work in process and finished goods	14,791,000	8,771,000
	<u>\$44,913,000</u>	<u>\$51,190,000</u>



**Stock options** - The Company has elected to follow Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" (APB 25), and related Interpretations in accounting for its employee stock options. Under APB 25, no compensation expense is recognized as the exercise price of the Company's employee stock options equals the market price of the underlying stock on the date of grant. The Company follows the disclosure requirements of Statement of Financial Accounting Standards (SFAS) No. 123, "Accounting for Stock-Based Compensation."

**Depreciation** - Depreciation is provided over estimated useful lives on accelerated methods, except for certain buildings, machinery and equipment with aggregate costs at June 30, 2001, of approximately \$9,650,000 which are being depreciated on the straight-line method. Estimated useful lives generally range from 5 to 50 years for buildings and improvements, 3 to 16 years for machinery and equipment and 3 to 5 years for test equipment.

**Research and development expenditures** - Expenditures for research and development not funded by customers amounted to approximately \$785,000 in fiscal 2001, \$4,707,000 in fiscal 2000 and \$2,079,000 in fiscal 1999.

**Treasury stock** - The Company records treasury stock purchases at cost. The excess of cost over par value is allocated to capital in excess of par value based on the per share amount of capital in excess of par value for all shares, with the difference charged to retained earnings.

In January and May 2001, the Company repurchased 180,000 shares and 78,000 shares of common stock at \$4.25 and \$6.63 per share, respectively, for its treasury at a cost of \$1,282,000.

**Earnings per share** - Basic earnings per share were computed using the weighted-average number of shares outstanding of 7,737,843 in fiscal 2001 and 7,828,090 in both the fiscal years ended 2000 and 1999. Differences in the weighted-average number of shares outstanding for purposes of computing diluted earnings per share were due to the inclusion of the dilutive effect of employee incentive stock options previously granted of 11,438 in fiscal 2001. There were no differences in the weighted-average number of shares outstanding for the calculation of basic and diluted earnings per share for the fiscal years ended 2000 and 1999. Options to purchase 130,500 shares in fiscal 2001, 148,500 shares in fiscal 2000 and 171,000 shares in fiscal 1999, of common stock were outstanding at their respective year ends. However, these options were not included in the computation of diluted earnings per share because the options exercise price was greater than the average market price of the common shares and, therefore, the effect would be antidilutive.

## 2. COMPREHENSIVE INCOME

Comprehensive income includes net income, as well as unrealized gains and losses, which are excluded from net income. They are, however, reflected as a direct charge or credit to shareholders' equity.

Total comprehensive income (loss) for the years ended June 30 are as follows:

	2001	2000	1999
Net income (loss)	\$1,619,000	\$(8,408,000)	\$(761,000)
Other Comprehensive Income:			
Unrealized losses on investment securities	(2,000)	(37,000)	(86,000)
Plus: net reclassification adjustment for losses realized and reported in net income	110,000	-	-
Comprehensive income (loss)	\$1,727,000	\$(8,445,000)	\$(847,000)

## 3. INVESTMENT SECURITIES

Details of the investment securities portfolio as of June 30, 2001 and 2000, are as follows:

June 30, 2001:	Amortized Cost	Gross Unrealized Losses	Estimated Fair Value
Debt securities:			
State and municipal	\$1,175,000	-	\$1,175,000
June 30, 2000:			
Debt securities:			
Corporate - primarily U.S.	\$2,046,000	\$ (29,000)	\$2,017,000
U.S. government and federal agency	119,000	(5,000)	114,000
State and municipal	1,250,000	-	1,250,000
Equity securities - primarily preferred stock	1,400,000	(137,000)	1,263,000
	\$4,815,000	\$(171,000)	\$4,644,000

The investment portfolio has an original maturity date of greater than 10 years and a daily market exists for all of the investment securities. The Company believes that the impact of fluctuations in interest rates on its investment portfolio should not have a material impact on financial position or results of operations. It is the Company's intention to use these investment securities to provide working capital, fund the expansion of its business and for other business purposes.

The Company had no net purchases of investment securities in either fiscal 2001 or fiscal 2000. Net sales of investment securities totaled \$3,469,000 and \$15,479,000 in the fiscal years ended 2001 and 2000, respectively.

In June 1999, the Company purchased an investment in Cybernet Systems for \$3,000,000. Cybernet is a privately owned developer of hardware, software, next-generation network computing, and robotics products. The investment is carried at cost and included in other assets on the balance sheet at June 30, 2001 and 2000.



#### 4. LONG-TERM CONTRACTS

Inventories include costs related to long-term contracts of approximately \$21,225,000 and \$18,847,000 at June 30, 2001 and 2000, respectively, reduced by progress billings to the United States government of approximately \$11,234,000 and \$3,309,000, respectively.

#### 5. LEASE INFORMATION

The Company leases certain machinery, data processing equipment, vehicles and other equipment. Such leases, some of which are noncancelable and which in many cases include renewal options, expire at various dates. The Company is responsible for most maintenance, insurance and taxes relating to these leased assets. Rent expense under agreements accounted for as operating leases was \$3,697,000 in fiscal 2001, \$2,094,000 in fiscal 2000 and \$1,920,000 in fiscal 1999. At June 30, 2001, future minimum lease payments for all noncancelable operating leases totaled \$9,457,000 and was payable as follows: 2002-\$3,836,000, 2003-\$3,567,000, 2004-\$1,701,000, 2005-\$342,000, 2006-\$11,000.

#### 6. STOCK OPTIONS

The Company has an incentive stock option plan under which 500,000 common shares were reserved for option grants to key employees at the fair market value of the stock at the date of the grant. This plan, approved by shareowners in October 1999, replaced a similar incentive stock option plan which had expired. Under the plan, the options generally become exercisable cumulatively, beginning one year after the date granted, in equal annual installments, and generally terminate five years after the date of grant. Individual grants may have a stock appreciation rights feature whereby optionees can surrender up to one-half of their unexercised options to the extent then exercisable in exchange for cash or common shares equal to the difference between the then-current market value and the option prices for shares issuable upon surrender of such options.

Information on options is as follows:

	Shares Under Option	Price Range
Outstanding at June 30, 1998	213,500	\$6.625 to 8.375
Granted	-	-
Exercised	-	-
Cancelled	(42,500)	8.375
Outstanding at June 30, 1999	171,000	6.625 to 8.375
Granted	10,000	3.813
Exercised	-	-
Cancelled	(22,500)	8.375
Outstanding at June 30, 2000	158,500	3.813 to 8.375
Granted	139,000	4.125 to 4.250
Exercised	-	-
Cancelled	(20,500)	4.250 to 8.375
Outstanding at June 30, 2001	277,000	3.813 to 8.375

At June 30, 2001, the per share weighted-average exercise price of options outstanding was \$5.97. The weighted-average remaining contractual life of those options is approximately 2.6 years. At June 30, 2001, there were 132,500 options exercisable at the per share weighted-average exercise price of \$7.88. Remaining shares available for grant under the plan were 353,500 at June 30, 2001. Had the compensation cost for the stock options been determined based on the fair value at the grant date consistent with the fair value method of SFAS 123, the Company's net earnings would have been reduced by \$50,000 (\$.01 per share) in fiscal 2001, and \$70,000 (\$.01 per share) in both the fiscal years ended 2000 and 1999.

Under SFAS 123, fair value was estimated at the date of grant using the Black-Scholes option pricing model and the following weighted-average assumptions for the options:

Stock Option Plan	2001	2000	1996
Expected option life	4	4	4
Expected volatility	36.7%	36.3%	32.7%
Risk-free interest rate	5.5	6.5	5.9
Dividend yield	0.0	0.0	0.0
Weighted-average fair value	\$1.53	\$1.41	\$1.53

#### 7. EMPLOYEE BENEFIT PLANS

##### *Pension Benefits*

Prior to March 31, 2000, the Company maintained a contributory defined benefit pension plan covering certain salaried and hourly employees. Pension benefits were based on years of credited service. Additional benefits were available to contributory participants based upon their years of contributory service and compensation.

Effective April 1, 2000, the Company amended its defined benefit retirement plan to determine future benefits using a cash balance formula. On March 31, 2000, credited and contributory credited service under the plan's previous formula was frozen and the benefit amount changed to be based on the final 5 years average compensation instead of the previously used final 10 years. Under the cash balance formula, each participant has an account which is credited yearly with 2% of their salary, as well as the interest earned on their previous year end cash balance. In addition, a transition benefit was added to eliminate the shortfall in projected benefits that some eligible employees could experience. The Company's policy is to fund the plan based upon legal requirements and tax regulations.

The following weighted-average assumptions were used as of June 30:

	2001	2000
Discount rate	7.25%	7.75%
Expected return on plan assets	7.5	7.5
Rate of compensation increase	5.0	5.0

Net periodic pension income of \$686,000, \$624,000 and \$666,000 was recognized in 2001, 2000 and 1999, respectively.



## 10. SELECTED QUARTERLY FINANCIAL DATA (UNAUDITED)

The following unaudited information shows selected items by quarter for the years ended June 30, 2001 and 2000, respectively.

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Net sales:				
2001	\$42,682,312	\$46,556,366	\$46,457,914	\$51,923,834
2000	34,473,957	36,737,575	41,756,764	48,946,150
Gross profit:				
2001	2,121,521	5,704,101	3,372,730	7,268,557
2000	3,096,937	1,974,277	360,488	6,113,858
Income (loss):				
2001	(1,109,047)	750,550	567,070	1,410,464
2000	76,168	(7,525,638)	(2,094,715)	1,136,451
Basic and diluted earnings per share:				
2001	\$(0.14)	\$0.09	\$0.08	\$0.18
2000	0.01	(0.96)	(0.27)	0.15

In the fourth quarter, gross profits were reduced by \$730,000 and increased by \$380,000 in the fiscal years ended 2001 and 2000, respectively, due to the net impact of adjustments to certain inventories and revisions in estimated completion costs on government defense contracts.

The results for the fourth quarter of fiscal 2000 were reduced by \$833,000 after adjusting the Company's full-year effective tax rate to (31.5%). The increased tax rate is due to the higher than expected losses at Sparton of Canada.

Finally, in the second quarter of fiscal 2000, the Company charged \$10,000,000 to operations to adjust its accrual for EPA-related costs as described in Note 9.

## 11. BUSINESS SEGMENT AND CONCENTRATION OF SALES

The Company operates in one business segment, electronic manufacturing services (EMS).

Total direct sales on prime contracts to United States government agencies were \$27,997,000 in fiscal 2001, \$33,715,000 in fiscal 2000 and \$25,754,000 in fiscal 1999. In fiscal 2001, two commercial customers accounted for 20% and 10%, respectively, of consolidated sales. In the fiscal years ended 2000 and 1999, one commercial customer accounted for 11% of consolidated sales. Foreign export sales by U.S. operations to unaffiliated customers were \$17,651,000 in fiscal 2001, \$32,072,000 in fiscal 2000 and \$27,891,000 in fiscal 1999. No single country accounted for 10% or more of export sales in the fiscal years ended 2001, 2000 or 1999.

Sales of anti-submarine warfare (ASW) devices and related engineering contract services for the years 2001-1999 contributed approximately 18%, 31% and 30%, respectively, to total sales. Intercompany sales were not significant in any of these years.



## SELECTED FINANCIAL DATA

### SPARTON CORPORATION & SUBSIDIARIES FOR YEARS ENDED JUNE 30

	2001	2000	1999	1998	1997
<b>OPERATING RESULTS</b>					
Net sales	\$187,620,426	\$161,914,446	\$131,900,489	\$145,935,583	\$142,736,800
Costs and expense	<u>185,486,583</u>	<u>175,566,602</u>	<u>129,850,749</u>	<u>141,753,150</u>	<u>139,451,913</u>
	2,133,843	(13,652,156)	2,049,740	4,182,433	3,284,887
Other income (expense):					
Interest and investment income	355,626	666,253	1,503,982	1,756,039	1,211,233
Interest expense	-	-	(416)	(26,845)	(896,010)
Other - net	<u>159,568</u>	<u>713,169</u>	<u>23,775</u>	<u>602,490</u>	<u>12,793</u>
	515,194	1,379,422	1,527,341	2,331,684	328,016
Income (loss) from continuing operations before income taxes	2,649,037	(12,272,734)	3,577,081	6,514,117	3,612,903
Provision (credit) for income taxes	<u>1,030,000</u>	<u>(3,865,000)</u>	<u>1,818,000</u>	<u>2,181,000</u>	<u>1,371,000</u>
Income (loss) from continuing operations	1,619,037	(8,407,734)	1,759,081	4,333,117	2,241,903
Income (loss) from discontinued automotive operations, net of income taxes	<u>-</u>	<u>-</u>	<u>(2,520,000)</u>	<u>(1,320,000)</u>	<u>31,458,637</u>
Net income (loss)	<u>\$1,619,037</u>	<u>\$(8,407,734)</u>	<u>\$ (760,919)</u>	<u>\$ 3,013,117</u>	<u>\$ 33,700,540</u>
Weighted-average common shares outstanding	7,737,843	7,828,090	7,828,090	7,826,840	7,816,417
<b>PER SHARE OF COMMON STOCK</b>					
Income (loss):					
Continuing operations	\$0.21	\$(1.07)	\$ 0.22	\$0.55	\$0.29
Discontinued operations	<u>-</u>	<u>-</u>	<u>(0.32)</u>	<u>(0.17)</u>	<u>4.02</u>
	\$0.21	\$(1.07)	\$(0.10)	\$0.38	\$4.31
Shareowners' equity	\$10.50	\$10.10	\$11.18	\$11.29	\$10.90
Dividends	-	-	-	-	-
<b>OTHER FINANCIAL DATA</b>					
Total assets	\$107,794,505	\$108,976,236	\$108,337,035	\$111,121,335	\$114,177,087
Working capital	65,977,180	64,778,574	68,578,975	71,118,395	68,760,933
Working capital ratio	4.21:1	4.00:1	4.85:1	4.52:1	3.53:1
Long-term obligations	-	-	-	-	-
Shareowners' equity	79,522,451	79,077,150	87,521,898	88,368,817	85,242,450



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

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## RESULTS OF OPERATIONS

The following is management's discussion and analysis of certain significant events affecting the Company's earnings and financial condition during the periods included in the accompanying financial statements. The Company's operations are in one line of business, electronic manufacturing services (EMS). This includes the design, development and/or manufacture of electronic parts and assemblies for both government and commercial customers worldwide.

The Private Securities Litigation Reform Act of 1995 reflects Congress' determination that the disclosures of forward-looking information is desirable for investors and encourages such disclosure by providing a safe harbor for forward-looking statements by corporate management. The following discussion about the Company's results of operations and financial condition contains forward-looking statements that involve risk and uncertainty. The Company notes that a variety of factors could cause the actual results and experience to differ materially from anticipated results or other expectations expressed in the Company's forward-looking statements. The risks and uncertainties that may affect the operations, performance, growth forecasts and results of the Company's business include, but are not limited to, timing and fluctuations in U.S. and/or world economies, customer demand for products, competition in the overall EMS business, the availability and cost of materials, production labor and management services under terms acceptable to the Company, Congressional budget outlays for sonobuoy development and production, Congressional legislation, changes in the interpretation of environmental laws and the uncertainties of environmental remediation. The Company has encountered availability and extended lead time issues on some electronic components. Shortages on some key electronic components have resulted in higher prices and late deliveries. This shortage on some critical electronic components could materially impact the electronics industry, and Sparton specifically, for some time. Availability of components could adversely affect the Company's ability to meet customers' production schedules. In addition, the ability to recover increasing material costs from customers will be a factor in future operating results. Management cautions readers not to place undue reliance on forward-looking statements, which are subject to influence by the enumerated risk factors as well as unanticipated future events.

### FISCAL 2001 COMPARED TO FISCAL 2000

Sales for the year ended June 30, 2001, were \$187,620,000, an increase of \$25,706,000 (16%) from fiscal 2000. Overall, commercial EMS sales increased 36%, while governmental EMS sales decreased 22%. Governmental EMS sales in fiscal 2001 were below forecast due to qualification and production delays on several major sonobuoy programs. All new production sonobuoy design programs are now qualified and production ready. Sonobuoy sales should increase for fiscal 2002.

Governmental sales included shipments on several government contracts which the Company expected to ship last year. These shipments increased reported sales by \$6,100,000 but carried no gross margin, due to incurred cost overruns in the prior year. Customer orders and shipping schedules have remained fairly consistent in fiscal 2001 despite the slowing of the economy. At June 30 the government backlog includes \$10,700,000 of sonobuoy sales, which contracts are loss contracts and will carry no gross margin in fiscal 2002.

New program start-up and cost management continue to be areas of focus. These efforts resulted in the identification and recovery of \$1.9 million from one customer in fiscal 2001. These efforts also contributed to the recovery of \$2.3 million of material price variances incurred during fiscal 2001. Many electronic components were in short supply and allocated. This drove up the prices of these items. These market conditions eased somewhat by June 30, 2001, and the availability and price of these components were at more traditional levels.

Selling and administrative expense decreased by \$8,865,000 to \$16,333,000 in fiscal 2001. This decrease was largely due to the inclusion of a \$10,000,000 charge for EPA remediation in the second quarter of fiscal 2000. Spending for Information Technology increased in fiscal 2001 from fiscal 2000, as the Company continues to upgrade its facilities and equipment.

Operating income of \$2,134,000 was reported for fiscal 2001 compared to loss of \$13,652,000 last year. Included within these operating results were adverse manufacturing variances of \$7,148,000 and \$3,337,000 for the fiscal years ended 2001 and 2000, respectively. The increased variances in fiscal 2001 were due to; higher material acquisition overhead costs as the Company transitions processes, increased lease costs for new SMT equipment, and lower than expected production schedules, generally in the first half of the fiscal year. These results also reflect Coors Road-related EPA costs and expenses of \$1,820,000 and \$10,811,000 in the fiscal years ended 2001 and 2000, respectively. These EPA charges are more fully described in Note 9 to the financial statements. During the past year the Company has experienced a number of material pricing and availability issues. These conditions now appear to be easing.

Interest and investment income decreased \$311,000 to \$356,000 in fiscal 2001. This decrease was due to a loss on sale of equities during the year of \$174,000, as well as lower average investments. The investment securities are more fully described in Note 3 to the financial statements. Other Income-net was \$160,000 and \$713,000 in the fiscal years ended 2001 and 2000, respectively. Included within fiscal 2000 Other Income-net was a gain of \$577,000 from the sale of equipment and other assets at the Canadian operating unit.



After provision for applicable income taxes as discussed in Note 8 to the financial statements, the Company reported net income of \$1,619,000 (\$0.21 per share) in fiscal 2001, compared to a net loss of \$8,408,000 (\$1.07 per share) in fiscal 2000.

#### FISCAL 2000 COMPARED TO FISCAL 1999

Sales for the year ended June 30, 2000, were \$161,914,000, an increase of \$30,014,000 (23%) from 1999. Governmental EMS sales increased \$9,140,000. These sales were below expectations. Commercial EMS sales of \$105,671,000 increased \$20,874,000. Sales increased \$34,385,000 (32%) to \$142,751,000 at Sparton Electronics due to higher commercial sales and increased shipments of sonobuoys. Sales increased \$2,199,000 (10%) to \$23,742,000 at Sparton Technology primarily as a result of increased wiring harness sales. Canadian revenues totaled \$4,313,000, an increase of 73% from last year.

The Company continues to address cost control measures on programs that have adversely affected operational costs. Costs on several development and production sonobuoy programs were higher than anticipated and estimates to complete the programs increased \$1,200,000 in the fourth quarter and \$4,500,000 for the year. In addition, a major commercial program adversely impacted margins with higher than expected startup costs of \$2,500,000.

An operating loss of \$13,652,000 was reported for fiscal 2000 compared to income of \$2,050,000 last year. The fiscal 2000 results were lower than expected. Included within these operating results were adverse capacity variances of \$3,337,000 and \$3,646,000 for the fiscal years ended 2000 and 1999, respectively, caused by underutilized capacity at several production facilities. These results also reflect Coors Road-related EPA costs and expenses of \$10,811,000 and \$1,756,000 in the fiscal years ended 2000 and 1999, respectively. This EPA charge is more fully described in Note 9 to the financial statements.

Selling and administrative expense increased by \$7,439,000 to \$25,198,000 in fiscal 2000. The largest expense incurred was \$10,811,000 for environmental remediation issues, including the \$10,000,000 increase to the EPA reserve reported in the second quarter. Without the increase in the EPA expense, selling and administrative costs would have been significantly below last year, mainly due to consolidation of operations.

Interest and investment income decreased \$838,000 to \$666,000 in fiscal 2000 due to lower average investments. These investment securities are more fully described in Note 3 to the financial statements.

The Company has been a policyholder in Metropolitan Life Insurance Company (MetLife) since 1927. Recently MetLife changed from a mutual to a stock company. In the fourth quarter of fiscal 2000, the Company received approximately \$1,500,000 upon the sale of its shares in the new company which proceeds were reported as a return of premium and included in operating income. Of the \$1,500,000, \$221,000

was credited as a reduction to administrative expense, with the balance to cost of sales.

After provision for applicable income taxes as discussed in Note 8 to the financial statements, the Company reported a loss from continuing operations of \$8,408,000 (\$1.07 per share) in fiscal 2000 compared to income of \$1,759,000 (\$.22 per share) in fiscal 1999.

A net loss of \$8,408,000 (\$1.07 per share) was reported in fiscal 2000 compared to a net loss of \$761,000 (\$(.10) per share) in fiscal 1999.

#### LIQUIDITY AND CAPITAL RESOURCES

The primary source of liquidity and capital resources has historically been from operations. Short-term credit facilities have been used in the past to provide added liquidity. The Company continues to experience a change in its liquidity sources as the volume of U.S. defense-related contract work declines as a percentage of total Company revenues. Certain government contracts provide for interim progress billings based on costs incurred. These progress billings reduce the amount of cash that would otherwise be required during the performance of these contracts. As the volume of U.S. defense-related contract work declines, so has the relative importance of progress billings as a liquidity resource. At the present time, the Company plans on using its investment securities to provide working capital and to strategically invest in additional property, plant and equipment to accommodate growth in the EMS business. The Company has had no short-term debt outstanding since December 1996, and currently has unused informal lines of credit totalling \$20 million through two banks. These lines of credit were negotiated in fiscal 2001.

Cash flows provided by operating activities were \$5,981,000 and \$1,878,000 in the fiscal years ended 2001 and 1999, respectively. In fiscal 2000 cash flows used by operating activities were \$12,755,000. In fiscal 2001 the primary cash flow use was an increase in accounts receivable. Primary sources included a decrease in inventory.

Cash flows provided by investing activities were \$3,283,000 and \$13,642,000 in the fiscal years ended 2001 and 2000, respectively. In fiscal 1999 cash flows used were \$1,672,000. Cash flows were primarily provided by the sale of investment securities. The major use of cash by investing activities was the purchase of equipment to update and expand the Company's production capabilities in its continuing electronics business. Additionally, the Company acquired common stock in Cybernet Systems for \$3,000,000 in fiscal 1999. Cybernet is a privately owned developer of hardware, software and next-generation network computing and robotics products.

Cash flows used by financing activities were \$1,282,000 in fiscal 2001 and \$123,000 in fiscal 1999. No financing activities occurred in fiscal 2000.

At June 30, 2001, the Company had \$65,977,000 in working capital.



### Market Risk Exposure

The Company manufactures its products in the United States and Canada. Sales of the Company's products are made in the U.S. and Canada, as well as other foreign markets. The Company is potentially subject to foreign currency exchange rate risk relating to receipts from customers and payments to suppliers in foreign currencies. As a result, the Company's financial results could be affected by factors such as changes in foreign currency exchange rates or weak economic conditions in the foreign markets in which the Company operates. However, minimal receivables and payables are denominated in foreign currency. The Company does not consider the market risk exposure relating to currency exchange to be material.

The Company has financial instruments that are subject to interest rate risk, principally short-term investments. Historically, the Company has not experienced material gains or losses due to such interest rate changes. Based on the current holdings of short-term investments, the interest rate risk is not considered to be material.

### **OTHER**

#### Litigation

Various litigation is pending against the Company, in many cases involving ordinary and routine claims incidental to the business of the Company and in others presenting allegations that are non-routine. The Company and its subsidiaries are also involved in certain compliance issues with the United States Environmental Protection Agency (EPA) and various state agencies, including being named as a potentially responsible party at several sites. Potentially responsible parties (PRPs) can be held jointly and severally liable for the cleanup costs at any specific site. The Company's past experience, however, has indicated that when it has contributed only relatively small amounts of materials or waste to a specific site relative to other PRPs, its ultimate share of any cleanup costs has been minor. Based upon available information, the Company believes it has contributed only small amounts to those sites in which it is currently viewed a potentially responsible party.

In February 1997, three lawsuits were filed against Sparton's wholly owned subsidiary, Sparton Technology, Inc., in Federal District Court in Albuquerque, one by the United States on behalf of the EPA, the second by the State of New Mexico and the New Mexico Office of Natural Resources Trustee and the third by the City of Albuquerque and the County of Bernalillo. All three actions alleged that the impacts to soil and groundwater associated with Sparton Technology's Coors Road facility presented an imminent and substantial threat to human health or the environment. On March 3, 2000, a Consent Decree was entered, settling the lawsuits as well as a related administrative enforcement action. The Consent Decree represents a judicially enforceable settlement agreement under which Sparton Technology has paid \$1,000,000 to resolve claims for damages to natural resources, \$475,000 to resolve claims for civil penalties for alleged violations of state

law and an order entered in the related administrative enforcement action, and \$200,000 for reimbursement of the litigation costs of certain plaintiffs. The Consent Decree also contains work plans describing remedial activity Sparton Technology agreed to undertake. In exchange for the monetary payment and an agreement to implement the work plans, Sparton Technology received covenants not to sue that, except in fairly extraordinary circumstances, prevent any further administrative or judicial action by state and federal entities in connection with the impacts to the environment associated with past activities at the Coors Road facility.

The work plans provide for the installation of an off-site containment well (already completed and operating), enhancement to an on-site soil vapor extraction system and an on-site containment well. It is anticipated that these remediation activities will operate for a period of time during which Sparton Technology and the regulatory agencies will analyze their effectiveness. The Company believes that it will take at least three to five years from the date of the Consent Decree before the effectiveness of the groundwater extraction wells can be established. If ineffective, additional remedies may be imposed at a significantly increased cost. There is no assurance that additional costs greater than the amount accrued will not be incurred or that changes in environmental laws or their interpretation will not require that additional amounts be spent.

Upon entering into the Consent Decree, the Company reviewed its estimates of the future costs expected to be incurred in connection with its remediation of the environmental issues associated with its Coors Road Plant over the next 30 years. The Company increased its accrual for the cost of addressing environmental impacts associated with its Coors Road Plant by \$10,000,000, pre-tax, in December 1999. At June 30, 2001, the remaining undiscounted minimum accrual for EPA remediation approximates \$8,559,000. The Company's estimate is based upon existing technology and current costs which have not been discounted. The estimate includes equipment and operating and maintenance costs for the on-site and off-site pump and treat containment systems, a soil vapor extraction program and continued on-site and off-site monitoring. It also includes the required periodic reporting requirements. This estimate does not include legal and related consulting costs which are expensed as incurred. The estimate does not reflect any offset or reduction for monies recovered from various parties which the Company is currently pursuing as described below.

In 1995 Sparton Corporation and Sparton Technology, Inc. filed a Complaint in the Circuit Court of Cook County, Illinois, against Lumbermens Mutual Casualty Company and American Manufacturers Mutual Insurance Company demanding reimbursement of expenses incurred in connection with its remediation efforts at the Coors Road facility based on various primary and excess comprehensive general liability policies in effect between 1959 and 1975. In 1999 the Complaint was amended to add various other excess insurers, including certain London market insurers and Fireman's Fund Insurance Company. The case is currently in the discovery stage, with discovery currently set to close on November 15, 2001.



On February 11, 1998, Sparton Technology, Inc. commenced litigation in the United States Court of Federal Claims alleging that the Department of Energy (DOE), acting through its contractors, Sandia Corporation and Allied Signal, Inc., is liable for reimbursement of Sparton's costs incurred in defending against and complying with federal and state regulatory requirements. The DOE prescribed certain mandatory performance requirements that were then imposed upon Sparton Technology through its agreements with Sandia Corporation and Allied Signal, Inc. On February 9, 1999, the Court of Federal Claims dismissed Sparton Technology's complaint on the basis of a lack of jurisdiction concluding that an agency relationship did not exist between Sandia Corporation and Allied Signal, Inc. and the United States for purposes of reimbursing costs incurred during litigation. Sparton Technology believed that the court erred in its decision and filed its notice of appeal on April 9, 1999. On April 18, 2000, the Federal Circuit Court reversed the lower court's decision and reinstated Sparton Technology's claim for purposes of examining whether the Court of Federal Claims does indeed have jurisdiction. Sparton Technology is now proceeding with discovery on the jurisdiction related issues.

Sparton Technology, Inc. filed a complaint on September 21, 1998, against Allied Signal, Inc. in U.S. District Court in Kansas City seeking to recover costs incurred to investigate and remediate impacts to the environment at its Coors Road facility. In July 1999, the Court allowed Sparton Technology to amend its complaint to add Sandia Corporation and the DOE as defendants. In March 2000, the case was transferred to the United States District Court in Albuquerque, New Mexico. Written discovery commenced, but was stayed on July 13, 2000, so that a court-ordered mediation could be conducted. Mediation did not result in settlement, and on December 20, 2000, the Court entered a new discovery scheduling order whereby fact discovery is currently scheduled to end in December 2001 and expert witness discovery in July 2002. Dispositive motions are due at that time. Trial is not yet scheduled, but normally takes place within six months of dispositive motions. Active discovery is now taking place.

At this time, the Company is unable to predict the amount or timing of recovery, if any, that may result from the pursuit of these before-mentioned three claims.



## DIRECTORS AND OFFICERS

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### DIRECTORS:

**James N. DeBoer (2,3)**

*Partner  
Law Firm of Varnum, Riddering, Schmidt  
and Howlett, LLP  
Grand Rapids, Michigan*

**James D. Fast**

*Chief Executive Officer and President  
Ionia County National Bank*

**David W. Hockenbrocht (2,3,4)**

*Chief Executive Officer and President  
Sparton Corporation*

**Robert J. Kirk (1)**

*Financial Consultant  
Toledo, Ohio*

**Richard L. Langley**

*Chief Financial Officer,  
Vice President and Treasurer  
Sparton Corporation*

**David P. Molfenter (1,2,4)**

*Retired Vice President  
Command, Control, Communication and  
Information Systems Segment  
Raytheon Systems Company  
Fort Wayne, Indiana*

**William I. Noecker (1)**

*Director of Program Management  
Fisher Dynamics Corporation  
St. Clair Shores, Michigan*

*Chairman*

*Brasco International Inc.  
Detroit, Michigan*

**W. Peter Slusser (2)**

*President  
Slusser Associates Inc.  
New York, New York*

**Bradley O. Smith (3,4)**

*Chairman of the Board  
Sparton Corporation*

### OFFICERS:

**SPARTON CORPORATION**

**Bradley O. Smith**

*Chairman of the Board*

**David W. Hockenbrocht**

*Chief Executive Officer and President*

**Douglas E. Johnson**

*Chief Operating Officer and Vice President*

**Richard L. Langley**

*Chief Financial Officer,  
Vice President and Treasurer*

**R. Jan Appel**

*Vice President,  
Secretary and General Counsel*

**Alan J. Houghtaling**

*Vice President,  
Director Business Development*

**Stephanie A. Martin**

*Vice President,  
Corporate Materials, Acquisitions and Logistics*

**Charles A. Stranko**

*Vice President, General Manager  
Sparton Technology, Inc.*

**Michael G. Woods**

*Vice President, General Manager  
Sparton of Canada, LTD.*

### COMMITTEE ASSIGNMENTS:

- (1) Audit committee
- (2) Compensation committee
- (3) Executive committee
- (4) Nominating committee



## SPARTON FACILITIES

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### SPARTON FACILITIES

#### **Sparton Electronics**

Administrative Office  
Johnson Lake Rd.  
DeLeon Springs, FL 32130

#### *Manufacturing Facilities:*

Jackson, MI  
DeLeon Springs, FL  
Brooksville, FL

#### **Sparton of Canada, LTD.**

99 Ash Street  
London, Ontario N5Z 4V3

#### **Sparton Technology, Inc.**

Administrative Office  
4901 Rockaway Blvd., N.E.  
Rio Rancho, NM 87124

#### *Manufacturing Facilities:*

Deming, NM  
Rio Rancho, NM

#### **Corporate Offices**

##### **Sparton Corporation**

2400 E. Ganson Street  
Jackson, MI 49202

Phone: (517) 787-8600  
Watts: (800) 248-9579  
Fax: (517) 787-1822

#### **WEBSITE:**

<http://www.sparton.com>

### COMMON STOCK LISTING:

New York Stock Exchange under the symbol **SPA**.

### TRANSFER AGENT/REGISTRAR:

#### **Principal Transfer Agent:**

Illinois Stock Transfer Company  
209 West Jackson Blvd., Suite 903  
Chicago, IL 60606-6905  
(312) 427-2953  
(800) 757-5755

#### **Registrar:**

HSBC Bank USA  
One Hanson Place - Lower Level  
Brooklyn, NY 11243

### FORM 10-K AVAILABLE:

A copy of Sparton Corporation's annual report on Form 10-K for the year ended June 30, 2001, filed with the Securities and Exchange Commission, will be furnished without charge to any shareowner upon written request to Richard L. Langley, CFO - Vice President, Sparton Corporation, 2400 E. Ganson St., Jackson, MI 49202.

### NOTICE OF ANNUAL MEETING:

The Annual Meeting of Sparton Corporation will be held at 10:00 a.m. on October 24, 2001, in the Company offices, 2400 E. Ganson St., Jackson, Michigan.

It is Sparton Corporation's policy to afford equal employment opportunity to all employees and qualified applicants for employment without regard to race, religion, creed, color, sex, national origin, age, handicap or veteran status.



**John J. Smith**  
1911- 2000



**Lawson K. Smith**  
1915 - 2000



*"...John J. Smith came to Sparton in November 1950 under rather tenuous circumstances. John made choices early in his tenure that probably saved the Company. Sparton exited the radio and TV business when they became unattractive due to competition. In the middle 50's, John lead Sparton into the sonobuoy business - where we still are today - one of two companies in the free world who design and build expendable anti-submarine warfare devices. Since 1956, the sonobuoy has been, and still is, one of our principal products and the U.S. Navy is still a major customer. Sparton had been in the automotive parts business, primarily involving horns, shifters, tire carriers and other assemblies, more than 30 years when John arrived. This was a good business and through the ensuing 40 years, that segment of the Company expanded. Sparton exited the automotive business in 1996. Sparton then entered the electronic design and contract manufacturing services business and without John's support, we would not have been able to refocus the Company as we have in the last several years.*

*Lawson K. Smith joined the Sparton Corporation in 1970 through Sparton's acquisition of Lake Odessa Machine Products, which Lawson had managed for many years. Lawson became Sparton's second largest shareowner after John. Lawson provided a quiet yet supportive leadership role for Sparton's automotive operations for over 30 years. Lawson was the foundation which supported the growth of Sparton's automotive business to a sales level of approximately \$121 million. In the mid 1990's, the dynamics of the automotive industry changed significantly. It became increasingly difficult for a mid-size automotive supplier to attain an attractive return on investment. Lawson along with John provided guidance to Sparton in making the difficult decision to exit the automotive supplier market. Lawson was always a strong and supportive leader, providing counsel to Sparton's other managers, furthering Sparton's success as an independent business entity.*

*Here is Sparton today, in our one hundred - first year, building a new company, and a new business. The leadership for that process throughout the years was the Smith brothers, John and Lawson. Sparton Corporation is one of the key manufacturers in the low to medium volume, high mix electronics manufacturing services; this enviable position would not have been obtainable without their leadership and financial investment.*

*Lawson K. Smith passed away in October 2000, followed by John J. Smith just four weeks later in November. The passing of the Smith brothers in 2000 ended an era that began 50 years earlier. Thank you, John and Lawson, for your vision, your leadership and your friendship..."*

*Bradley O. Smith  
David W. Hockenbrocht*





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**CIRTRONICS**  
CORPORATION

CIRTRONICS CORPORATION  
New Hampshire  
603.249.9190  
[www.cirtronics.com](http://www.cirtronics.com)

**GASTON**  
electronics

GASTON ELECTRONICS  
North Carolina  
704.822.5000  
[www.gastonelectronics.com](http://www.gastonelectronics.com)

## The **SPARTON** Alliance Network

Sparton Corporation in its quest to build a worldwide network of high quality Electronic Design and Manufacturing Services (EMS) providers focused in the high-mix and low to mid-volume marketplace has developed alliances with a growing number of outstanding companies.

Each one is privately owned and locally operated and possess a culture similar to Sparton. The alliance network offers a localized, yet global network for design and manufacturing services to Original Equipment Manufacturers in a seamless and efficient way.



OCM TECHNOLOGY INC.  
Canada  
613.736.5665  
[www.ocmtech.com](http://www.ocmtech.com)



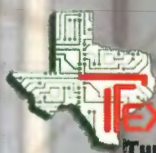
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# **SPARTON**

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**Sparton Electronics**  
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386.985.4631

**Sparton Medical Solutions**  
Research Triangle Park  
4819 Emperor Blvd., Fourth Floor  
Durham, North Carolina 27703  
919.313.4570

**Sparton Technology, Inc.**  
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Rio Rancho, New Mexico 87124  
505.892.5300