

STARRETT L S CO  
Form 10-Q  
May 06, 2010

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 March 27, 2010

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 1-367

THE L. S. STARRETT COMPANY  
(Exact name of registrant as specified in its charter)

MASSACHUSETTS  
(State or other jurisdiction of incorporation or organization)

04-1866480  
(I.R.S. Employer Identification No.)

121 CRESCENT STREET, ATHOL, MASSACHUSETTS  
(Address of principal executive offices)

01331-1915  
(Zip Code)

Registrant's telephone number, including area code 978-249-3551

Former name, address and fiscal year, if changed since last report

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 is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definition of "accelerated filer," "large accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act, (Check One):

Edgar Filing: STARRETT L S CO - Form 10-Q

Large Accelerated Filer  Accelerated Filer  Non-Accelerated Filer  Smaller Reporting Company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

YES  NO

Common Shares April 30, 2010  
outstanding as of

Class A Common Shares 5,831,895

Class B Common Shares 842,056

1

---

THE L. S. STARRETT COMPANY

CONTENTS

	Page No.
Part I. Condensed Consolidated Unaudited Financial Statements:	
Item 1. Financial Statements	
Consolidated Balance Sheets- March 27, 2010 (unaudited) and June 27, 2009	3
Consolidated Statements of Operations thirteen and thirty-nine weeks ended March 27, 2010 and March 28, 2009 (unaudited)	4
Consolidated Statements of Cash Flows- thirty-nine weeks ended March 27, 2010 and March 28, 2009 (unaudited)	5
Consolidated Statements of Stockholders' Equity - Thirty-nine weeks ended March 27, 2010 and March 28, 2009 (unaudited)	6
Notes to Consolidated Financial Statements	7-10
Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations	10-12
Item 3. Quantitative and Qualitative Disclosures About Market Risk	12
Item 4. Controls and Procedures	12
Part II. Other information:	
Item 1A. Risk Factors	13
Item 6. Exhibits	13
SIGNATURES	

## Part I. Financial Information

## Item 1. Condensed Consolidated Unaudited Financial Statements

THE L. S. STARRETT COMPANY  
Consolidated Balance Sheets  
(in thousands of dollars except share data)

	March 27 2010 (unaudited)	June 27 2009
<b>ASSETS</b>		
Current assets:		
Cash	\$15,229	\$10,248
Investments	1,254	1,791
Accounts receivable (less allowance for doubtful accounts of \$544 and \$678)	31,733	27,233
Inventories:		
Raw materials and supplies	13,004	19,672
Goods in process and finished parts	16,054	20,265
Finished goods	19,113	20,289
	48,171	60,226
Current deferred income tax asset	4,752	5,170
Prepaid expenses, taxes and other current assets	7,994	8,054
<b>Total current assets</b>	<b>109,133</b>	<b>112,722</b>
Property, plant and equipment, at cost (less accumulated depreciation of \$129,671 and \$122,856)		
	57,123	56,956
Property held for sale	2,699	2,771
Intangible assets (less accumulated amortization of \$4,661 and \$3,724)	1,615	2,517
Goodwill	1,091	981
Other assets	744	275
Long-term taxes receivable	2,807	2,807
Long-term deferred income tax asset	16,309	15,212
<b>Total assets</b>	<b>\$191,521</b>	<b>\$194,241</b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Notes payable and current maturities	\$5,226	\$10,136
Accounts payable and accrued expenses	14,016	10,369
Accrued salaries and wages	4,304	5,109
<b>Total current liabilities</b>	<b>23,546</b>	<b>25,614</b>
Long-term taxes payable	8,885	9,140
Long-term debt	848	1,264
Postretirement benefit liability	17,252	15,345
<b>Total liabilities</b>	<b>50,531</b>	<b>51,363</b>
Stockholders' equity:		
Class A Common \$1 par (20,000,000 shares authorized)		
5,834,888 outstanding on 3/27/10 and		
5,769,894 outstanding on 6/27/09	5,835	5,770
Class B Common \$1 par (10,000,000 shares authorized)	839	869

Edgar Filing: STARRETT L S CO - Form 10-Q

839,042 outstanding on 3/27/10 and

869,426 outstanding on 6/27/09

Additional paid-in capital	50,304	49,984
Retained earnings reinvested and employed in the business	122,844	127,707
Accumulated other comprehensive loss	(38,832 )	(41,452 )
Total stockholders' equity	140,990	142,878
Total liabilities and stockholders' equity	\$ 191,521	\$ 194,241

See Notes to Consolidated Financial Statements

THE L. S. STARRETT COMPANY  
 Consolidated Statements of Operations  
 (in thousands of dollars except per share data)(unaudited)

	13 Weeks Ended		39 Weeks Ended	
	3/27/2010	3/28/2009	3/27/2010	3/28/2009
Net sales	\$48,643	\$42,764	\$139,751	\$164,830
Cost of goods sold	33,110	31,628	98,285	116,186
Gross Margin	15,533	11,136	41,466	48,644
% of Net Sales	31.9	% 26.0	% 29.7	% 29.5
Selling and general expense	14,600	13,190	43,312	46,181
Goodwill impairment	0	5,260	0	5,260
Operating Income (loss)	933	(7,314 )	(1,846 )	(2,797 )
Other income (expense)	108	(201 )	(534 )	1,154
Earnings (loss) before income taxes	1,041	(7,515 )	(2,380 )	(1,643 )
Income tax expense (benefit)	862	(2,765 )	884	(651 )
Net (loss) earnings	\$179	\$(4,750 )	\$(3,264 )	\$(992 )
Basic and diluted earnings (loss) earnings per share	\$.03	\$(0.72 )	\$(0.49 )	\$(0.15 )
Average outstanding shares used in per share calculations (in thousands):				
Basic	6,673	6,622	6,663	6,619
Diluted	6,687	6,622	6,663	6,619
Dividends per share	\$0.06	\$0.12	\$0.24	\$0.36

See Notes to Consolidated Financial Statements

THE L. S. STARRETT COMPANY  
Consolidated Statements of Cash Flows  
(in thousands of dollars)(unaudited)

	39 Weeks Ended	
	3/27/2010	3/28/2009
Cash flows from operating activities:		
Net loss	\$(3,264 )	\$(992 )
Non-cash items included:		
Depreciation	6,795	6,569
Amortization	902	936
Goodwill impairment	0	5,260
Fixed asset impairment	130	0
Net long-term tax payable	(453 )	328
Deferred taxes	(623 )	(3,654 )
Unrealized transaction (gains) losses	(222 )	1,336
Retirement benefits	2,229	(1,477 )
Working capital changes		
Receivables	(4,441 )	3,336
Inventories	13,855	(12,032 )
Other current assets	510	(1,145 )
Other current liabilities	2,474	(5,295 )
Prepaid pension cost and other	(116 )	1,963
Net cash provided by (used in) operating activities	17,776	(4,867 )
Cash flows from investing activities:		
Additions to plant and equipment	(5,914 )	(7,840 )
Decrease in investments	618	8,483
Earn out paid for Kinemetric Engineering	(110 )	(208 )
Net cash (used in) provided by investing activities	(5,406 )	435
Cash flows from financing activities:		
Proceeds from short-term borrowings	13,982	16,135
Short-term debt repayments	(19,233 )	(5,702 )
Proceeds from long-term borrowings	129	1,188
Long-term debt repayments	(523 )	(335 )
Proceeds from common stock issued	305	470
Treasury shares purchased	0	(263 )
Dividends paid	(1,599 )	(2,384 )
Net cash (used in) provided by financing activities	(6,939 )	9,109
Effect of exchange rate changes on cash	(450 )	(1,998 )
Net increase in cash	4,981	2,679
Cash, beginning of period	10,248	6,515
Cash, end of period	\$15,229	\$9,194

See Notes to Consolidated Financial Statements

THE L. S. STARRETT COMPANY  
 Consolidated Statements of Stockholders' Equity  
 For the Thirty-nine Weeks Ended March 27, 2010 and March 28, 2009  
 (in thousands of dollars except per share data)(unaudited)

	Common Stock Out-standing (\$1 Par)		Addi- tional Paid-in Capital	Retained Earnings	Accumulated Other Com-prehensive Loss	Total
	Class A	Class B				
Balance June 28, 2008	\$5,708	\$906	\$49,613	\$134,109	\$ (3,563 )	\$186,773
Comprehensive income (loss):						
Net loss				(992 )		(992 )
Unrealized net gain on investments and swap agreement					312	312
Translation loss, net					(24,574 )	(24,574 )
Dividends (\$.36 per share)				(2,384 )		(2,384 )
Treasury shares:						
Purchased	(26 )		(237 )			(263 )
Issued	28		393			421
Issuance of stock under ESPP		4	96			100
Conversion	36	(36 )				0
Balance March 28,2009	\$5,746	\$874	\$49,865	\$130,733	\$ (27,825 )	\$159,393
Balance June 27, 2009	\$5,770	\$869	\$49,984	\$127,707	\$ (41,452 )	\$142,878
Comprehensive income (loss):						
Net loss				(3,264 )		(3,264 )
Unrealized net gain on investments					5	5
Translation gain, net					2,615	2,615
Dividends (\$0.24 per share)				(1,599 )		(1,599 )
Treasury shares:						
Issued	33		261			294
Issuance of stock under ESPP		2	59			61
Conversion	32	(32 )				0
Balance March 27, 2010	\$5,835	\$839	\$50,304	\$122,844	\$ (38,832 )	\$140,990
Cumulative Balance:						
Translation loss					(11,203 )	
Unrealized gain on investments					3	
Amounts not recognized as a component of net periodic					(27,632 )	

benefit cost

\$ (38,832 )

See Notes to Consolidated Financial Statements

6

---

THE L. S. STARRETT COMPANY  
Notes to Consolidated Financial Statements

Note 1: Basis of Presentation

In the opinion of management, the accompanying financial statements contain all adjustments, consisting only of normal recurring adjustments, necessary to present fairly the financial position of the Company as of March 27, 2010 and June 27, 2009; the results of operations for the thirteen and thirty-nine weeks ended March 27, 2010 and March 28, 2009, the cash flows for the thirty-nine weeks ended March 27, 2010 and March 28, 2009; and changes in stockholders' equity for the thirty-nine weeks ended March 27, 2010 and March 28, 2009.

The Company follows the same accounting policies in the preparation of interim statements as described in the Company's Annual Report filed on Form 10-K for the year ended June 27, 2009, and these financial statements should be read in conjunction with said Annual Report on Form 10-K. Note that significant foreign locations are reported on a one month lag.

The preparation of financial statements and related disclosures in conformity with accounting principles generally accepted in the United States of America requires management to make judgments, assumptions and estimates that affect amounts reported in the consolidated financial statements and accompanying notes. The second footnote to the Company's Consolidated Financial Statements included in the Annual Report on Form 10-K for the fiscal year ended June 27, 2009 describes the significant accounting policies and methods used in the preparation of the consolidated financial statements.

Note 2: Cash and Investments

The Company has categorized its financial assets, based on the priority of the inputs to the valuation technique, into a three-level fair value hierarchy. If the inputs used to measure the financial instruments fall within different levels of the hierarchy, the categorization is based on the lowest level input that is significant to the fair value measurement of the instrument.

Financial assets recorded on the balance sheets are categorized based on the inputs to the valuation techniques as follows:

- o Level 1 – Financial assets whose values are based on unadjusted quoted prices for identical assets or liabilities in an active market which the company has the ability to access at the measurement date (examples include active exchange-traded equity securities and most U.S. Government and agency securities).

As of March 27, 2010, the Company's Level 1 financial assets were as follows (in thousands):

	Level 1
International Bonds Puerto Rican debt obligations	\$1,254

As of March 27, 2010, the Company did not have any level 2 or 3 assets.

Note 3: Recent Accounting Pronouncements

In fiscal 2010 the Company adopted a new accounting standard which requires employers to provide more transparency about the assets in their postretirement benefit plans, including defined benefit pension plans. This new standard was issued in response to users' concerns that employers' financial statements do not provide adequate

transparency about the types of assets and associated risks in employers' postretirement plans. In current disclosures of the major categories of plan assets, many employers provide information about only four asset categories: equity, debt, real estate, and other investments. For many employers, the "other investment" category has increased to include a significant percentage of plan assets. Users indicate that such disclosure is not sufficiently specific to permit evaluation of the nature and risks of assets held as investments. Our adoption did not have a material effect on the Company's financial position and results of operation.

Effective December 27, 2009, the Company adopted new accounting guidance on fair value measurements and disclosures. The new guidance requires more robust disclosures about (1) the different classes of assets and liabilities measured at fair value, (2) the valuation techniques and inputs used, (3) the activity in Level 3 fair value measurements, and (4) the transfers between Levels 1, 2 and 3. Our adoption did not have a material effect on the Company's financial position or results of operations.

## Note 4: Inventories

Approximately 51% of all inventories are valued on the LIFO method. LIFO inventories were \$11.4 million and \$17.8 million at March 27, 2010 and June 27, 2009, respectively, such amounts being approximately \$26.7 million and \$33.7 million, respectively, less than if determined on a FIFO basis. The impact of LIFO on a year-to-date third quarter basis was a \$6.9 million reduction in cost of sales in fiscal 2010 compared to a \$6.3 million increase in cost of sales in fiscal 2009.

## Note 5: Goodwill and Intangibles

The Company paid \$0.1 million in the second quarter of fiscal 2010 related to a Kinemetric contractual obligation for a management earn-out. This amount was capitalized to goodwill.

The Company completed its annual evaluation of goodwill and intangibles at June 27, 2009. At this time we did not recognize any additional impairment of goodwill and intangibles beyond what was previously disclosed in our second quarter 2009 form 10Q.

During the third quarter of 2010, the Company investigated if there was a triggering event that would cause the Company to reevaluate impairment of goodwill and intangible assets as outlined in the accounting standards for goodwill and intangible assets. The Company concluded there were no triggering events during the third quarter.

As there were no triggering events for the intangible assets, the Company also concluded there were no triggering events in relation to impairment of long lived tangible assets.

## Note 6: Pension and Post Retirement Benefits

Net periodic benefit costs (benefits) for the Company's defined benefit pension plans consist of the following (in thousands):

	Thirteen Weeks Ended March		Thirty-nine Weeks Ended March	
	2010	2009	2010	2009
Service cost	\$484	\$541	\$1,457	\$1,670
Interest cost	1,567	1,639	4,720	5,133
Expected return on plan assets	(1,775 )	(2,490 )	(5,346 )	(7,686 )
Amortization of prior service cost	95	100	288	314
Amortization of unrecognized loss (gain)	701	(3 )	2,104	(8 )
	\$1,072	\$(213 )	\$3,223	\$(577 )

Net periodic benefit costs (benefits) for the Company's postretirement medical plan consists of the following (in thousands):

	Thirteen Weeks Ended March		Thirty-nine Weeks Ended March	
	2010	2009	2010	2009
Service cost	\$85	\$88	\$254	\$265
Interest cost	169	177	508	531
Amortization of prior service benefit	(226 )	(226 )	(679 )	(679 )
Amortization of unrecognized loss	0	0	0	0
	\$28	\$39	\$83	\$117



## Note 7: Notes payable and current maturities

Notes payable and current maturities are comprised of the following (in thousands):

	March 27, 2010	June 27, 2009
Loan and Security Agreement	\$2,000	0
Revolving credit facility	0	\$7,200
Short-term foreign credit facility	2,971	2,711
Other	255	225
	\$5,226	\$10,136

## Note 8: Income Tax

The Company is subject to U.S. federal income tax and various state, local and international income taxes in numerous jurisdictions. The Company's domestic and international tax liabilities are subject to the allocation of revenues and expenses in different jurisdictions and the timing of recognizing revenues and expenses. Additionally, the amount of income taxes paid is subject to the Company's interpretation of applicable tax laws in the jurisdictions in which it files.

The Company has substantially concluded all U.S. federal income tax matters for years through fiscal 2005. Currently, we do not have any income tax audits in progress in the numerous federal, state, local and international jurisdictions in which we operate. In international jurisdictions including Argentina, Australia, Brazil, Canada, China, UK, Germany, New Zealand, and Mexico, which comprise a significant portion of the Company's operations, the years that may be examined vary, with the earliest year being 2004.

The Company has identified no new uncertain tax positions for which it is reasonably possible that the total amount of unrecognized tax benefits will significantly increase or decrease within the next twelve months.

The Company reviewed its third quarter and projected fiscal year tax provision and determined that a tax expense of \$0.9 million through the third quarter was necessary despite a \$2.4 million loss before tax due to a \$0.4 million tax amnesty expense for Brazil, previously recorded and discussed in the second quarter, and the application of a negative forecasted consolidated annual effective tax rate on the year-to-date operating loss. The negative effective tax rate projected for the year is due primarily to the effect of a large favorable permanent tax difference that results in a net tax benefit on a forecasted world-wide income for the fiscal year.

No valuation allowance has been recorded for the domestic federal net operating losses (NOL) as the Company continues to believe that based on forecasted future taxable income and certain tax planning strategies available, it is more likely than not that it will be able to utilize its tax operating loss carry forward assets.

## Note 9: Fair Value

The following methods and assumptions were used to estimate the fair value of each class of financial instruments for which it is practicable to estimate value.

- o Cash and short term instruments

The carrying amount approximates fair value because of the short maturity of those investments

- o Long term investments

The fair value of some investments are estimated on quoted market prices for those or similar investments.

o Long term debt

The fair value of the Company's long term debt is estimated on quoted market prices for the same or similar issues or on the current rates offered to the Company for debt of the same remaining maturities.

o Foreign currency contracts

The fair value of foreign currency contracts is estimated by taking the difference from the contract exchange rate and the current exchange rate of the contract and multiplying it by the face value of the contract.

The estimated fair value of the Company's financial instruments is as follows in thousands (000):

	March 27, 2010		June 27, 2009	
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Cash	\$15,229	\$15,229	\$10,248	\$10,248
Investments	1,254	1,254	1,791	1,791
Foreign currency contracts	0	0	0	273
Long term debt	848	848	1,264	1,264

Item 2.

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

### RESULTS OF OPERATIONS

THREE MONTHS ENDED March 27, 2010 and March 28, 2009

#### Overview

Net sales increased \$5.9 million or 14% from \$42.8 million to \$48.7 million. Operating income improved \$8.2 million as a \$4.4 million gain in gross margin more than offset a \$1.4 million increase in selling and general expenses as well as the absence of a goodwill impairment charge in fiscal 2010 compared to a \$5.2 goodwill impairment charge in fiscal 2009. Net income improved \$4.9 million from a loss of \$4.7 million (\$0.72 per share) in fiscal 2009 to a profit of \$0.2 million (\$0.03 per share) in fiscal 2010. Excluding the goodwill impairment recorded in Tru-Stone, the third quarter fiscal 2009 loss would have been \$1.4 million or \$0.22 per share.

#### Net Sales

Net sales in North America increased \$5.0 million or 23% from \$21.3 million to \$26.3 million led by strong gains across most product lines in the industrial markets due to improvements in the economy. International sales increased \$0.9 million or 4% from \$21.5 million to \$22.4 million; however, a weaker dollar represented a \$4.0 million sales exchange gain. In constant dollars, International sales declined \$3.7 million or 16% as the worldwide recession adversely impacted operation in Europe, Latin America and China.

#### Gross Margin

Gross margin increased \$4.4 million from \$11.1 million (26.0% of sales) to \$15.5 million (31.9% of sales) with a North American improvement of \$5.5 million partially offset by a \$1.1 million International decline. Reduced manufacturing overhead spending coupled with the LIFO benefit of \$4.8 million due to reduced inventory levels were the key factors influencing a North American margin improvement from 14% in fiscal 2009 to 32% in fiscal 2010. International margin declined due to lower revenue volume and higher costs in local currency of \$2.4 million, which was partially offset by a favorable currency gain of \$1.3 million as overall margins declined from 40% to 32%.

#### Selling and General Expenses

Selling and general expenses increased \$1.4 million or 11% from \$13.2 million to \$14.6 million as International expenses rose \$1.4 million to \$7.2 million while North American expense remained flat at \$7.4 million. International expenses were flat in local currency but increased in consolidated dollars due to the weakening U. S. currency, particularly related to the Brazilian Real.

Earnings Before Taxes

Earnings before taxes increased \$8.6 million from a fiscal 2009 loss of \$7.5 million to a fiscal 2010 profit of \$1.1 million. The significantly improved performance is due to the comparative recovering economy in fiscal 2010 versus the recession in fiscal 2009 as well as the absence of a \$5.3 million goodwill impairment in fiscal 2009.

NINE MONTHS ENDED March 27, 2010 and March 28, 2009

#### Overview

Net sales declined \$25.0 million or 15% from \$164.8 million to \$139.8 million. Operating income improved \$1.0 million as an erosion of gross margin of \$7.2 million was offset by a reduction in selling and general expenses of \$2.8 million and the absence of a goodwill impairment charge in fiscal 2010 compared to a \$5.2 goodwill impairment charge in fiscal 2009. Other income was \$1.7 million unfavorable principally due to a comparative \$1.6 million negative impact from foreign exchange rates. The net loss increased \$2.3 million from a loss of \$1.0 million (\$0.15 per share) to a loss of \$3.3 million (\$0.49 per share).

#### Net Sales

Net sales in North America declined \$11.9 million or 14% as the \$5.0 million improvement in the third quarter was not sufficient to offset a \$16.9 million deficit in the first half. The first half sales reflects the deep recession in the U. S. industrial markets while the growth in the third quarter represents the beginning of the recovery in the U. S. economy. International sales declined \$13.1 million or 16% as the worldwide recession adversely impacted our South American, European and Asian operations.

#### Gross Margin

Gross margin declined \$7.1 million but the margin percentage of revenue improved from 29.5% in fiscal 2009 to 29.7% in fiscal 2010. The significant decline in sales revenue accounted for \$9.8 million, however, margin improvements, particularly in North America, contributed a favorable gain of \$2.7 million. Reduced overhead costs and lower costs associated with the LIFO impact of lower inventory levels were the principal factors influencing the improved North American operations.

#### Selling and General Expenses

Selling and general expenses declined \$2.9 million, but increased as a percentage of revenue from 28% in fiscal 2009 to 31 % in fiscal 2010. North American expenses were lowered \$1.0 million or 4% while International expenses declined \$1.9 million or 9%. North American savings were salaries and travel of \$0.6 million and \$0.2 million, respectively coupled with reduced catalog and advertising expenses of \$0.2 million International savings were the result of salaries (\$0.1) million, bonus and commissions of (\$1.6) million and travel of (\$0.1) million.

#### Earnings Before Taxes

Earnings before taxes declined \$0.7 million from a loss of \$1.7 million in fiscal 2009 to a loss of \$2.4 million in fiscal 2010. Operating income improved \$1.0 million but was offset by an increase in other expense of \$1.7 million. principally related to foreign exchange.

#### LIQUIDITY AND CAPITAL RESOURCES

##### Cash flows (in thousands)

	Thirty-nine Weeks	
	3/27/2010	3/28/2009
Cash provided by (used in) operations	\$17,776	\$(4,867)
Cash (used in) provided from investing activities	(5,406)	435
Cash (used in) provided from financing activities	(6,939)	9,109
Effect of exchange rates changes on cash	(450)	(1,998)

Net increase (decrease) in cash	\$4,981	\$2,679
---------------------------------	---------	---------

Net cash increased \$5.0 million as the Company adjusted to the economic environment by adjusting inventory to reduced sales; postponing capital expenditures and reducing debt. The major factors impacting the positive cash flow were lower inventory levels of \$13.9 million. The improved cash flow was used for capital expenditures of \$5.9 million and reduction of debt of \$5.6 million.

### Liquidity and credit arrangements

The Company believes it maintains sufficient liquidity and has the resources to fund its operations in the near term. If the Company is unable to maintain consistent profitability, additional steps will be taken in order to maintain liquidity, including plant consolidations, work force and dividend reductions. In addition to its cash and investments, the Company maintains a \$23 million Loan and Security agreement, of which, \$2.0 million was outstanding as of March 27, 2010. This Loan and Security agreement matures as of April 30, 2012. The Loan and Security agreement was modified in the second quarter of fiscal 2010 and amends certain financial covenants. As of March 27, 2010, the Company is in compliance with all debt covenants related to its Loan and Security Agreement. The effective interest rate on the Loan and Security agreement through March 27, 2010 was 2.4%.

### INFLATION

The Company has experienced modest inflation relative to its material cost, much of which cannot be passed on to the customer through increased prices.

### OFF-BALANCE SHEET ARRANGEMENTS

The Company does not have any material off-balance sheet arrangements as defined under the Securities and Exchange Commission's rules.

### Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK

There have been no material changes in qualitative and quantitative disclosures about market risk from what was reported in our Annual Report on Form 10-K for the fiscal year ended June 27, 2009.

### Item 4. CONTROLS AND PROCEDURES

The Company's management, under the supervision and with the participation of the Company's President and Chief Executive Officer and Chief Financial Officer, has evaluated the Company's disclosure controls and procedures as of March 27, 2010, and they have concluded that our disclosure controls and procedures were effective as of such date. All information required to be filed in this report was recorded, processed, summarized and reported within the time period required by the rules and regulations of the Securities and Exchange Commission, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. There have been no changes in internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

Management's remediation efforts related to the material weakness that existed as of June 27, 2009, and noted in Item 9A of the Company's 2009 Annual Report on Form 10-K filed on September 10, 2009, are not complete as of March 27, 2010. Efforts to remediate the material weakness will continue during fiscal 2010. An update as to the status of management's efforts is listed below:

- o The Company hired a new Chief Financial Officer, effective as of November 5, 2009
- o The Company has completed an enhanced accounting policies and procedures manual
- o The Company has affirmed subsidiaries' responsibility to the Corporate Finance Group

o

The Company is developing an improved financial reporting framework which will facilitate a uniform approach to consolidated and subsidiary financial analysis. This project is scheduled to be completed in the fourth quarter.

- o The new CFO visited our Brazil subsidiary in April and plans to visit our Scotland operation this summer. Additional visits to international and domestic subsidiaries are planned for fiscal 2011.

PART II. OTHER INFORMATION

Item 1A. Risk Factors

SAFE HARBOR STATEMENT  
UNDER THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995

This Quarterly Report on Form 10-Q contains forward-looking statements about the Company's business, competition, sales, expenditures, foreign operations, plans for reorganization, interest rate sensitivity, debt service, liquidity and capital resources, and other operating and capital requirements. In addition, forward-looking statements may be included in future Company documents and in oral statements by Company representatives to securities analysts and investors. The Company is subject to risks that could cause actual events to vary materially from such forward-looking statements. You should carefully review and consider the information regarding certain factors which could materially affect our business, financial condition or future results set forth under Item 1A. "Risk Factors" in our Form 10-K for the year ended June 27, 2009. There have been no material changes from the factors disclosed in our Form 10-K for the year ended June 27, 2009.

In addition to the risk factors outlined in Form 10-K, management has developed a plan to remediate material weaknesses over financial reporting, which is described in Item 4 in this Form 10-Q. We may disclose changes to such factors or disclose additional factors from time to time in our future filings with the Securities and Exchange Commission.

Item 6. Exhibits

31a Certification of Chief Executive Officer Pursuant to Rules 13a-15(e)/15(d)-15(e) and 13a-15(f)/15(d)-15(f), filed herewith.

31b Certification of Principal Accounting Officer Pursuant to Rules 13a-15(e)/15(d)-15(e) and 13a-15(f)/15(d)-15(f), filed herewith.

32 Certification of Chief Executive Officer and Principal Accounting Officer Pursuant to Rule 13a-14(b) and Section 906 of the Sarbanes-Oxley Act of 2002 (subsections (a) and (b) of Section 1350, Chapter 63 of Title 18, United States Code), filed herewith.

SIGNATURES

Pursuant to the requirements 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.

THE L. S. STARRETT COMPANY  
(Registrant)

Date May 6, 2010

S/R. Douglas A. Starrett  
Douglas A. Starrett - President and CEO

Date May 6, 2010

S/R. Francis J. O'Brien  
Francis J. O'Brien - Treasurer and CFO

13

---

