

CTS CORP
Form 10-Q
July 28, 2015
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

For The Quarterly Period Ended June 28, 2015

OR

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

For the Transition Period from _____ to _____

Commission File Number: 1-4639

CTS CORPORATION

(Exact name of registrant as specified in its charter)

Indiana	35-0225010
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification Number)
1142 West Beardsley Avenue, Elkhart, IN	46514
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code: 574-523-3800

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

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

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

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

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of July 20, 2015: 32,828,731.



Table of Contents

CTS CORPORATION AND SUBSIDIARIES

TABLE OF CONTENTS

	Page
 <u>PART I. FINANCIAL INFORMATION</u>	
<u>Item 1. Financial Statements</u>	3
<u>Condensed Consolidated Statements of Earnings – Unaudited For the Periods Ended June 28, 2015 and June 29, 2014</u>	3
<u>Condensed Consolidated Statements of Comprehensive Earnings – Unaudited For the Periods Ended June 28, 2015 and June 29, 2014</u>	4
<u>Condensed Consolidated Balance Sheets As of June 28, 2015 (Unaudited) and December 31, 2014</u>	5
<u>Condensed Consolidated Statements of Cash Flows – Unaudited For the Periods Ended June 28, 2015 and June 29, 2014</u>	6
<u>Notes to Condensed Consolidated Financial Statements – Unaudited</u>	7
<u>Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>	24
<u>Item 3. Quantitative and Qualitative Disclosures about Market Risk</u>	32
<u>Item 4. Controls and Procedures</u>	32
 <u>PART II. OTHER INFORMATION</u>	
<u>Item 1. Legal Proceedings</u>	33
<u>Item 1A. Risk Factors</u>	33
<u>Item 2. Unregistered Sales of Equity Securities and Use of Proceeds</u>	34
<u>Item 6. Exhibits</u>	35
<u>SIGNATURES</u>	36

Table of Contents

PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

CTS CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF EARNINGS - UNAUDITED

(In thousands of dollars, except per share amounts)

	Three Months Ended		Six Months Ended	
	June 28, 2015	June 29, 2014	June 28, 2015	June 29, 2014
Net sales	\$ 100,071	\$ 102,980	\$ 198,382	\$ 203,686
Costs and expenses:				
Cost of goods sold	66,698	69,157	132,873	139,248
Selling, general and administrative expenses	15,224	15,813	30,935	29,454
Research and development expenses	5,487	5,332	10,686	10,958
Restructuring and impairment charges	2,118	2,733	2,856	3,236
Operating earnings	10,544	9,945	21,032	20,790
Other (expense) income:				
Interest expense	(653)	(582)	(1,241)	(1,195)
Interest income	853	688	1,641	1,252
Other	115	(409)	(1,569)	(2,180)
Total other (expense) income	315	(303)	(1,169)	(2,123)
Earnings before income taxes	10,859	9,642	19,863	18,667
Income tax (benefit) expense	(8,221)	3,281	(5,504)	7,226
Net earnings	\$ 19,080	\$ 6,361	\$ 25,367	\$ 11,441
Earnings per share:				
Basic	\$ 0.58	\$ 0.19	\$ 0.76	\$ 0.34
Diluted	\$ 0.57	\$ 0.19	\$ 0.75	\$ 0.33
Basic weighted – average common shares outstanding:	33,080	33,741	33,243	33,725
Effect of dilutive securities	471	467	497	519
Diluted weighted – average common shares outstanding	33,551	34,208	33,740	34,244

Edgar Filing: CTS CORP - Form 10-Q

Cash dividends declared per share	\$ 0.040	\$ 0.040	\$ 0.080	\$ 0.080
-----------------------------------	----------	----------	----------	----------

See notes to unaudited condensed consolidated financial statements.

3

Table of Contents

CTS CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE EARNINGS UNAUDITED

(In thousands of dollars)

	Three Months Ended		Six Months Ended	
	June 28, 2015	June 29, 2014	June 28, 2015	June 29, 2014
Net earnings	\$ 19,080	\$ 6,361	\$ 25,367	\$ 11,441
Other comprehensive (loss) earnings:				
Changes in fair market value of hedges, net of tax	69	(147)	(17)	(107)
Changes in unrealized pension cost, net of tax	705	887	1,962	1,801
Cumulative translation adjustment, net of tax	1,491	617	388	821
Other comprehensive earnings	\$ 2,265	\$ 1,357	\$ 2,333	\$ 2,515
Comprehensive earnings	\$ 21,345	\$ 7,718	\$ 27,700	\$ 13,956

See notes to unaudited condensed consolidated financial statements.

Table of Contents

CTS CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands of dollars)

	(Unaudited) June 28, 2015	December 31, 2014
ASSETS		
Current Assets		
Cash and cash equivalents	\$ 146,791	\$ 134,508
Accounts receivable, net	63,046	56,894
Inventories, net	30,424	27,887
Other current assets	21,400	21,112
Total current assets	261,661	240,401
Property, plant and equipment, net	70,166	71,414
Other Assets		
Prepaid pension asset	36,563	32,099
Goodwill	32,047	32,047
Indefinite-lived intangible asset	690	690
Other intangible assets, net	33,945	35,902
Deferred income taxes	53,088	43,120
Other	1,110	1,253
Total other assets	157,443	145,111
Total Assets	\$ 489,270	\$ 456,926
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current Liabilities		
Accounts payable	\$ 45,724	\$ 43,343
Accrued payroll and benefits	10,364	11,283
Accrued liabilities	27,395	25,356
Total current liabilities	83,483	79,982
Long-term debt	88,700	75,000
Post retirement obligations	2,908	3,049
Other long-term obligations	8,647	9,106
Shareholders' Equity		
Common stock	300,869	299,892
Additional contributed capital	40,237	39,153
Retained earnings	402,863	380,145
Accumulated other comprehensive loss	(101,900)	(104,233)
Total shareholders' equity before treasury stock	642,069	614,957
Treasury stock	(336,537)	(325,168)

Edgar Filing: CTS CORP - Form 10-Q

Total shareholders' equity	305,532	289,789
Total Liabilities and Shareholders' Equity	\$ 489,270	\$ 456,926

See notes to unaudited condensed consolidated financial statements.

5

Table of Contents

CTS CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS UNAUDITED

(In thousands of dollars)

	Six Months Ended	
	June 28, 2015	June 29, 2014
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net earnings	\$ 25,367	\$ 11,441
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation and amortization	8,093	8,401
Amortization of retirement benefit adjustments	3,297	2,906
Equity-based compensation	2,362	1,179
Restructuring charges	2,856	3,236
Prepaid pension asset	(4,422)	(4,208)
Gain on sale of fixed assets	(1)	(1,855)
Changes in assets and liabilities, net of acquisitions and divestitures:		
Accounts receivable	(6,628)	1,346
Inventories	(2,914)	3,632
Accounts payable	1,556	(3,145)
Accrued liabilities	(3,292)	(10,864)
Income taxes payable	1,210	(357)
Deferred income taxes	(11,243)	2,714
Other	(747)	(4,370)
Total adjustments	(9,873)	(1,385)
Net cash provided by operating activities	15,494	10,056
CASH FLOWS FROM INVESTING ACTIVITIES:		
Capital expenditures	(3,905)	(5,991)
Proceeds from sale of assets	3	1,910
Net cash used in investing activities	(3,902)	(4,081)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Payments of long-term debt	(562,300)	(482,400)
Proceeds from borrowings of long-term debt	576,000	483,600
Payments of short-term notes payable	—	(778)
Proceeds from borrowings of short-term notes payable	—	778
Purchase of treasury stock	(11,369)	(3,732)
Dividends paid	(2,668)	(2,693)
Exercise of stock options	64	1,328
Other	147	222
Net cash used in financing activities	(126)	(3,675)
Effect of exchange rate on cash and cash equivalents	817	562
Net increase in cash and cash equivalents	12,283	2,862

Edgar Filing: CTS CORP - Form 10-Q

Cash and cash equivalents at beginning of year	134,508	124,368
Cash and cash equivalents at end of year	\$ 146,791	\$ 127,230
Supplemental cash flow information		
Cash paid for Interest	\$ 1,046	\$ 834
Cash paid for Income taxes, net	\$ 4,248	\$ 4,737

See notes to unaudited condensed consolidated financial statements.

6

Table of Contents

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - UNAUDITED

June 28, 2015

NOTE 1—Basis of Presentation

The accompanying condensed consolidated financial statements have been prepared by CTS Corporation (“CTS” or “the Company”), without audit, pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been omitted pursuant to such rules and regulations. The unaudited condensed consolidated financial statements should be read in conjunction with the financial statements, notes thereto, and other information included in the Company’s Annual Report on Form 10 K for the year ended December 31, 2014.

The accompanying unaudited condensed consolidated financial statements reflect, in the opinion of management, all adjustments (consisting of normal recurring items) necessary for a fair statement, in all material respects, of the financial position and results of operations for the periods presented. The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reported period. Actual results could differ materially from those estimates. The results of operations for the interim periods are not necessarily indicative of the results for the entire year.

NOTE 2 – Accounts Receivable

The components of accounts receivable are as follows:

(\$ in thousands)	As of	
	June 28, 2015	December 31, 2014
Accounts receivable, gross	\$ 63,174	\$ 56,994
Less: Allowance for doubtful accounts	(128)	(100)
Accounts receivable, net	\$ 63,046	\$ 56,894

NOTE 3 – Inventories

Inventories consist of the following:

(\$ in thousands)	As of June 28, 2015	December 31, 2014
Finished goods	\$ 12,922	\$ 11,728
Work-in-process	8,000	7,297
Raw materials	16,297	15,562
Less: Inventory reserves	(6,795)	(6,700)
Inventories, net	\$ 30,424	\$ 27,887

NOTE 4 – Property, Plant and Equipment

Property, plant and equipment is comprised of the following:

(\$ in thousands)	As of June 28, 2015	December 31, 2014
Land	\$ 3,044	\$ 3,044
Buildings and improvements	68,371	67,269
Machinery and equipment	188,507	185,999
Less: Accumulated depreciation	(189,756)	(184,898)
Property, plant and equipment, net	\$ 70,166	\$ 71,414

NOTE 5 – Retirement Plans

Pension Plans

Net pension income for our domestic and foreign plans was as follows:

Edgar Filing: CTS CORP - Form 10-Q

(\$ in thousands)	Three Months Ended		Six Months Ended	
	June 28, 2015	June 29, 2014	June 28, 2015	June 29, 2014
Net pension income	\$ (530)	\$ (454)	\$ (1,059)	\$ (1,080)

Net pension (income) expense breakdown for our domestic and foreign plans include the following components:

Three months: (\$ in thousands)	Domestic Pension Plans		Foreign Pension Plans	
	Three Months Ended		Three Months Ended	
	June 28, 2015	June 29, 2014	June 28, 2015	June 29, 2014
Service cost	\$ 42	\$ 48	\$ 16	\$ 21
Interest cost	2,815	3,053	124	155
Expected return on plan assets (1)	(5,068)	(5,208)	(134)	(170)
Amortization of loss	1,585	1,416	90	59
Other cost due to retirement	—	172	—	—
(Income) expense, net	\$ (626)	\$ (519)	\$ 96	\$ 65

Six months: (\$ in thousands)	Domestic Pension Plans		Foreign Pension Plans	
	Six Months Ended		Six Months Ended	
	June 28, 2015	June 29, 2014	June 28, 2015	June 29, 2014
Service cost	\$ 86	\$ 96	\$ 33	\$ 42
Interest cost	5,629	6,111	247	305
Expected return on plan assets (1)	(10,136)	(10,416)	(267)	(337)
Amortization of loss	3,169	2,829	180	118
Other cost due to retirement	—	172	—	—
(Income) expense, net	\$ (1,252)	\$ (1,208)	\$ 193	\$ 128

(1) Expected return on plan assets is net of expected investment expenses and certain administrative expenses.

Other Postretirement Benefit Plan

Net postretirement expense for our postretirement plan includes the following components:

Three Months Ended	Six Months Ended
--------------------	------------------

Edgar Filing: CTS CORP - Form 10-Q

(\$ in thousands)	June 28, 2015		June 29, 2014	
Other postretirement benefit plan				
Service cost	\$ 1	\$ 1	\$ 2	\$ 2
Interest cost	51	58	102	115
Amortization of gain	(25)	(40)	(50)	(79)
Postretirement expense	\$ 27	\$ 19	\$ 54	\$ 38

NOTE 6 – Other Intangible Assets

Intangible assets consist of the following components:

(\$ in thousands)	As of June 28, 2015		
	Gross Carrying Amount	Accumulated Amortization	Net Amount
Amortized intangible assets:			
Customer lists/relationships	\$ 51,804	\$ (25,752)	\$ 26,052
Patents	10,319	(10,319)	—
Other intangibles	12,270	(4,377)	7,893
Other intangible assets, net	\$ 74,393	\$ (40,448)	\$ 33,945
Amortization expense for the three months ended June 28, 2015		\$ 984	
Amortization expense for the six months ended June 28, 2015		\$ 1,957	
(\$ in thousands)	As of December 31, 2014		
	Gross Carrying Amount	Accumulated Amortization	Net Amount
Amortized intangible assets:			
Customer lists/relationships	\$ 51,804	\$ (24,415)	\$ 27,389
Patents	10,319	(10,319)	—
Other intangibles	12,270	(3,757)	8,513
Other intangible assets, net	\$ 74,393	\$ (38,491)	\$ 35,902
Amortization expense for the three months ended June 29, 2014		\$ 1,045	
Amortization expense for the six months ended June 29, 2014		\$ 2,079	

Amortization expense remaining for other intangible assets is as follows:

(\$ in thousands)	Amortization expense
2015	\$ 1,992
2016	3,647
2017	3,569
2018	3,484
2019	3,475
Thereafter	17,778
Total amortization expense	\$ 33,945

NOTE 7 – Costs Associated with Exit and Restructuring Activities

Costs associated with exit and restructuring activities are recorded in the Condensed Consolidated Statement of Earnings as follows: restructuring related charges are recorded as a component of Cost of Goods Sold, and restructuring and impairment charges are reported on a separate line and included in Operating Earnings. Total restructuring, impairment and restructuring related charges were \$2,335,000 for the three month period and \$3,148,000 for the six month period ended June 28, 2015. Total restructuring, impairment and restructuring related charges were \$3,072,000 for the three month period ended and \$4,146,000 for the six month period ended June 29, 2014.

Restructuring related charges were \$217,000 for the three month period and \$292,000 for the six month period ended June 28, 2015. Restructuring related charges were \$338,000 for the three month period and \$910,000 for the six month period ended June 29, 2014. Restructuring and impairment charges were \$2,118,000 for the three month period and \$2,856,000 for the six month period ended June 28, 2015. Restructuring and impairment charges were \$2,733,000 for the three month period and \$3,236,000 for the six month period ended June 29, 2014.

During April 2014, CTS announced plans to restructure its operations and consolidate its Canadian operations into other existing CTS facilities as part of CTS' overall plan to simplify its business model and rationalize its global footprint ("April 2014 Plan").

During the second quarter of 2015, CTS management revised the April 2014 Plan. The amendment added an additional \$4,250,000 in planned costs. Additional administrative and legal costs are estimated to account for \$1,300,000 of additional restructuring and impairment charges due to the extension of the timing of the plant

shutdown. The remaining \$2,950,000 in restructuring related charges are for additional costs related to equipment relocation, training, travel and shipping costs to facilitate an effective transition. The above actions are expected to be substantially complete in 2015.

These restructuring actions will result in the elimination of approximately 120 positions. These actions are expected to be completed in 2015. The following table displays the planned restructuring and restructuring-related charges associated with the April 2014 Plan, as well as a summary of the actual costs incurred through June 28, 2015:

(\$ in thousands)	April 2014 Plan	Planned Costs	Actual costs incurred through June 28, 2015
Inventory write-down		\$ 850	\$ —
Equipment relocation		1,800	135
Other charges		1,400	82
Restructuring related charges, included in cost of goods sold		\$ 4,050	\$ 217
Workforce reduction		\$ 4,200	\$ 3,888
Asset impairment charge		—	—
Other charges, including pension termination costs		1,700	1,459
Restructuring and impairment charges		\$ 5,900	\$ 5,347
Total restructuring, impairment and restructuring related charges		\$ 9,950	\$ 5,564

Under the April 2014 Plan, restructuring and impairment charges were \$1,516,000 in the three month period and \$1,877,000 in the six month period ended June 28, 2015. Restructuring and impairment charges were \$2,405,000 for the three and six month periods ended June 29, 2014. Restructuring related charges were \$217,000 for the three and six month periods ended June 28, 2015. Restructuring related charges were \$0 for the three and six month periods ended June 29, 2014.

During June 2013, CTS announced a restructuring plan to simplify CTS' global footprint by consolidating manufacturing facilities into existing locations ("June 2013 Plan"). The June 2013 Plan includes the consolidation of operations from the U.K. manufacturing facility into the Czech Republic facility, the Carol Stream, Illinois manufacturing facility into the Juarez, Mexico facility and to discontinue manufacturing at its Singapore facility. Certain Corporate functions were consolidated or eliminated as a result of the June 2013 Plan.

These restructuring actions will result in the elimination of approximately 350 positions. The above actions are expected to be completed in 2015.

Edgar Filing: CTS CORP - Form 10-Q

During the fourth quarter of 2014, CTS management revised the June 2013 Plan. The amendment added an additional \$4,000,000 in planned costs. Future settlement of the U.K. pension plan is estimated to account for \$2,000,000 of the added cost. The remaining \$2,000,000 in restructuring and impairment charges are for severance costs and will result in the elimination of approximately 130 additional positions. The positions eliminated will be spread globally throughout CTS businesses. The above actions are expected to be substantially complete in 2015.

The following table displays the planned restructuring and restructuring-related charges associated with the realignment, as well as a summary of the actual costs incurred through June 28, 2015:

(\$ in thousands)	June 2013 Plan	Planned Costs	Actual costs incurred through June 28, 2015
Inventory write-down		\$ 800	\$ 1,143
Equipment relocation		900	1,792
Other charges		100	652
Restructuring-related charges, included in cost of goods sold		\$ 1,800	\$ 3,587
Workforce reduction		\$ 10,150	\$ 8,793
Asset impairment charge		3,000	4,258
Other charges, including pension termination costs		7,650	1,740
Restructuring and impairment charges		\$ 20,800	\$ 14,791
Total restructuring and restructuring-related charges		\$ 22,600	\$ 18,378

Under the June 2013 Plan, total restructuring, impairment and restructuring related charges incurred were \$602,000 for the three month period June 28, 2015 and were \$1,054,000 for the six month period ended June 28, 2015. Total restructuring, impairment and restructuring related charges incurred were \$667,000 for the three month period June 29, 2014 and were \$1,741,000 for the six month period ended June 28, 2014. For the three month period June 28, 2015, the restructuring related charges were \$0 and the restructuring and impairment charges were \$602,000. For the three month period June 29, 2014, the restructuring related charges were \$338,000 and the restructuring and impairment charges were \$329,000. For the six month period June 28, 2015, the restructuring related charges were \$75,000 and the restructuring and impairment charges were \$979,000. For the six month period ended June 29, 2014, the restructuring related charges were \$910,000 and the restructuring and impairment charges were \$832,000.

The following table displays the restructuring reserve activity for the period ended June 28, 2015:

(\$ in thousands)	June 2013 Plan and April 2014 Plan	
Restructuring liability at January 1, 2015		\$ 3,904
Restructuring and restructuring-related charges, excluding asset impairments and write-offs		3,148

Cost paid	(2,849)
Restructuring liability at June 28, 2015	\$ 4,203

NOTE 8 – Accrued Liabilities

The components of accrued liabilities are as follows:

(\$ in thousands)	As of	
	June 28, 2015	December 31, 2014
Accrued product related costs	\$ 4,020	\$ 5,216
Accrued income taxes	4,560	3,346
Accrued property and other taxes	3,032	2,547
Dividends payable	1,316	1,336
Remediation and monitoring reserves	4,980	3,918
Other accrued liabilities	9,487	8,993
Total accrued liabilities	\$ 27,395	\$ 25,356

NOTE 9 – Contingencies

Certain processes in the manufacture of CTS' current and past products create hazardous waste by-products as currently defined by federal and state laws and regulations. CTS has been notified by the U.S. Environmental Protection Agency ("EPA"), state environmental agencies and, in some cases, generator groups, that it is or may be a potentially responsible party regarding hazardous substances at several sites either owned, not owned or operated by CTS. Some sites are Superfund sites such as in Asheville, North Carolina and Mountain View, California. Estimating our degree of responsibility for remediation is inherently difficult. CTS recognizes and accrues for an estimated remediation liability when it determines that such liability is probable and estimable. As a result of this practice, to provide for certain groundwater remedial work expected to commence in 2016 relating to the Asheville site, CTS increased its accrual for remediation and monitoring reserves, as set forth in Note 8. This increased amount reflects the most probable costs to remediate identified environmental conditions at the site for which costs can be reasonably estimated. CTS understands that some additional work may be needed to investigate and/or remediate groundwater that has migrated from the former plant property at Asheville, but the scope of the work has yet to be determined with the EPA. As assessments and cleanups proceed, the reserve will be adjusted based on progress made in determining the extent of remedial actions and related costs. In the opinion of management, based upon presently available information relating to all such matters, adequate provision for probable and estimable costs has been made.

CTS manufactures accelerator pedals for a number of automobile manufacturers, including subsidiaries of Toyota Motor Corporation (“Toyota”). In January 2010, Toyota initiated a recall of a substantial number of vehicles in North America containing pedals manufactured by CTS. The recall expanded to include vehicles in Europe and Asia. The pedal recall and associated events have led to CTS being named as a co-defendant with Toyota in certain litigation in the United States and Canada. CTS is not aware of any legal actions filed in Asia or Europe against CTS at this time. In February 2010, CTS entered into an agreement with Toyota whereby Toyota agreed that it will indemnify, defend, and hold CTS harmless from, and the parties will cooperate in the defense of, third-party civil claims and actions that are filed or asserted in the United States or Canada and that arise from or relate to alleged incidents of unintended acceleration of Toyota and Lexus vehicles. The limited exceptions to indemnification restrict CTS’ share of any liability to amounts collectable from its insurers.

Certain other claims are pending against CTS with respect to matters arising out of the ordinary conduct of CTS’ business. In the opinion of management, based upon past experience and presently available information, either adequate provision for anticipated costs has been reserved or the ultimate anticipated costs will not materially affect CTS’ consolidated financial position, results of operations, or cash flows.

NOTE 10 - Debt

Long-term debt was comprised of the following:

(\$ in thousands)	As of June 28, 2015	December 31, 2014
Revolving credit facility due in 2017	\$ 88,700	\$ 75,000
Weighted average interest rate	1.4 %	1.5 %
Amount available	\$ 108,985	\$ 122,535
Total credit facility	\$ 200,000	\$ 200,000
Standby letters of credit	\$ 2,315	\$ 2,465
Commitment fee percentage per annum	0.25	0.25

The revolving credit facility requires, among other things, that CTS comply with a maximum total leverage ratio and a minimum fixed charge coverage ratio. Failure of CTS to comply with these covenants could reduce the borrowing availability under the revolving credit facility. CTS was in compliance with all debt covenants at June 28, 2015. The revolving credit facility requires CTS to deliver quarterly financial statements, annual financial statements, auditors certifications and compliance certificates within a specified number of days after the end of a quarter and year. Additionally, the revolving credit facility contains restrictions limiting CTS' ability to: dispose of assets; incur certain additional debt; repay other debt or amend subordinated debt instruments; create liens on assets; make investments,

loans or advances; make acquisitions or engage in mergers or consolidations; engage in certain transactions with CTS' subsidiaries and affiliates; and make stock repurchases and dividend payments. Interest rates on the revolving credit facility fluctuate based upon the London Interbank Offered Rate and the Company's quarterly total leverage ratio. CTS pays a commitment fee on the undrawn portion of the revolving credit facility. The commitment fee varies based on the quarterly leverage ratio.

CTS has debt issuance costs related to its long-term debt that are being amortized using the straight-line method over the life of the debt. Amortization expense was approximately \$50,000 for the three months ended June 28, 2015 and approximately \$100,000 for the six months ended June 28, 2015 and was recognized as interest expense.

CTS uses interest rate swaps to convert the revolving credit facility's variable rate of interest into a fixed rate. In the second quarter of 2012, CTS entered into four separate interest rate swap agreements to fix interest rates on \$50,000,000 of long-term debt for the periods January 2013 to January 2017. In the third quarter of 2012, CTS entered into four separate interest rate swap agreements to fix interest rates on \$25,000,000 of long-term debt for the periods January 2013 to January 2017. The difference to be paid or received under the terms of the swap agreements will be recognized as an adjustment to interest expense when settled.

These swaps are treated as cash flow hedges and consequently, the changes in fair value were recorded in Other comprehensive income. The estimated net amount of the existing gains or losses that are reported in accumulated other comprehensive income that is expected to be reclassified into earnings within the next twelve months is approximately \$480,000. Interest rate swaps activity recorded in Other comprehensive earnings before tax includes the following:

(\$ in thousands)	Three Months Ended		Six Months Ended	
	June 28, 2015	June 29, 2014	June 28, 2015	June 29, 2014
Unrealized loss	\$ (82)	\$ (360)	\$ (409)	\$ (414)
Realized gain reclassified to interest expense	\$ 192	\$ 122	\$ 382	\$ 240

Interest rate swaps included on the balance sheets are comprised of the following:

(\$ in thousands)	As of	
	June 28, 2015	December 31, 2014
Accrued liabilities	\$ 788	\$ 640
Other long-term obligations	\$ 259	\$ 380

NOTE 11 – Other Comprehensive Income

Shareholders' equity includes certain items classified as Accumulated other comprehensive (loss) income ("AOCI") in the Consolidated Balance Sheets, including:

- Unrealized gains (losses) on hedges relate to interest rate swaps to convert the line of credit's variable rate of interest into a fixed rate. These hedges are designated as cash flow hedges, and CTS has deferred income statement recognition of gains and losses until the hedged transaction occurs. Amounts reclassified to income from AOCI for hedges are included in interest expense. Further information related to CTS' interest rate swaps is included in NOTE 10 – Debt and NOTE 14 – Fair Value Measurement.
- Unrealized gains (losses) on pension obligations are deferred from income statement recognition until the gains or losses are realized. Amounts reclassified to income from AOCI are included in net periodic pension expense. Further information related to CTS' pension obligations is included in NOTE 5 – Retirement Plans.
- Cumulative translation adjustment relates to our non-U.S. subsidiary companies that have designated a functional currency other than the U.S. dollar. CTS is required to translate the subsidiary functional currency financial statements to dollars using a combination of historical, period-end, and average foreign exchange rates. This combination of rates creates the foreign currency translation adjustment component of other comprehensive income. Changes in exchange rates between the functional currency and the currency in which a transaction is denominated is a foreign exchange transaction gain or loss. Transaction loss for the six month period ended June 28, 2015 was \$1,563,000 which is included in Other in the Condensed Consolidated Statement of Earnings.

The components of other comprehensive loss for the three months ended June 28, 2015 are as follows:

(\$ in thousands)	As of March 29, 2015	Gain (Loss) Recognized in OCI	Gain (Loss) reclassified from AOCI to income	As of June 28, 2015
Changes in fair market value of hedges:				
Gross	\$ (1,157)	\$ (82)	\$ 192	\$ (1,047)
Income tax (benefit)	(435)	(31)	72	(394)
Net	(722)	(51)	120	(653)
Changes in unrealized pension cost:				
Gross	(167,361)	1,199	—	(166,162)
Income tax (benefit)	(64,451)	494	—	(63,957)
Net	(102,910)	705	—	(102,205)
Cumulative translation adjustment:				
Gross	(491)	1,064	—	573
Income tax (benefit)	42	(427)	—	(385)
Net	(533)	1,491	—	958
Total accumulated other comprehensive (loss) income	\$ (104,165)	\$ 2,145	\$ 120	\$ (101,900)

Edgar Filing: CTS CORP - Form 10-Q

The components of other comprehensive loss for the three months ended June 29, 2014 are as follows:

(\$ in thousands)	As of March 30, 2014	Gain (Loss) Recognized in OCI	Gain (Loss) reclassified from AOCI to income	As of June 29, 2014
Changes in fair market value of hedges:				
Gross	\$ (934)	\$ (358)	\$ 122	\$ (1,170)
Income tax (benefit)	(378)	(136)	47	(467)
Net	(556)	(222)	75	(703)
Changes in unrealized pension cost:				
Gross	(136,683)	1,251	172	(135,260)
Income tax (benefit)	(54,492)	470	66	(53,956)
Net	(82,191)	781	106	(81,304)
Cumulative translation adjustment:				
Gross	1,082	388	—	1,470
Income tax (benefit)	(926)	(229)	—	(1,155)
Net	2,008	617	—	2,625
Total accumulated other comprehensive (loss) income	\$ (80,739)	\$ 1,176	\$ 181	\$ (79,382)

The components of other comprehensive loss for the six months ended June 28, 2015 are as follows:

(\$ in thousands)	As of December 31, 2014	Gain (Loss) Recognized in OCI	Gain (Loss) reclassified from AOCI to income	As of June 28, 2015
Changes in fair market value of hedges:				
Gross	\$ (1,020)	\$ (409)	\$ 382	\$ (1,047)
Income tax (benefit)	(384)	(154)	144	(394)
Net	(636)	(255)	238	(653)
Changes in unrealized pension cost:				
Gross	(169,291)	3,129	—	(166,162)
Income tax (benefit)	(65,124)	1,167	—	(63,957)
Net	(104,167)	1,962	—	(102,205)
Cumulative translation adjustment:				
Gross	245	328	—	573
Income tax (benefit)	(325)	(60)	—	(385)

Edgar Filing: CTS CORP - Form 10-Q

Net	570	388	—	958
Total accumulated other comprehensive (loss) income	\$ (104,233)	\$ 2,095	\$ 238	\$ (101,900)

The components of other comprehensive loss for the six months ended June 29, 2014 are as follows:

(\$ in thousands)	As of December 31, 2013	Gain (Loss) Recognized in OCI	Gain (Loss) reclassified from AOCI to income	As of June 29, 2014
Changes in fair market value of hedges:				
Gross	\$ (998)	\$ (412)	\$ 240	\$ (1,170)
Income tax (benefit)	(402)	(157)	92	(467)
Net	(596)	(255)	148	(703)
Changes in unrealized pension cost:				
Gross	(138,133)	2,701	172	(135,260)
Income tax (benefit)	(55,028)	1,006	66	(53,956)
Net	(83,105)	1,695	106	(81,304)
Cumulative translation adjustment:				
Gross	949	521	—	1,470
Income tax (benefit)	(855)	(300)	—	(1,155)
Net	1,804	821	—	2,625
Total accumulated other comprehensive (loss) income	\$ (81,897)	\$ 2,261	\$ 254	\$ (79,382)

NOTE 12 – Shareholders’ Equity

Share count and par value data related to shareholders’ equity are as follows:

	As of June 28, 2015	December 31, 2014
Preferred Stock		
Par value per share	No par value	No par value
Shares authorized	25,000,000	25,000,000
Shares outstanding	—	—
Common Stock		
Par value per share	No par value	No par value
Shares authorized	75,000,000	75,000,000

Edgar Filing: CTS CORP - Form 10-Q

Shares issued	56,240,253	56,101,700
Shares outstanding	32,903,731	33,392,060
Treasury stock		
Shares held	23,336,522	22,709,640

CTS uses the cost method to account for its common stock purchases. During the six month period ended June 28, 2015, CTS purchased 626,882 shares of common stock for an aggregate of \$11,369,132 under a board-authorized share repurchase plan. For the six month period ended June 29, 2014, CTS purchased 211,270 shares of common stock for an aggregate of \$3,732,000. Approximately 9,517,922 shares are available for future issuances.

A roll forward of common shares outstanding is as follows:

	Six Months Ended	
	June 28, 2015	June 29, 2014
Balance at the beginning of the year	33,392,060	33,558,864
Repurchases	(626,882)	(211,270)
Shares issued upon exercise of stock options	5,200	101,350
Restricted share issuances	133,353	169,937
Balance at the end of the period	32,903,731	33,618,881

NOTE 13 - Equity-Based Compensation

At June 28, 2015, CTS had five equity-based compensation plans: the 2001 Stock Option Plan (“2001 Plan”), the Nonemployee Directors’ Stock Retirement Plan (“Directors’ Plan”), the 2004 Omnibus Long-Term Incentive Plan (“2004 Plan”), the 2009 Omnibus Equity and Performance Incentive Plan (“2009 Plan”), and the 2014 Performance & Incentive Plan (“2014 Plan”). Future grants can only be made under the 2014 Plan.

The 2009 Plan, and previously the 2001 Plan and 2004 Plan, provides for grants of incentive stock options or nonqualified stock options to officers, key employees, and nonemployee members of CTS’ Board of Directors. In addition, the 2014 Plan, the 2009 Plan and the 2004 Plan allow for grants of stock appreciation rights, restricted stock, RSUs, performance shares, performance units, and other stock awards.

Edgar Filing: CTS CORP - Form 10-Q

The following table summarizes the compensation expense included in Selling, general and administrative expenses in the Consolidated Statements of Earnings related to equity-based compensation plans:

(\$ in thousands)	Three Months Ended		Six Months Ended	
	June 28, 2015	June 29, 2014	June 28, 2015	June 29, 2014
Service-Based RSUs	\$ 400	\$ 210	\$ 949	\$ 683
Performance-Based RSUs	251	99	771	273
Market-Based RSUs	191	91	642	223
Total	\$ 842	\$ 400	\$ 2,362	\$ 1,179
Income tax benefit	\$ 317	\$ 153	\$ 888	\$ 450

The following table summarizes the unrecognized compensation expense related to non-vested RSUs by type and the weighted-average period in which the expense is to be recognized:

(\$ in thousands)	Unrecognized compensation expense at June 28, 2015	Weighted-average period
Service-Based RSUs	\$ 1,886	1.2 years
Performance-Based RSUs	1,656	1.4 years
Market-Based RSUs	988	1.3 years
Total	\$ 4,530	

CTS recognizes expense on a straight-line basis over the requisite service period for each separately vesting portion of the award as if the award was, in substance, multiple awards.

The following table summarizes the status of these plans as of June 28, 2015:

	2014 Plan	2009 Plan	2004 Plan	2001 Plan
Awards originally available	1,500,000	3,400,000	6,500,000	2,000,000
Stock options outstanding	—	—	—	—
RSUs outstanding	78,947	248,389	129,025	—
Options exercisable	—	—	—	—
Awards available for grant	1,352,075	1,617,062	106,423	—

Stock Options

Stock options are exercisable in cumulative annual installments over a maximum 10-year period, commencing at least one year from the date of grant. Stock options are generally granted with an exercise price equal to the market price of CTS' stock on the date of grant. The stock options generally vest over four years and have a 10-year contractual life. The awards generally contain provisions to either accelerate vesting or allow vesting to continue on schedule upon retirement if certain service and age requirements are met. The awards also provide for accelerated vesting if there is a change in control event.

CTS estimated the fair value of the stock option on the grant date using the Black-Scholes option-pricing model and assumptions for expected price volatility, option term, risk-free interest rate, and dividend yield. Expected price volatilities were based on historical volatilities of CTS' common stock. The expected option term is derived from historical data on exercise behavior. The dividend yield was based on historical dividend payments. The risk-free rate for periods within the contractual life of the option was based on the U.S. Treasury yield curve in effect at the time of grant.

A summary of the status of stock options as of June 28, 2015, and changes during the period then ended, is presented below:

	Six Months Ended June 28, 2015	
	Options	Weighted Average Exercise Price
Outstanding at beginning of year	5,200	\$ 12.35
Exercised	(5,200)	\$ 12.35
Outstanding at end of period	—	\$ —
Exercisable at end of period	—	\$ —

Performance-Based Stock Options

During the second quarter of 2015, the Compensation Committee of the Board of Directors of the Company (the "Committee") granted a total of 430,000 performance-based stock option awards ("Performance-Based Option Awards") for certain CTS employees under the 2014 Plan. The Performance-Based Option Awards, which have a grant date of May 26, 2015 and a grant date fair value of \$18.37, are subject to the terms of the 2014 Plan. The Performance-Based Option Awards generally have a term of five years and generally will become exercisable (provided the optionee remains employed by CTS or an affiliate) upon CTS' attainment of at least \$600,000,000 in revenues during any of CTS' four-fiscal-quarter trailing periods (as determined by the Committee) during the term. CTS has not recognized any expense on these Performance-Based Option Awards for the six months ended June 28, 2015 since the revenue target is not likely to be attained, based upon the Company's earnings history and forecast, at this time.

Service-Based Restricted Stock Units

Service-based RSUs entitle the holder to receive one share of common stock for each unit when the unit vests. RSUs are issued to officers, key employees and non-employee directors as compensation. Generally, the RSUs vest over a three-year period. RSUs granted to non-employee directors vest one month after granted. Upon vesting, the non-employee directors elect to either receive the stock associated with the RSU immediately, or defer receipt of the stock until their retirement from the Board of Directors. The fair value of the RSUs is equivalent to the trading value of CTS' common stock on the grant date.

A summary of the status of RSUs is presented below:

	Six Months Ended June 28, 2015	
	Units	Weighted Average Grant Date Fair Value
Outstanding at January 1, 2015	517,965	\$ 12.06
Granted	114,025	16.93
Converted	(163,633)	12.34
Forfeited	(11,996)	16.78
Outstanding at June 28, 2015	456,361	\$ 13.05

Performance-Based Restricted Stock Units

CTS grants performance-based restricted stock unit awards for certain executives. Vesting may occur in the range from zero percent to 200% of the target amount. Vesting is subject to certification of the fiscal results of the year prior to the target year by CTS' independent auditors. Vesting is dependent upon CTS' achievement of either sales growth targets or cash flow targets as noted in the table below.

Performance-Based RSUs include the following components:

Grant Date	Target Units	Vesting Year	Vesting Dependency	Units Awarded
February 11, 2013	47,164	2016	Sales growth	—
February 11, 2013	40,425	2016	Cash flow	—

Edgar Filing: CTS CORP - Form 10-Q

February 14, 2014	22,538	2017	Sales growth	—
February 14, 2014	19,319	2017	Cash flow	—
February 13, 2015	30,993	2018	Sales growth	—
February 13, 2015	26,565	2018	Cash flow	—

Market-Based Restricted Stock Units

CTS grants market-based restricted stock unit awards for certain executives and key employees. Vesting may occur in the range from zero percent to 200% of the target amount. Vesting is subject to certification of the fiscal results of the year prior to the target year by CTS' independent auditors. The vesting rate will be determined using a matrix based on a percentile ranking of CTS total stockholder return with peer group total shareholder return over a three-year period. Vesting is tied exclusively to CTS total stockholder return relative to peer group companies' total stockholder return rates.

Market-Based RSUs include the following components:

Grant Date	Target Units	Vesting Year	Number of Peer Group Companies	Units Awarded
February 11, 2013	40,425	2016	20	—
February 11, 2013	48,750	2016	20	—
February 14, 2014	22,538	2017	15	—
February 13, 2015	30,993	2018	23	—

NOTE 14 — Fair Value Measurements

CTS uses interest rate swaps to convert the line of credit's variable rate of interest into a fixed rate. The interest rate swaps are measured at fair value on a recurring basis. The table below summarizes CTS' financial liability that was measured at fair value as of three month period June 28, 2015 and the loss recorded during the six month period ended June 28, 2015:

Quoted
Prices

Edgar Filing: CTS CORP - Form 10-Q

(\$ in thousands)	Carrying Value at June 28, 2015	in Active Markets for Identical Instruments (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Loss for Six Months Ended June 28, 2015
Interest rate swap – cash flow hedge	\$ 1,047	\$ —	\$ 1,047	\$ —	\$ 27

The table below summarizes the financial liability that was measured at fair value on a recurring basis as of December 31, 2014 and the loss recorded during the year ended December 31, 2014:

(\$ in thousands)	Carrying Value at December 31, 2014	Quoted Prices in Active Markets for Identical Instruments (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Loss for Year Ended December 31, 2014
Interest rate swap – cash flow hedge	\$ 1,020	\$ —	\$ 1,020	\$ —	\$ 488

The fair value of CTS' interest rate swaps were measured using a market approach which uses current industry information. There is a readily determinable market and these swaps are classified within level 2 of the fair value hierarchy.

The table below provides a reconciliation of the recurring financial liability related to interest rate swaps:

(\$ in thousands)	Interest Rate Swaps
Balance at January 1, 2014	\$ (998)
Total gains (losses) for the period:	
Included in earnings	488
Included in other comprehensive earnings	(510)
Balance at December 31, 2014	\$ (1,020)
Total gains (losses) for the period:	
Included in earnings	382
Included in other comprehensive earnings	(409)
Balance at June 28, 2015	\$ (1,047)

CTS' long-term debt consists of a revolving credit facility which is recorded at its carrying value. There is a readily determinable market for CTS' revolving credit debt and it is classified within Level 2 of the fair value hierarchy as the market is not deemed to be active. The fair value of long-term debt was measured using a market approach which uses current industry information and approximates carrying value.

NOTE 15 — Income Taxes

The effective tax rates for 2015 and 2014 are as follows:

	Three Months Ended		Six Months Ended	
	June 28, 2015	June 29, 2014	June 28, 2015	June 29, 2014
Effective tax rate	(75.7)	% 34.0	(27.7)	% 38.7

The 2015 effective tax rate for the three months ended June 28, 2015 reflects two significant discrete items. First, there was an increase in the effective rate of 45.7 percentage points due to a reserve on an uncertain tax position. Second, there was a decrease in the effective rate of 145.5 percentage points due to CTS' intent to file amended tax returns for years ended 2006 to 2013, in which the treatment of foreign taxes will be changed from deductions to credits. For the six months ended June 28, 2015, the effect of the uncertain tax benefits increased the effective tax rate by 25.0 percentage points and the effect of amending the tax returns for 2006 to 2013 decreased the effective rate by 79.5 percentage points.

The 2014 effective tax rate reflected the effect of a tax adjustment that decreased the effective rate by 2.6 percentage points in the second quarter of 2014 and increased the effective rate by 2.7 percentage points in the first six months of 2014.

CTS' continuing practice is to recognize interest and/or penalties related to income tax matters as income tax expense. For the three and six months ended June 28, 2015 CTS accrued approximately \$820,000 of potential interest into income tax expense related to a foreign tax item. For the three and six months ended June 29, 2014, CTS did not accrue any interest or penalties into income tax expense.

NOTE 16 — Recent Accounting Pronouncements

ASU 2015-08, "Business Combinations (Topic 805): Pushdown Accounting – amendments to SEC Paragraphs Pursuant to Staff Accounting Bulletin No. 115"

In May 2015, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2015-08, "Business Combinations (Topic 805): Pushdown Accounting – amendments to SEC Paragraphs Pursuant to Staff Accounting Bulletin No. 115". This ASU amends various SEC paragraphs included in the FASB's ASC to reflect the issuance of Staff Accounting Bulletin ("SAB") No. 115. SAB 115 rescinds portions of the interpretive guidance included in the SEC's Staff Accounting Bulletin series and brings existing guidance into conformity with ASU 2014-17, Pushdown Accounting, which provides an acquired entity with an option to apply pushdown accounting in

its separate financial statements upon occurrence of an event in which an acquirer obtains control of the acquired entity.

An acquired entity is not only able to apply this amendment to change in control events occurring after the effective date, but is also permitted to apply pushdown accounting as a change in accounting principle to its most recent change in control event that had occurred before the effective date of this new amendment. The decision to apply pushdown accounting to a specific change in control event, if elected by an acquiree, is irrevocable.

The amendment also amends the reporting for a bargain purchase option. The acquired entity would not report a gain in its income statement as a result of a bargain purchase. Rather, the acquiree shall recognize the bargain purchase gain recognized by the acquirer as an adjustment to additional paid-in capital.

This amendment is effective immediately. These provisions are not anticipated to have a material impact on our financial statements.

ASU 2015-07, “Fair Value Measurement (Topic 820): Disclosures for Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent)”

In May 2015, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) 2015-07, “Fair Value Measurement (Topic 820): Disclosures for Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent)”. This ASU permits a reporting entity, as a practical expedient, to measure the fair value of certain investments using the net asset value per share of the investment. This amendment applies to reporting entities that elect to measure the fair value of an investment within the scope of paragraphs 820-10-15-4 through 15-5 using the net asset value per share (or its equivalent) practical expedient in paragraph 820-10-35-59. This amendment removes the requirement to categorize within the fair value hierarchy all investments for which fair value is measured using the net asset value per share practical expedient. It also removes the requirement to make certain disclosures for all investments that are eligible to be measured at fair value using the net asset value per share practical expedient. Rather, those disclosures are limited to investments for which the entity has elected to measure the fair value using that practical expedient.

The amendments will be effective for annual periods, including interim periods within those annual periods, beginning after December 15, 2015. Early adoption is permitted. An entity should apply the amendments retrospectively to all periods presented. The retrospective approach requires that an investment for which fair value is measured using the net asset value per share practical expedient be removed from the fair value hierarchy in all periods presented in an entity’s financial statements. These provisions are not anticipated to have a material impact on our financial statements.

ASU 2015-04, “Compensation – Retirement Benefits (Topic 715): Practical Expedient for the Measurement Date of an Employer’s Benefit Obligation and Plan Assets”

In April 2015, FASB issued ASU 2015-04, “Compensation – Retirement Benefits (Topic 715): Practical Expedient for the Measurement Date of an Employer’s Defined Benefit Obligation and Plan Assets”. The amended guidance permits companies to use a practical expedient which allows an employer to measure defined benefit plan assets and obligations as of the month-end date that is closest to the employer’s fiscal year-end (alternative measurement date). An employer using this policy election must apply it consistently to all of its defined benefit plans.

In accordance with this ASU, an employer using the practical expedient is required to adjust the funded status for contributions and other significant events (as defined in paragraph 715-30-35-66) occurring between the alternative measurement date and its fiscal year-end. Paragraph 715-30-35-66 defines a significant event as: a plan amendment, settlement, or curtailment that calls for remeasurement. This ASU also allows employers the use of the practical expedient in interim remeasurements of significant events.

The employer would be required to disclose the election to use the practical expedient and the measurement date of the plan assets and obligations. Early application of this ASU is permitted. Entities must apply the guidance prospectively.

The guidance is effective for financial statements for fiscal years beginning after December 15, 2015, and interim periods within those fiscal years. The changes would be effective for employee benefit plans for financial statements issued for fiscal years beginning after December 15, 2016, and interim periods within fiscal years beginning after December 15, 2017. These provisions are not anticipated to have a material impact on our financial statements.

ASU 2015-05, “Intangibles-Goodwill and Other-Internal-Use Software (Subtopic 350-40) Customer’s Accounting for Fees Paid in a Cloud Computing Arrangement”

In April 2015, the FASB issued ASU 2015-05, “Intangibles—Goodwill and Other—Internal-Use Software (Subtopic 350-40) Customer’s Accounting for Fees Paid in a Cloud Computing Arrangement”. The amendments in this ASU provide guidance to customers about a customer’s accounting for fees paid in a cloud computing arrangement. This ASU clarifies that if a cloud computing arrangement includes a software license, then the customer should account for the software license element of the arrangement consistent with the acquisition of other software licenses. If a cloud computing arrangement does not include a software license, the customer should account for the arrangement as a service contract. The guidance will not change U.S. GAAP for a customer’s accounting for service contracts. All software licenses within the scope of Subtopic 350-40 will be accounted for consistent with other licenses of intangible assets.

The amendments will be effective for annual periods, including interim periods within those annual periods, beginning after December 15, 2015. Early adoption is permitted. An entity can elect to adopt the amendments either prospectively to all arrangements entered into or materially modified after the effective date or retrospectively. For prospective transition, the disclosure requirements at transition include the nature of and reason for the change in accounting principle, the transition method, and a qualitative description of the financial statement line items affected by the change. For retrospective transition, the disclosure requirements at transition include the requirements for prospective transition and quantitative information about the effects of the accounting change. These provisions are not anticipated to have a material impact on our financial statements.

ASU 2015-03, “Interest – Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs”

In April 2015, the FASB issued ASU 2015-03, “Interest – Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs”. The amended guidance require that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. The recognition and measurement guidance for debt issuance costs are not affected by the amendments in this ASU. The amendments in this ASU are effective for financial statements issued for fiscal years beginning after December 15, 2015, and interim periods within those fiscal years.

Early adoption of this ASU is permitted for financial statements that have not been previously issued. Entities must apply the new guidance on a retrospective basis, wherein the balance sheet of each individual period presented should be adjusted to reflect the period-specific effects of applying the new guidance. Upon transition, an entity is required to comply with the applicable disclosures for a change in an accounting principle. These provisions are not anticipated to have a material impact on our financial statements.

ASU 2014-12, “Compensation – Stock Compensation (Topic 718): Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period”

In June 2014, the FASB issued ASU 2014-12, “Compensation — Stock Compensation (Topic 718): Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the

Requisite Service Period”. The amended guidance requires that a performance target that affects vesting and that could be achieved after the requisite service period should be treated as a performance condition.

Current U.S. GAAP does not contain explicit guidance on whether to treat a performance target that could be achieved after the requisite service period as a performance condition that affects vesting or as a nonvesting condition that affects the grant-date fair value of an award. The amendments in this update provide explicit guidance for those awards.

The amendments are effective for annual periods and interim periods within those annual periods beginning after December 15, 2015. Earlier adoption is permitted. Entities may apply the amendments either prospectively to all awards granted or modified after the effective date, or retrospectively to all awards with performance targets that are outstanding as of the beginning of the earliest annual period presented in the financial statements and to all new or modified awards thereafter. These provisions are not anticipated to have a material impact on our financial statements.

ASU 2014-09, “Revenue from Contracts with Customers”

In May 2014, the FASB issued ASU 2014-09, “Revenue from Contracts with Customers”. The guidance in this ASU affects any entity that either enters into contracts with customers to transfer goods or services or enters into contracts for the transfer of nonfinancial assets unless those contracts are within the scope of other standards (for example, insurance contracts or lease contracts). The new revenue recognition guidance more closely aligns U.S. GAAP with International Financial Reporting Standards (“IFRS”). The core principle of the guidance is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services.

To achieve that core principle, an entity should apply the following steps:

Step 1: Identify the contract(s) with a customer.

Step 2: Identify the performance obligations in the contract.

Step 3: Determine the transaction price.

Step 4: Allocate the transaction price to the performance obligations in the contract.

Step 5: Recognize revenue when (or as) the entity satisfies a performance obligation.

The guidance is effective for annual periods beginning on or after December 15, 2017 and interim periods within that reporting period. Early adoption is permitted provided that it is not before the original effective date of December 15, 2016. These provisions of this guidance are still being evaluated. The impact on CTS' financial statements has not yet been determined.

Table of Contents

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A")

The following discussion should be read in conjunction with our unaudited Condensed Consolidated Financial Statements and notes included under Item 1, as well as our Consolidated Financial Statements and notes and related Management's Discussion and Analysis of Financial Condition and Results of Operations included in our Annual Report on Form 10-K for the year ended December 31, 2014.

Overview

CTS Corporation ("CTS", "we", "our" or "us") is a global manufacturer of electronic components and sensors used primarily in the automotive, communications, defense and aerospace, medical, industrial and computer markets.

Results of Operations: Second Quarter 2015 versus Second Quarter 2014

The following table highlights changes in significant components of the Unaudited Condensed Consolidated Statements of Earnings for the quarters ended June 28, 2015 and June 29, 2014:

(Amounts in thousands, except percentages and per share amounts)	Three Months Ended		Percent Change	Percent of Net Sales – 2015	Percent of Net Sales – 2014
	June 28, 2015	June 29, 2014			
Net sales	\$ 100,071	\$ 102,980	(2.8)	100.0	100.0
Cost of goods sold(1)	66,698	69,157	(3.6)	66.7	67.2
Gross margin	33,373	33,823	(1.3)	33.3	32.8
Selling, general and administrative expenses	15,224	15,813	(3.7)	15.2	15.4
Research and development expenses	5,487	5,332	2.9	5.5	5.2
Restructuring and impairment charges	2,118	2,733	(22.5)	2.1	2.7
Total operating expenses	22,829	23,878	(4.4)	22.8	23.2
Operating earnings	10,544	9,945	6.0	10.5	9.7
Other (expense) income	315	(303)	(204.0)	0.3	(0.3)
Earnings before income taxes	10,859	9,642	12.6	10.9	9.4
Income tax expense (benefit)	(8,221)	3,281	(350.6)	(8.2)	3.2
Net earnings	\$ 19,080	\$ 6,361	200.0	19.1	6.2
Earnings per share:					
Diluted net earnings per share	\$ 0.57	\$ 0.19			

(1) Cost of goods sold includes restructuring related charges of \$217 in 2015 and \$338 in 2014.

Sales of \$100,071,000 in the second quarter of 2015 decreased \$2,909,000 or 2.8% from the second quarter of 2014. Sales to automotive markets decreased \$2,819,000 of which approximately \$2,100,000 was due to the U.S. Dollar

appreciating compared to the Euro.

Gross margin as a percent of sales was 33.3% in the second quarter of 2015 compared to 32.8% in the second quarter of 2014. The increase in gross margin resulted from continued efficiency gains, material and labor productivity projects and savings from restructuring projects implemented over the past several quarters. The impact of foreign currency on gross margin was negligible. The unfavorable impact on sales was offset by a favorable impact on cost as the U.S. Dollar appreciated against various local currencies in countries in which we have manufacturing operations.

Selling, general and administrative expenses were \$15,224,000 or 15.2% of sales in the second quarter of 2015 versus \$15,813,000 or 15.4% of sales in the comparable quarter of 2014. The decrease in the second quarter of 2015 was primarily due to continued efficiency gains from restructuring projects implemented over the past several quarters.

Research and development expenses were \$5,487,000 or 5.5% of sales in the second quarter of 2015 compared to \$5,332,000 or 5.2% of sales in the comparable quarter of 2014. Research and development expenses are focused on expanded applications of existing products and new product development as well as current product and process enhancements.

Restructuring and impairment charges in the second quarter totaled \$2,118,000 and consist primarily of severance, transition and shutdown costs related to the consolidation of CTS' Canadian operation in Streetsville, Ontario into other CTS facilities. Also included in the 2015 charges are costs to close the Brugg facility as well as other severance and restructuring costs in Singapore. The second quarter 2014 restructuring charges totaled \$2,733,000 and consist primarily of severance accruals related to the consolidation of CTS' Canadian operation into other CTS facilities. Restructuring related costs included in cost of goods sold are primarily equipment related relocation costs which were higher in the second quarter of 2014 when compared to the second quarter of 2015.

Operating earnings were \$10,544,000 or 10.5% of sales in the second quarter of 2015 compared to \$9,945,000 or 9.7% of sales in the comparable quarter of 2014 as a result of the items discussed above. Other income and expense items are summarized in the following table:

(\$ in thousands)	Three Months Ended	
	June 28, 2015	June 29, 2014
Interest expense	\$ (653)	\$ (582)
Interest income	853	688
Other (expense) income, net	115	(409)
Total other (expense) income	\$ 315	\$ (303)

Interest expense increased slightly in the second quarter of 2015 versus the second quarter of 2014. Interest income increased primarily due to higher cash balances. The increase in other expense in the second quarter of 2015 was driven by favorable foreign currency gains, primarily due to the appreciation of the U.S. Dollar compared to the Euro and Chinese Renminbi, while other expense in the second quarter of 2014 was driven by foreign currency translation losses, primarily due to the depreciation of the U.S. Dollar compared to the Chinese Renminbi.

	Three Months Ended			
	June 28, 2015		June 29, 2014	
Effective tax rate	(75.7)	%	34.0	%

The effective income tax rate for the second quarter of 2015 was negative 75.7% which reflects two significant discrete items. First, there was an increase in the effective rate of 45.7 percentage points due to a reserve on an uncertain tax position. Second, there was a decrease in the effective rate of 145.5 percentage points due to CTS' intent to file amended tax returns for the years ended 2006 through 2013, in which the treatment of foreign taxes will be changed from deductions to credits. CTS will also file its 2014 tax return treating foreign taxes as a credit. In the second quarter of 2014, the effective tax rate was 34.0%.

Results of Operations: Six months ended June 28, 2015 versus six months ended June 29, 2014

The following table highlights changes in significant components of the Unaudited Condensed Consolidated Statements of Earnings for the six month periods ended June 28, 2015 and June 29, 2014:

(Amounts in thousands, except percentages and per share amounts):

(Amounts in thousands, except percentages and per share amounts)	Six months ended			Percent of Net Sales – 2015	Percent of Net Sales – 2014
	June 28, 2015	June 29, 2014	Percent Change		
Net sales	\$ 198,382	\$ 203,686	(2.6)	100.0	100.0
Cost of goods sold(1)	132,873	139,248	(4.6)	67.0	68.4
Gross margin	65,509	64,438	1.7	33.0	31.6
Selling and general and administrative expenses	30,935	29,454	5.0	15.6	14.5
Research and development expenses	10,686	10,958	(2.5)	5.4	5.4
Restructuring and impairment charges	2,856	3,236	(11.7)	1.4	1.6
Total operating expenses	44,477	43,648	1.9	22.4	21.4
Operating earnings	21,032	20,790	1.2	10.6	10.2
Other expense	(1,169)	(2,123)	(44.9)	(0.6)	(1.0)
Earnings from continuing operations before income taxes	19,863	18,667	6.4	10.0	9.2
Income tax expense (benefit)	(5,504)	7,226	(176.2)	(2.8)	3.5
Net earnings	\$ 25,367	\$ 11,441	121.7	12.8	5.6
Earnings per share:					
Diluted net earnings per share	\$ 0.75	\$ 0.33			

Edgar Filing: CTS CORP - Form 10-Q

(1) Cost of goods sold includes restructuring related costs of \$292 in 2015 and \$910 in 2014.

Sales of \$198,382,000 in the first six months of 2015 decreased \$5,304,000 or 2.6% from the comparable period of 2014. Sales to automotive markets decreased \$6,522,000 of which approximately \$4,500,000 was due to the U.S. Dollar appreciating compared to the Euro and Chinese Renminbi. Other sales were \$1,218,000 higher driven by higher shipments of electronic components.

Gross margin as a percent of sales was 33.0% in the first six months of 2015 versus 31.6% in the comparable period of 2014. The increase in gross margin resulted from productivity improvements, mix and favorable foreign exchange impact on operating results and continued benefits from prior restructuring actions.

Selling, general and administrative expenses were \$30,935,000 or 15.6% of sales in the six month period of 2015 versus \$29,454,000 or 14.5% of sales in the comparable period of 2014. The slight increase in 2015 is attributable to higher employee related costs.

Research and development expenses were \$10,686,000 or 5.4% of sales in the six month period ending June 28, 2015 compared to \$10,958,000 or 5.4% of sales in the comparable period of 2014. Research and development expenses are primarily focused on expanded applications of existing products and new product development as well as current product and process enhancements.

Restructuring and impairment charges for the six month period ending June 28, 2015 totaled \$2,856,000 and consist primarily of severance, training and shutdown costs related to the consolidation of CTS' Canadian operation in Streetsville, Ontario into other CTS facilities. Also included in 2015 are costs to close the Brugg facility as well as other severance and restructuring costs in Singapore. Restructuring and impairment charges for the six month period ending June 29, 2014 totaled \$3,236,000 and consist primarily of severance costs related to the consolidation of CTS' Canadian operation as well as severance and other restructuring costs related to the June 2013 Restructuring Plan.

Operating earnings were \$21,032,000 or 10.6% of sales for the six month period ending June 28, 2015 compared to \$20,790,000 or 10.2% of sales in the comparable period of 2014 as a result of the items discussed above. Other income and expense items are summarized in the following table:

(\$ in thousands)	Six Months Ended	
	June 28, 2015	June 29, 2014
Interest expense	\$ (1,241)	\$ (1,195)
Interest income	1,641	1,252
Other income, net	(1,569)	(2,180)
Total other income (expense)	\$ (1,169)	\$ (2,123)

Interest expense increased slightly in the six month period ending June 28, 2015 versus the comparable period in 2014 as a result of higher outstanding borrowings in 2015. Interest income increased primarily due to higher cash balances. Other expense in the six month period ending June 28, 2015 has decreased as the amount of currency related impact in 2015 was lower than foreign currency impact in same period of 2014.

Edgar Filing: CTS CORP - Form 10-Q

	Six Months Ended	
	June 28, 2015	June 29, 2014
Effective tax rate	(27.7) %	38.7 %

The effective income tax rate for the six months ending June 28, 2015 was a negative 27.7% which reflects two significant discrete items. First, there was an increase in the effective rate of 25.0 percentage points due to a reserve on an uncertain tax position. Second, there was a decrease in the effective rate of 79.5 percentage points due to CTS' intent to file amended tax returns for the years ended 2006 through 2013, in which the treatment of foreign taxes will be changed from deductions to credits. CTS will also file its 2014 tax return treating foreign taxes as a credit. The effective income tax rate for the six months ending June 29, 2014 was 38.7%. The 2014 effective rate includes the effect of tax adjustments for the first six months of 2014 which increased the effective rate by 2.7 percentage points.

Liquidity and Capital Resources

Cash and cash equivalents were \$146,791,000 at June 28, 2015 and \$134,508,000 at December 31, 2014. The increase in cash and cash equivalents was driven by cash generated from operations which exceeded the cash used for financing and investing activities. Total debt as of June 28, 2015 was \$88,700,000 and at December 31, 2014 was \$75,000,000. Total debt as a percentage of total capitalization was 22.5% at June 28, 2015 compared to 20.6% at December 31, 2014. Total debt as a percentage of total capitalization is defined as the sum of notes payable and long-term debt as a percentage of total debt and shareholders' equity.

Working capital increased by \$17,759,000 from December 31, 2014 to June 28, 2015, primarily due to a \$6,152,000 increase in accounts receivable, a \$12,283,000 increase in cash and cash equivalents, and a \$2,537,000 increase in inventories which were partially offset by a \$2,381,000 increase in accounts payable.

Cash Flows from Operating Activities

Net cash provided by operating activities was \$15,494,000 during the first six months of 2015. Components of net cash provided by operating activities included net earnings of \$25,367,000, depreciation and amortization expense of \$8,093,000 and net changes of other non-cash items such as the prepaid pension asset, equity based compensation, restructuring charges and amortization of retirement benefits totaling \$4,092,000 which were offset by net changes in assets and liabilities of \$22,058,000. The net changes in assets and liabilities were primarily driven by increases in deferred income taxes and accounts receivable.

Cash Flows from Investing Activities

Net cash used in investing activities for the first six months of 2015 was \$3,902,000, which was primarily for capital expenditures.

Cash Flows from Financing Activities

Net cash used by financing activities for the first six months of 2015 was \$126,000. The primary driver for the cash inflow from financing activities was a \$13,700,000 increase in net borrowings, which was offset by \$11,369,000 paid to purchase shares of CTS common stock and \$2,668,000 of dividend payments.

Capital Resources

Edgar Filing: CTS CORP - Form 10-Q

CTS has an unsecured revolving credit facility, which matures on January 10, 2017.

Long term debt was comprised of the following:

(\$ in thousands)	June 28, 2015	December 31, 2014
Revolving credit facility due in 2017	\$ 88,700	\$ 75,000
Weighted average interest rate	1.4 %	1.5 %
Amount available	\$ 108,985	\$ 122,535
Total credit facility	\$ 200,000	\$ 200,000
Standby letters of credit	\$ 2,315	\$ 2,465
Commitment fee percentage per annum	0.25	0.25

The revolving credit facility requires, among other things, that CTS comply with a maximum total leverage ratio and a minimum fixed charge coverage ratio. Failure of CTS to comply with these covenants could reduce the borrowing availability under the revolving credit facility. CTS was in compliance with all debt covenants at June 28, 2015.

CTS uses interest rate swaps to convert the revolving credit facility's variable rate of interest into a fixed rate. In the second quarter of 2012, CTS entered into four separate interest rate swap agreements to fix interest rates on \$50,000,000 of long-term debt for the periods January 2013 to January 2017. In the third quarter of 2012, CTS entered into four separate interest rate swap agreements to fix interest rates on \$25,000,000 of long-term debt for the periods January 2013 to January 2017. The difference to be paid or received under the terms of the swap agreements will be recognized as an adjustment to interest expense when settled.

During the first six months of 2015, we repurchased 626,882 shares of CTS common stock at a total cost of \$11,369,000, or an average price of \$18.14 per share.

As of June 28, 2015, CTS' intent is to permanently reinvest funds outside the U.S. Any repatriation may not result in significant cash income tax payments as the taxable event would likely be offset by the utilization of the then available net operating losses and tax credits. CTS does not provide for U.S. income taxes on undistributed earnings of its foreign subsidiaries that are intended to be permanently reinvested.

We have historically funded our capital and operating needs primarily through cash flows from operating activities, supported by available credit under our credit agreements. We believe that cash flows from operating activities and available borrowings under our current credit agreements will be adequate to fund our working capital, capital expenditures and debt service requirements for at least the next twelve months. However, we may choose to pursue additional equity and debt financing to provide additional liquidity or to fund acquisitions.

Critical Accounting Policies and Estimates

Management prepared the consolidated financial statements of CTS under accounting principles generally accepted in the United States of America. These principles require the use of estimates, judgments and assumptions. We believe that the estimates, judgments and assumptions we used are reasonable, based upon the information available.

Our estimates and assumptions affect the reported amounts in our financial statements. The following accounting policies comprise those that we believe are the most critical in understanding and evaluating CTS' reported financial results.

Revenue Recognition

Product revenue is recognized once four criteria are met: (1) we have persuasive evidence that an arrangement exists; (2) delivery has occurred and title has passed to the customer, which generally happens at the point of shipment provided that no significant obligations remain; (3) the price is fixed and determinable; and (4) collectability is reasonably assured.

Accounts Receivable

We have standardized credit granting and review policies and procedures for all customer accounts, including:

- Credit reviews of all new customer accounts,

- Ongoing credit evaluations of current customers,

- Credit limits and payment terms based on available credit information,

- Adjustments to credit limits based upon payment history and the customer's current credit worthiness,

- An active collection effort by regional credit functions, reporting directly to the corporate financial officers, and

- Limited credit insurance on the majority of our international receivables.

We reserve for estimated credit losses based upon historical experience and specific customer collection issues. Over the last three years, accounts receivable allowance varied from 0.2% to 0.5% of total accounts receivable. We believe our allowance for doubtful accounts is appropriate considering the quality of the portfolio. While credit losses have historically been within expectations and the provisions established, we cannot guarantee that our credit loss experience will continue to be consistent with historical experience.

Inventories

We value our inventories at the lower of the actual cost to purchase or manufacture using the first in, first out ("FIFO") method, or the current estimated market value. We review inventory quantities on hand and record a reserve for excess and obsolete inventory based on forecasts of product demand and production requirements.

Over the last three years, our reserves for excess and obsolete inventories have ranged from 8.1% to 15.6% of gross inventory. We believe our reserve level is appropriate considering the quantities and quality of the inventories.

Retirement Plans

Actuarial assumptions are used in determining pension income and expense and our pension benefit obligation. We utilize actuaries from consulting companies in each country to develop our discount rates that match high quality bonds currently available and expected to be available during the period to maturity of the pension benefit in order to provide the necessary future cash flows to pay the accumulated benefits when due. After considering the recommendations of our actuaries, we have assumed a discount rate, expected rate of return on plan assets and a rate of compensation increase in determining our annual pension income and expense and the projected benefit obligation. During the fourth quarter of each year, we review our actuarial assumptions in light of current economic factors to determine if the assumptions need to be adjusted. Changes in the actuarial assumptions could have a material effect on our results of operations.

Valuation of Goodwill

Goodwill of a reporting unit is tested for impairment between annual tests if an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying amount. Examples of such events or circumstances include:

Significant adverse change in legal factors or in the business climate,

Adverse action or assessment by a regulator,

Unanticipated competition,

Loss of key personnel,

More likely than not expectation that a reporting unit or a significant portion of a reporting unit will be sold or otherwise disposed of,

Testing for recoverability of a significant asset group within a reporting unit, and

Allocation of a portion of goodwill to a business to be disposed of.

If CTS believes that one or more of the above indicators of impairment have occurred, it performs an impairment test. The performance of the test involves a two step process. The first step of the impairment test involves comparing the fair values of the applicable reporting units with their aggregate carrying values, including goodwill. We generally determine the fair value of our reporting units using two valuation methods: Income Approach — Discounted Cash Flow Method and Market Approach — Guideline Public Company Method. The approach defined below is based upon our last impairment test conducted as of December 31, 2014.

Under the “Income Approach — Discounted Cash Flow Method”, the key assumptions consider sales, cost of sales and operating expenses projected through the year 2018. These assumptions were determined by management utilizing our internal operating plan and assuming growth rates for revenues and operating expenses, and margin assumptions. The fourth key assumption under this approach is the discount rate which is determined by looking at current risk free rates of capital, current market interest rates and the evaluation of risk premium relevant to the business segment. If our assumptions relative to growth rates were to change or were incorrect, our fair value calculation may change which could result in impairment.

Under the “Market Approach — Guideline Public Company Method”, we identified eight publicly traded companies, including CTS, which we believe have significant relevant similarities. For these eight companies, we calculated the mean ratio of invested capital to revenues and invested capital to EBITDA. Similar to the Income approach discussed above, sales, cost of sales, operating expenses and their respective growth rates were the key assumptions utilized. The market prices of CTS and other guideline company shares are key assumptions. If these market prices increase, the estimated market value would increase. If the market prices decrease, the estimated market value would decrease.

The results of these two methods are weighted based upon management’s determination. The Market approach is based upon historical and current economic conditions, which might not reflect the long term prospects or opportunities for CTS’ business being evaluated.

If the carrying amount of a reporting unit exceeds the reporting unit’s fair value, we perform the second step of the goodwill impairment test to determine the amount of impairment loss. The second step of the goodwill impairment test involves comparing the implied fair value of the affected reporting unit’s goodwill with the carrying value of that goodwill.

There have not been any significant changes to our impairment testing methodology other than updating the assumptions to reflect the current market environment. As discussed above, key assumptions used in the first step of the goodwill impairment test were determined by management utilizing the internal operating plan. The key assumptions utilized include forecasted growth rates for revenues and operating expenses as well as a discount rate which is determined by looking at current risk free rates of capital, current market interest rates and the evaluation of a risk premium relevant to the business segment. CTS will monitor future results and will perform a test if indicators trigger an impairment review.

We test the impairment of goodwill whenever events or changes in circumstances indicate that the carrying value may not be recoverable. Based upon our latest assessment, we determined that our goodwill was not impaired as of the end of December 2014.

Valuation of Long Lived and Other Intangible Assets

We evaluate the impairment of identifiable intangibles and other long lived assets whenever events or changes in circumstances indicate that the carrying value may not be recoverable. Factors considered that may trigger an impairment review consist of:

- Significant underperformance relative to expected historical or projected future operating results,
- Significant changes in the manner of use of the acquired assets or the strategy for the overall business,
- Significant negative industry or economic trends,
- Significant decline in CTS' stock price for a sustained period, and
- Significant decline in market capitalization relative to net book value.

If CTS believes that one or more of the above indicators of impairment have occurred and the undiscounted cash flow test has failed in the case of amortizable assets, it measures impairment based on projected discounted cash flows using a discount rate that incorporates the risk inherent in the cash flows.

Income Taxes

CTS has identified, evaluated, and measured the amount of income tax benefits to be recognized for all of our income tax positions. Included in deferred tax assets are amounts related to federal, state and foreign net operating losses. CTS intends to utilize these net operating loss carryforwards to offset future income taxes.

CTS' practice is to recognize interest and penalties related to income tax matters as part of income tax expense.

CTS earns a significant amount of its operating income outside of the U.S., which is deemed to be permanently reinvested in foreign jurisdictions. CTS does not intend to repatriate funds, however, should CTS require more capital in the U.S. than is generated by our operations locally, CTS could elect to repatriate funds held in foreign jurisdictions or raise capital in the U.S. through debt or equity issuances. Repatriation could result in higher effective tax rates. Borrowing in the U.S. would result in increased interest expense.

Significant Customer

Our net sales to significant customers as a percentage of total net sales were as follows:

Edgar Filing: CTS CORP - Form 10-Q

	Three Months Ended June 28, 2015		2014		Six Months Ended June 28, 2015		2014	
Customer A	10.3 %	10.5 %	9.9 %	10.2 %				

No other customer accounted for 10% or more of total net sales during these periods.

Forward Looking Statements

This document contains statements that are, or may be deemed to be, forward looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These forward looking statements include, but are not limited to, any financial or other guidance, statements that reflect our current expectations concerning future results and events, and any other statements that are not based solely on historical fact. Forward looking statements are based on management's expectations, certain assumptions and currently available information. Readers are cautioned not to place undue reliance on these forward looking statements, which speak only as of the date hereof and are based on various assumptions as to future events, the occurrence of which necessarily are subject to uncertainties. These forward looking statements are made subject to certain risks, uncertainties and other factors, which could cause our actual results, performance or achievements to differ materially from those presented in the forward looking statements. Examples of factors that may affect future operating results and financial condition include, but are not limited to: changes in the economy generally and in respect to the business in which CTS operates; unanticipated issues in integrating acquisitions; the results of actions to reposition our business; rapid technological change; general market conditions in the automotive, communications, and computer industries, as well as conditions in the industrial, defense and aerospace, and medical markets; reliance on key customers; unanticipated natural disasters or other events; the ability to protect our intellectual property; pricing pressures and demand for our products; unanticipated developments that could occur with respect to contingencies such as litigation and environmental matters as well as any product liability claims; and risks associated with our international operations, including trade and tariff barriers, exchange rates and political and geopolitical risks. Many of these and other risks and uncertainties are discussed in further detail in Item 1A. of this Annual Report on Form 10 K for the fiscal year ended December 31, 2014. We undertake no obligation to publicly update our forward looking statements to reflect new information or events or circumstances that arise after the date hereof, including market or industry changes.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

There have been no material changes in our market risk since December 31, 2014.

Item 4. Controls and Procedures

Pursuant to Rule 13a-15(e) of the Securities and Exchange Act of 1934, management, under the direction of our Chief Executive Officer and Chief Financial Officer, evaluated our disclosure controls and procedures. Based on such evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective as of June 28, 2015.

Changes in Internal Control Over Financial Reporting

There were no changes in our internal control over financial reporting for the quarter ended June 28, 2015 that have materially affected or are reasonably likely to materially affect our internal control over financial reporting.

PART II - OTHER INFORMATION

Item 1. Legal Proceedings

We manufacture accelerator pedals for a number of automobile manufacturers, including subsidiaries of Toyota. In January 2010, Toyota initiated a recall of a substantial number of vehicles in North America containing pedals manufactured by CTS. The recall expanded to include vehicles in Europe and Asia. The pedal recall and associated events have led to us being named as a co-defendant with Toyota in certain litigation in the United States and Canada. CTS is not aware of any legal actions filed in Asia or Europe against CTS at this time.

In February 2010, we entered into an agreement with Toyota whereby Toyota agreed that it will indemnify, defend, and hold us harmless from, and the parties will cooperate in the defense of, certain third-party civil claims and actions that are filed or asserted in the United States or Canada and that arise from or relate to alleged incidents of unintended acceleration of Toyota and Lexus vehicles. Under our agreement with Toyota, if it is determined that CTS acted negligently in selecting materials or processes where we had sole control over the selection process, in failing to meet Toyota's specifications, or in making unapproved changes in component design or materials, and such negligence caused or contributed to a claim, we will be responsible for any judgment that may be rendered against us individually, or any portion of a judgment that may be allocated to us, but limited only to the extent of insurance collected from our insurers. Toyota would remain responsible to defend CTS in these actions and would remain responsible for any balance of the remaining liability over amounts recovered by insurance. The agreement also does not cover costs or liabilities in connection with government investigations, government hearings, or government recalls.

Presently, we have been served process and are a named co-defendant with Toyota in approximately thirty-one lawsuits. The claims generally fall into two categories, those that allege sudden unintended acceleration of Toyota vehicles led to injury or death, and those that allege economic harm to owners of Toyota vehicles related to vehicle defects. Some suits combine elements of both. Claims include demands for compensatory and special damages. To date, the only actions filed where we are aware we have been named as a co-defendant are civil actions filed in the United States or Canada. All currently open lawsuits are subject to the indemnification agreement described above. Some of these lawsuits arise out of incidents involving models for which we do not manufacture the pedal, such as all Lexus models, the Toyota Prius, and the Toyota Tacoma, or for which we manufacture only a portion of the pedals, such as the Toyota Camry. Many lawsuits have been consolidated in federal multidistrict litigation in the United States District Court, Southern District of California, though some remain in various other courts.

Certain other claims are pending against us with respect to matters arising out of the ordinary conduct of our business. For all other claims, in the opinion of management, based upon presently available information, either adequate provision for anticipated costs have been accrued or the ultimate anticipated costs will not materially affect our consolidated financial position, results of operations or cash flows. However, given the uncertainty, the complexity and the many variables involved in litigation and other claims, our actual costs may differ from our estimates.

Item 1A. Risk Factors

There have been no significant changes to our risk factors since December 31, 2014.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

The following table summarizes the repurchases of CTS common stock during the three months ended June 28, 2015 made by the Company under the initial repurchase program originally announced on June 11, 2013:

	(a) Total Number of Shares Purchased	(b) Average Price Paid per Share	(c) Total Number of Shares Purchased as Part of Plans or Program	(d) Maximum Number of Shares That May Yet Be Purchased Under the Plans or Programs(1)
Balance at March 29, 2015				423,767
March 30, 2015 – April 26, 2015	129,673	\$ 17.80	129,673	294,094
April 27, 2015 – May 24, 2015	170,453	\$ 18.26	170,453	123,641
May 25, 2015 – June 28, 2015(3)	123,641	\$ 18.84	123,641	—
Total(4)	423,767	\$ 18.28	423,767	

(1) On June 11, 2013, CTS announced that its Board of Directors authorized a program to repurchase up to one million shares of its common stock in the open market. This authorization has no expiration.

The following table summarizes the repurchases of CTS common stock during the three months ended June 28, 2015 made by the Company under the expanded repurchase program announced on April 27, 2015:

	(a) Total Number of Shares Purchased	(b) Average Price Paid per Share	(c) Total Number of Shares Purchased as Part of Plans or Program	(d) Maximum Dollar Value of Shares That May Yet Be Purchased Under the Plans or Programs(2)
Balance at March 29, 2015				\$ —
March 30, 2015 – April 26, 2015	—	\$ —	—	\$ —
April 27, 2015 – May 24, 2015	—	\$ —	—	\$ 25,000,000
May 25, 2015 – June 28, 2015(3)	38,263	\$ 19.02	38,263	\$ 24,272,100
Total(4)	38,263	\$ 19.02	38,263	

(2) On April 27, 2015, CTS announced that its Board of Directors authorized an expansion to its repurchase program by authorizing the purchase of an additional \$25 million dollars of its common stock in the open market. This authorization has no expiration.

- (3) The combined number of shares of stock repurchased for this period, including the shares listed in the first table above, is 161,904 at an average price of \$18.88.
- (4) The total combined number of shares of stock repurchased for this quarter, including the shares listed in the first table above, is 462,030 at an average price of \$18.35.

Table of Contents

Item 6. Exhibits

- (10)(a) Transition Agreement dated June 26, 2015, by and between CTS Corporation and Anthony Urban (incorporated by reference to Exhibit 10.1 to the Current Report on Form 8-K, filed with the SEC on July 1, 2015).
- (31)(a) Certification pursuant to Section 302 of the Sarbanes Oxley Act of 2002.
- (31)(b) Certification pursuant to Section 302 of the Sarbanes Oxley Act of 2002.
- (32)(a) Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes Oxley Act of 2002.
- (32)(b) Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes Oxley Act of 2002.
- 101.INS XBRL Instance Document
- 101.SCH XBRL Taxonomy Extension Schema Document
- 101.CAL XBRL Taxonomy Extension Calculation Linkbase Document
- 101.DEF XBRL Taxonomy Extension Definition Linkbase Document
- 101.LAB XBRL Taxonomy Extension Label Linkbase Document
- 101.PRE XBRL Taxonomy Extension Presentation Linkbase Document

Table of Contents

SIGNATURES

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

CTS Corporation

/s/ Robert J. Patton

Robert J. Patton

Vice President, General Counsel and Secretary

Dated: July 28, 2015

CTS Corporation

/s/ Ashish Agrawal

Ashish Agrawal

Vice President and Chief Financial Officer

Dated: July 28, 2015