CTS CORP
Form 10-Q
October 24, 2012
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

For the Quarterly Period Ended September 30, 2012

OR

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

For the Transition Period from to

Commission File Number: 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)**
905 West Boulevard North, 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 x No ¨

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

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

Large accelerated filer ¨	Accelerated filer x
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 x

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of October 19, 2012: 33,781,837.

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CTS CORPORATION AND SUBSIDIARIES

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PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

CTS CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF EARNINGS - UNAUDITED

(In thousands, except per share amounts)

	Three Months Ended		Nine Months Ended	
	September 30, 2012	October 2, 2011	September 30, 2012	October 2, 2011
Net sales	$ **137,357**	$ 146,070	$ **438,620**	$ 444,507
Costs and expenses:				
Cost of goods sold	**110,763**	118,610	**364,039**	360,496
Insurance recovery for business interruption - casualties	**(4,192)**	(1,113)	**(15,242)**	(1,892)
Selling, general and administrative expenses	**19,387**	18,343	**58,169**	55,074
Research and development expenses	**4,350**	5,163	**15,590**	14,782
Insurance recovery for property damage - casualties		(2,687)	**(1,769)**	(2,687)
Restructuring and impairment charge - Note M	**245**		**3,384**	694
Operating earnings	**6,804**	7,754	**14,449**	18,040
Other (expense)/income:				
Interest expense	**(584)**	(549)	**(1,869)**	(1,552)
Interest income	**425**	359	**1,341**	831
Other	**763**	(65)	**297**	1,808
Total other (expense)/income	**604**	(255)	**(231)**	1,087
Earnings before income taxes	**7,408**	7,499	**14,218**	19,127
Income tax expense	**1,491**	1,636	**2,717**	4,016
Net earnings	$ **5,917**	$ 5,863	$ **11,501**	$ 15,111
Net earnings per share - Note J				
Basic	$ **0.17**	$ 0.17	$ **0.34**	$ 0.44
Diluted	$ **0.17**	$ 0.17	$ **0.33**	$ 0.43
Cash dividends declared per share	$ **0.035**	$ 0.03	$ **0.105**	$ 0.09
Average common shares outstanding:				
Basic	**33,923**	34,375	**34,017**	34,347
Diluted	**34,471**	34,994	**34,588**	35,026

See notes to unaudited condensed consolidated financial statements.

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CTS CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE EARNINGS - UNAUDITED

(In thousands of dollars)

	Three Months Ended		Nine Months Ended	
	September 30, 2012	October 2, 2011	September 30, 2012	October 2, 2011
Net earnings	**$ 5,917**	$ 5,863	**$ 11,501**	$ 15,111
Other comprehensive earnings/(loss):				
Cumulative translation adjustment (net of tax)	**1,371**	(801)	**1,616**	194
Amortization of retirement benefit adjustments (net of tax)	**950**	1,291	**3,219**	2,777
Unrealized loss on cash flow hedges (net of tax)	**(436)**		**(943)**	
Comprehensive earnings	**$ 7,802**	$ 6,353	**$ 15,393**	$ 18,082

See notes to unaudited condensed consolidated financial statements.

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CTS CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands of dollars except share amounts)

	(Unaudited) September 30, 2012	December 31, 2011
ASSETS		
Current Assets		
Cash and cash equivalents	**$ 88,620**	$ 76,412
Accounts receivable, less allowances (2012 - $744; 2011 - $1,100)	**81,014**	88,345
Inventories - Note D	**75,007**	92,540
Other current assets	**24,512**	26,089
Total current assets	**269,153**	283,386
Property, plant and equipment, less accumulated depreciation (2012 - $243,727; 2011 - $241,585)	**89,721**	84,860
Other Assets		
Prepaid pension asset	**9,482**	4,359
Goodwill Note L	**6,759**	500
Other intangible assets, net Note L	**30,346**	29,886
Deferred income taxes	**74,642**	76,200
Other	**1,273**	1,624
Total other assets	**122,502**	112,569
Total Assets	**$ 481,376**	$ 480,815
LIABILITIES AND SHAREHOLDERS EQUITY		
Current Liabilities		
Accounts payable	**$ 59,207**	$ 80,468
Accrued liabilities	**36,866**	43,769
Total current liabilities	**96,073**	124,237
Long-term debt - Note E	**94,500**	74,400
Other long-term obligations	**18,450**	18,881
Shareholders Equity		
Preferred stock - authorized 25,000,000 shares without par value; none issued		
Common stock - authorized 75,000,000 shares without par value; 55,263,082 shares issued at September 30, 2012 and 54,790,110 shares issued at December 31, 2011	**291,512**	287,661
Additional contributed capital	**39,090**	39,161
Retained earnings	**360,139**	352,205
Accumulated other comprehensive loss	**(111,254)**	(115,146)
	579,487	563,881
Cost of common stock held in treasury (2012 21,389,445 and 2011 20,724,106 shares)	**(307,134)**	(300,584)
Total shareholders equity	**272,353**	263,297
Total Liabilities and Shareholders Equity	**$ 481,376**	$ 480,815

See notes to unaudited condensed consolidated financial statements.

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CTS CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS - UNAUDITED

(In thousands of dollars)

	Nine Months Ended September 30, 2012	Nine Months Ended October 2, 2011
Cash flows from operating activities:		
Net earnings	**$ 11,501**	$ 15,111
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation and amortization	**14,583**	13,176
Prepaid pension asset	**(5,122)**	(6,486)
Equity-based compensation Note B	**3,181**	3,363
Restructuring and impairment charges Note M	**3,384**	694
Amortization of retirement benefit adjustments Note F	**5,193**	4,431
Insurance recovery for business interruption and property damage - casualties	**(17,011)**	(4,579)
Insurance proceeds for business interruption and property damage other than property, plant and equipment - casualties	**17,703**	3,745
Other	**(965)**	(1,955)
Changes in assets and liabilities, net of acquisition		
Accounts receivable	**10,020**	6,619
Inventories	**19,483**	(14,184)
Other current assets	**1,205**	(1,750)
Accounts payable and accrued liabilities	**(38,169)**	(4,809)
Total adjustments	**13,485**	(1,735)
Net cash provided by operating activities	**24,986**	13,376
Cash flows from investing activities:		
Capital expenditures	**(9,779)**	(10,216)
Capital expenditures to replace property, plant and equipment damaged in casualties	**(2,859)**	(2,930)
Insurance proceeds for property, plant and equipment damaged in casualties	**2,250**	3,057
Proceeds from sale of fixed assets and assets held for sale	**499**	
Payment for acquisition, net of cash acquired	**(14,689)**	(2,930)
Net cash used in investing activities	**(24,578)**	(13,019)
Cash flows from financing activities:		
Payments of long-term debt Note E	**(3,979,650)**	(3,056,200)
Proceeds from borrowings of long-term debt Note E	**3,999,750**	3,075,900
Payments of short-term notes payable	**(2,166)**	(4,464)
Proceeds from borrowings of short-term notes payable	**2,166**	4,464
Purchase of treasury stock	**(6,550)**	(1,337)
Dividends paid	**(3,574)**	(3,089)
Exercise of stock options	**1,672**	472
Other	**167**	206
Net cash provided by financing activities	**11,815**	15,952
Effect of exchange rate on cash and cash equivalents	**(15)**	(452)
Net increase in cash and cash equivalents	**12,208**	15,857

Cash and cash equivalents at beginning of year		**76,412**		73,315
Cash and cash equivalents at end of period	$	**88,620**	$	89,172
Supplemental cash flow information				
Cash paid during the period for:				
Interest	$	**1,581**	$	1,314
Income taxes net	$	**4,468**	$	3,038

See notes to unaudited condensed consolidated financial statements.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - UNAUDITED

September 30, 2012

NOTE A 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, 2011.

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 B Equity-Based Compensation

At September 30, 2012, CTS had five equity-based compensation plans: the 1996 Stock Option Plan (1996 Plan), the 2001 Stock Option Plan (2001 Plan), the Nonemployee Directors Stock Retirement Plan (Directors Plan), the 2004 Omnibus Long-Term Incentive Plan (2004 Plan), an the 2009 Omnibus Equity and Performance Incentive Plan (2009 Plan). All of these plans, except the Directors Plan, were approved by shareholders. As of December 31, 2009, additional grants can only be made under the 2004 and 2009 Plans. CTS believes that equity-based awards align the interest of employees with those of its shareholders.

The 2009 Plan, and previously the 1996 Plan, 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 2009 Plan and the 2004 Plan allow for grants of stock appreciation rights, restricted stock, restricted stock units, performance shares, performance units, and other stock awards.

The following table summarizes the compensation expense included in the Unaudited Condensed Consolidated Statements of Earnings for the three and nine months ended September 30, 2012 and October 2, 2011, respectively, relating to these plans:

	Three Months Ended		**Nine Months Ended**	
($ in thousands)	**September 30, 2012**	**October 2, 2011**	**September 30, 2012**	**October 2, 2011**
Restricted stock units	**1,010**	1,002	**3,181**	3,363

The following table summarizes the status of these plans as of September 30, 2012:

	2009 Plan	**2004 Plan**	**2001 Plan**	**1996 Plan**
Awards originally available	3,400,000	6,500,000	2,000,000	1,200,000
Stock options outstanding		217,700	186,800	36,000
Restricted stock units outstanding	533,568	101,223		
Options exercisable		217,700	186,800	36,000
Awards available for grant	2,158,202	262,466		

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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 the Company s 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.

The Company 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 the Company s 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 September 30, 2012 and October 2, 2011, and changes during the nine-month periods then ended, is presented below:

	September 30, 2012		October 2, 2011	
	Options	**Weighted-Average Exercise Price**	**Options**	**Weighted-Average Exercise Price**
Outstanding at beginning of year	**728,050**	**$ 10.24**	1,093,063	$ 12.61
Exercised	**(195,300)**	**$ 8.50**	(59,263)	$ 7.91
Expired	**(24,100)**	**$ 11.59**	(296,750)	$ 19.27
Forfeited	**(68,150)**	**$ 10.87**		$
Outstanding at end of period	**440,500**	**$ 10.86**	737,050	$ 10.30
Exercisable at end of period	**440,500**	**$ 10.86**	737,050	$ 10.30

The total intrinsic value of share options exercised during the nine-month periods ended September 30, 2012 and October 2, 2011, were $320,000 and $209,000, respectively.

The weighted average remaining contractual life of options outstanding and options exercisable at September 30, 2012 and October 2, 2011 were 1.6 years and 2.1 years, respectively. The aggregate intrinsic values of options outstanding and options exercisable at September 30, 2012 and October 2, 2011 were approximately $167,000 and $79,000, respectively.

There were no unvested stock options at September 30, 2012.

The following table summarizes information about stock options outstanding at September 30, 2012:

	Options Outstanding and Exercisable		
Range of Exercise Prices	**Number Outstanding And Exercisable at 9/30/12**	**Weighted Average Remaining Contractual Life (Years)**	**Weighted Average Exercise Price**
$ 7.70 11.11	347,700	1.38	$ 10.03
$ 13.68 16.24	92,800	3.04	$ 13.95

Service-Based Restricted Stock Units

Service-based restricted stock units (RSUs) entitle the holder to receive one share of common stock for each unit when the unit vests. RSUs are issued to officers, nonemployee directors and key employees as compensation. Generally, the RSUs vest over a three-year period. A summary of the status of RSUs as of September 30, 2012 and October 2, 2011, and changes during the nine-month periods then ended is presented below:

	September 30, 2012		October 2, 2011	
	RSUs	**Weighted-average Grant-Date Fair Value**	**RSUs**	**Weighted-average Grant-Date Fair Value**
Outstanding at beginning of year	**701,449**	**$ 9.35**	807,601	$ 8.39
Granted	**236,750**	**$ 10.38**	241,100	$ 11.70
Converted	**(273,800)**	**$ 8.68**	(299,304)	$ 8.54
Forfeited	**(29,608)**	**$ 9.18**	(44,324)	$ 9.07
Outstanding at end of period	**634,791**	**$ 10.04**	705,073	$ 9.42
Weighted-average remaining contractual life	**8.3 years**		6.4 years	

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CTS recorded compensation expense of approximately $553,000 and $1,802,000 related to service-based restricted stock units during the three and nine month periods ended September 30, 2012, respectively. CTS recorded compensation expense of approximately $574,000 and $1,986,000 related to service-based restricted stock units during the three and nine month periods ended October 2, 2011, respectively.

As of September 30, 2012, there was $2.0 million of unrecognized compensation cost related to nonvested RSUs. That cost is expected to be recognized over a weighted-average period of 1.2 years. 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.

Performance-Based Restricted Stock Units

On February 2, 2010, CTS granted performance-based restricted stock unit awards for certain executives. Vesting may occur in the range from zero percent to 200% of the target amount of 78,000 units in 2012 subject to certification of the 2011 fiscal year results by CTS independent auditors. Vesting is dependent upon CTS achievement of sales growth targets and, as a result, 49,320 units were awarded and vested.

On February 3, 2011, CTS granted performance-based restricted stock unit awards for certain executives. Vesting may occur in the range from zero percent to 200% of the target amount of 53,200 units in 2013 subject to certification of the 2012 fiscal year results by CTS independent auditors. Vesting is dependent upon CTS achievement of sales growth targets.

On February 8, 2012, CTS granted performance-based restricted stock unit awards for certain executives. Vesting may occur in the range from zero percent to 200% of the target amount of 45,850 units in 2014 subject to certification of the 2013 fiscal year results by CTS independent auditors. Vesting is dependent upon CTS achievement of sales growth targets.

On February 8, 2012, CTS granted performance-based restricted stock unit awards for certain executives. Vesting may occur in the range from zero percent to 200% of the target amount of 39,300 units in 2014 subject to certification of the 2013 fiscal year results by CTS independent auditors. Vesting is dependent upon CTS achievement of free cash flow targets.

CTS recorded compensation expense of approximately $229,000 and $688,000 related to performance-based restricted stock units during the three and nine month periods ended September 30, 2012, respectively. CTS recorded compensation expense of approximately $157,000 and $500,000 related to performance-based restricted stock units during the three and nine month periods ended October 2, 2011, respectively. As of September 30, 2012 there was approximately $807,000 of unrecognized compensation cost related to performance-based RSUs. That cost is expected to be recognized over a weighted-average period of 1.0 years.

Market-Based Restricted Stock Units

On July 2, 2007, CTS granted a market-based restricted stock unit award for an executive officer. An aggregate of 25,000 units may be earned in performance years ending in the following three consecutive years on the anniversary of the award date. Vesting may occur in the range from zero percent to 150% of the target award on the end date of each performance period and is tied exclusively to CTS total stockholder return relative to 32 enumerated peer group companies total stockholder return rates. 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. During the year ended December 31, 2010, 12,500 units were earned and awarded to the executive officer. There were no units awarded in 2011. On July 2, 2012, 8,334 units were earned and awarded to the executive officer.

On February 2, 2010, CTS granted 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 of 117,000 units in 2012. Vesting is dependent upon CTS total stockholder return relative to 28 enumerated peer group companies stockholder return rates and, as a result, 67,130 units were awarded and vested.

On February 3, 2011, CTS granted 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 of 79,800 units in 2013. Vesting is dependent upon CTS total stockholder return relative to 28 enumerated peer group companies stockholder return rates.

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On February 8, 2012, CTS granted 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 of 45,850 units in 2014. Vesting is dependent upon CTS total stockholder return relative to 28 enumerated peer group companies stockholder return rates.

CTS recorded compensation expense of approximately $228,000 and $691,000 related to market-based restricted stock units during the three and nine month periods ended September 30, 2012, respectively. CTS recorded compensation expense of approximately $271,000 and $877,000 related to market-based restricted stock units during the three and nine month periods ended October 2, 2011, respectively. As of September 30, 2012, there was approximately $555,000 of unrecognized compensation cost related to market-based RSUs. That cost is expected to be recognized over a weighted-average period of 0.8 year.

Stock Retirement Plan

The Directors Plan provides for a portion of the total compensation payable to nonemployee directors to be deferred and paid in CTS stock. The Directors Plan was frozen effective December 1, 2004. All future grants will be from the 2009 Plan.

NOTE C Acquisition

In January 2012, CTS acquired 100% of the common stock of Valpey-Fisher Corporation (Valpey-Fisher), a publicly held company located in Hopkinton, Massachusetts for approximately $18.3 million. Valpey-Fisher is a recognized technology leader in the design and manufacture of precision frequency crystal oscillators. This acquisition expands CTS technology, and brings strong engineering capabilities and management leadership to support the Company s strategic initiatives in CTS Component and Sensors segment.

The following table summarizes the estimated fair values of the assets acquired and the liabilities assumed at the date of acquisition:

($ in thousands)	Estimated Fair Values At January 23, 2012
Current assets	$ 9,077
Property, plant and equipment	6,231
Goodwill	6,259
Amortizable intangible assets	2,420
In-process research and development	400
Other assets	231
Fair value of assets acquired, including $3,578 cash acquired	24,618
Less fair value of liabilities acquired	(6,351)
Net assets acquired	18,267
Cash acquired	3,578
Net cash paid	$ 14,689

Included in current assets is the fair value of accounts receivable of $2,479. Goodwill recorded in connection with the above acquisition is primarily attributable to the synergies expected to arise after the Company s acquisition of the business and the assembled workforce of the acquired business. None of the goodwill is expected to be deductible for tax purposes.

The following table summarizes the net sales and earnings before income taxes of Valpey-Fisher that is included in CTS Condensed Consolidated Statements of Earnings since the acquisition date, January 23, 2012, which is included in the consolidated statement of earnings for the three and nine months ended September 30, 2012:

($ in thousands)	**Three Months Ended September 30, 2012**	**Nine Months Ended September 30, 2012**
Net Sales	$ 3,759	$ 10,705
Earnings before income taxes	$ 429	$ 318

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The following table summarizes the combined net sales and earnings before income taxes of CTS and Valpey-Fisher on a pro forma basis as if the acquisition date had occurred at the beginning of the reporting period:

	Three Months Ended		Nine Months Ended	
($ in thousands)	**September 30, 2012 (Proforma)**	**October 2, 2011 (Proforma)**	**September 30, 2012 (Proforma)**	**October 2, 2011 (Proforma)**
Net Sales	$ 137,357	$ 150,137	$ 439,736	$ 455,979
Earnings before income taxes	$ 7,419	$ 7,675	$ 14,223	$ 19,456

The Valpey-Fisher acquisition will be accounted for using the acquisition method of accounting whereby the total purchase price will be allocated to tangible and intangible assets and liabilities based on the fair market values on the date of acquisition. CTS will determine the purchase price allocations on the acquisition based on estimates of the fair values of the assets acquired and liabilities assumed. These allocations are expected to be finalized by the end of 2012.

In January 2011, CTS acquired certain assets and assumed certain liabilities of Fordahl SA, a privately held company located in Brugg, Switzerland. This business was acquired for approximately $2.9 million, net of cash acquired. The assets acquired include inventory, accounts receivable, leasehold improvements, machinery and equipment, and certain intangible assets.

The Fordahl SA product line includes high-performance temperature compensated crystal oscillators and voltage controlled crystal oscillators. This product line expanded CTS frequency product portfolio from clock and crystals to highly-engineered precision ovenized oscillators. This acquisition added new customers and opened up new market opportunities for CTS.

The Fordahl acquisition was accounted for using the acquisition method of accounting whereby the total purchase price was allocated to tangible and intangible assets based on the fair market values on the date of acquisition. CTS determined the purchase price allocations on the acquisition based on estimates of the fair values of the assets acquired and liabilities assumed. CTS finalized the purchase price allocation at December 31, 2011. The land and building, machinery and equipment and intangible assets are classified as Level 3 under the fair value hierarchy. The pro forma effect of this acquisition is not material to CTS results of operations or financial position.

NOTE D Inventories

Inventories consist of the following:

($ in thousands)	**September 30, 2012**	**December 31, 2011**
Finished goods	**$ 11,718**	$ 14,697
Work-in-process	**16,295**	20,602
Raw materials	**46,994**	57,241
Total inventories	**$ 75,007**	$ 92,540

NOTE E Debt

On January 10, 2012, CTS amended its November 18, 2010 unsecured revolving credit agreement. This amendment provided for an increase in the revolving credit facility to $200 million and increased the accordion feature, whereby CTS can expand the facility to $300 million, subject to participating banks approval. Additionally, among other covenants, the amendment reduced the applicable margin by 25 basis points, increased the total consideration the company may pay for non-U.S. based acquisitions, and extended the term of the credit agreement through January 10, 2017.

Long-term debt was comprised of the following:

($ in thousands)	**September 30, 2012**	**December 31, 2011**
Revolving credit agreement, weighted-average interest rate of 1.8% (2012), and 1.9% (2011) due in 2017 and 2015, respectively	$ **94,500**	$ 74,400

There was $94.5 million outstanding under the $200 million revolving credit agreement at September 30, 2012, and $74.4 million outstanding under the $150 million revolving credit agreement at December 31, 2011. The Company had $102.9 million available under the $200 million credit agreement at September 30, 2012, net of standby letters of credit of $2.6 million, and $72.8 million available under the $150 million credit agreement at December 31, 2011, net of standby letters of credit of $2.8 million. Interest rates on the revolving credit agreement fluctuate based upon London Interbank Offered Rate and the Company s quarterly total leverage ratio. CTS pays a commitment fee on the undrawn portion of the

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revolving credit agreement. The commitment fee varies based on the quarterly leverage ratio and was 0.30 percent per annum at September 30, 2012. The revolving credit agreement 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 agreement. CTS was in compliance with all debt covenants at September 30, 2012. The revolving credit agreement 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 agreement 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.

CTS uses interest rate swaps to convert the line of credit s variable rate of interest into a fixed rate. During the second quarter of 2012, CTS entered into four separate interest rate swap agreements to fix interest rates on $50 million 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 million 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 agreement will be recognized as an adjustment to interest expense for the related line of credit when settled.

These swaps are treated as cash flow hedges and consequently, the changes in fair value were recorded in Other Comprehensive Income. An unrealized loss of approximately $715,000 and $1,547,000 were recorded in Other Comprehensive Income for the three and nine months ended September 30, 2012, respectively. Accordingly, approximately $198,000 was recorded as accrued liabilities and $1,349,000 recorded as a non-current liability in Other Long-term Obligations on the Condensed Consolidated Balance Sheets.

As a result of the use of these derivative instruments, the Company is exposed to the risk that counterparties to derivative contracts will fail to meet their contractual obligations. To mitigate the counterparty credit risk, the Company has a policy of only entering into contracts with carefully selected major financial institutions based upon their credit ratings and other factors. CTS established policies and procedures for mitigating credit risk on principal transactions include reviewing and establishing limits for credit exposure and continually assessing the creditworthiness of counterparties.

NOTE F Retirement Plans

Net pension expense/(income) for the three months ended September 30, 2012 and October 2, 2011 for our domestic and foreign plans include the following components:

	Domestic Pension Plans		Foreign Pension Plans	
($ in thousands)	**September 30, 2012**	**October 2, 2011**	**September 30, 2012**	**October 2, 2011**
Service cost	**$ 683**	$ 687	**$ 31**	$ 35
Interest cost	**2,979**	3,045	**143**	151
Expected return on plan assets [(1)]	**(5,376)**	(5,916)	**(111)**	(146)
Amortization of prior service cost	**151**	153		
Amortization of loss	**1,513**	1,032	**74**	70
Additional cost due to retirement		637		
(Income)/expense, net	**$ (50)**	$ (362)	**$ 137**	$ 110

Net pension expense/(income) for the nine months ended September 30, 2012 and October 2, 2011 for our domestic and foreign plans include the following components:

	Domestic Pension Plans		Foreign Pension Plans	
($ in thousands)	**September 30, 2012**	**October 2, 2011**	**September 30, 2012**	**October 2, 2011**
Service cost	**$ 2,050**	$ 2,061	**$ 93**	$ 106

Interest cost	**8,957**	9,201	**428**	452
Expected return on plan assets [1]	**(16,129)**	(17,748)	**(331)**	(436)
Amortization of prior service cost	**453**	459		
Amortization of loss	**4,549**	3,132	**222**	207
Additional cost due to retirement	**282**	637		
Expense/(income), net	**$ 162**	$ (2,258)	**$ 412**	$ 329

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

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Net post retirement expense for the three and nine months ended September 30, 2012 and October 2, 2011 for our post-retirement plan includes the following components:

($ in thousands)	Three Months Ended September 30, 2012	Three Months Ended October 2, 2011	Nine Months Ended September 30, 2012	Nine Months Ended October 2, 2011
OTHER POSTRETIREMENT BENEFIT PLAN				
Service cost	**$ 2**	$ 4	**$ 6**	$ 12
Interest cost	**64**	72	**192**	216
Amortization of gain	**(10)**	(1)	**(30)**	(4)
Postretirement expense	**$ 56**	$ 75	**$ 168**	$ 224

NOTE G Segments

CTS reportable segments are grouped by entities that exhibit similar economic characteristics and the segment s reporting results are regularly reviewed by CTS chief operating decision maker to make decisions about resources to be allocated to these segments and to evaluate the segment s performance. CTS has two reportable segments: 1) Components and Sensors and 2) EMS.

Components and sensors are products which perform specific electronic functions for a given product family and are intended for use in customer assemblies. Components and sensors consist principally of: automotive sensors and actuators used in commercial or consumer vehicles; electronic components used in communications infrastructure and computer markets; terminators, including ClearONE terminators, used in computer and other high speed applications, switches, resistor networks and potentiometers used to serve multiple markets; and fabricated piezo-electric materials and substrates used primarily in medical, computer and industrial markets.

EMS includes the higher level assembly of electronic and mechanical components into a finished subassembly or assembly performed under a contract manufacturing agreement with an Original Equipment Manufacturer (OEM) or other contract manufacturer. Additionally for some customers, CTS provides full turnkey manufacturing and completion including design, bill-of-material management, logistics, and repair.

The accounting policies of the reportable segments are the same as those described in the summary of significant accounting policies in the Company s annual report on Form 10-K. Management evaluates performance based upon segment operating earnings before interest expense, interest income, other non-operating income/(expense), and income tax expense.

Summarized financial information concerning CTS reportable segments is shown in the following table:

($ in thousands)	Components and Sensors	EMS	Total
Third Quarter of 2012			
Net sales to external customers	**$ 75,565**	**$ 61,792**	**$ 137,357**
Segment operating earnings before corporate and shared services charges	**$ 9,492**	**$ 4,202**	**$ 13,694**
Corporate and shared services charges	**(4,185)**	**(1,827)**	**(6,012)**
Segment operating earnings	**$ 5,307**	**$ 2,375**	**$ 7,682**
Total assets	**$ 369,614**	**$ 111,762**	**$ 481,376**
Third Quarter of 2011			
Net sales to external customers	$ 69,089	$ 76,981	$ 146,070

Segment operating earnings before corporate and shared services charges	$ 7,738	$ 5,870	$ 13,608
Corporate and shared services charges	(3,557)	(2,297)	(5,854)
Segment operating earnings[(1)]	$ 4,181	$ 3,573	$ 7,754
Total assets	$ 367,387	$ 149,088	$ 516,475
First Nine Months of 2012			
Net sales to external customers	**$ 228,806**	**$ 209,814**	**$ 438,620**
Segment operating earnings before corporate and shared services charges	**$ 25,233**	**$ 10,744**	**$ 35,977**
Corporate and shared services charges	**(11,543)**	**(5,276)**	**(16,819)**
Segment operating earnings[(2)]	**$ 13,690**	**$ 5,468**	**$ 19,158**
Total assets	**$ 369,614**	**$ 111,762**	**$ 481,376**
First Nine Months of 2011			
Net sales to external customers	$ 209,158	$ 235,349	$ 444,507
Segment operating earnings before corporate and shared services charges	$ 26,388	$ 9,960	$ 36,348
Corporate and shared services charges	(11,601)	(6,013)	(17,614)
Segment operating earnings[(3)]	$ 14,787	$ 3,947	$ 18,734
Total assets	$ 367,387	$ 149,088	$ 516,475

(1) EMS segment s operating earnings of $3,573 includes $2,687 of insurance recovery for property damage related to the fire at CTS Scotland s manufacturing facility.

(2) EMS segment s operating earnings of $5,468 includes $1,769 of insurance recover for property damage related to the flood at CTS Thailand s manufacturing facility.

(3) EMS segment s operating earnings of $3,947 includes $2,687 of insurance recovery for property damage related to the fire at CTS Scotland s manufacturing facility.

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Reconciling information between reportable segments operating earnings and CTS consolidated earnings before income taxes is shown in the following table for the three and nine-month periods then ended:

	Three Months Ended		Nine Months Ended	
($ in thousands)	**September 30, 2012**	**October 2, 2011**	**September 30, 2012**	**October 2, 2011**
Total segment operating earnings	**$ 7,682**	$ 7,754	**$ 19,158**	$ 18,734
Restructuring and restructuring-related charges	**(878)**		**(4,709)**	(694)
Interest expense	**(584)**	(549)	**(1,869)**	(1,552)
Interest income	**425**	359	**1,341**	831
Other income/(expense)	**763**	(65)	**297**	1,808
Earnings before income taxes	**$ 7,408**	$ 7,499	**$ 14,218**	$ 19,127

NOTE H 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, state environmental agencies and, in some cases, generator groups, that it is or may be a potentially responsible party regarding hazardous waste remediation at several non-CTS sites. In addition to these non-CTS sites, CTS has an ongoing practice of providing reserves for probable remediation activities at certain of its manufacturing locations and for claims and proceedings against CTS with respect to other environmental matters. In the opinion of management, based upon presently available information relating to all such matters, either adequate provision for probable costs has been made, or the ultimate costs resulting will not materially affect the consolidated financial position, results of operations, or cash flows of CTS.

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 pedal recall and associated events have led to the Company being named as a co-defendant with Toyota in certain litigation. In February 2010, CTS entered into an agreement with Toyota whereby Toyota agreed that it will indemnify, defend, and hold the Company 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 the Company s business. For all other claims, in the opinion of management, based upon presently available information, either adequate provision for anticipated costs has been accrued or the ultimate anticipated costs will not materially affect CTS consolidated financial position, results of operations, or cash flows.

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Scotland EMS Manufacturing Facility Fire

During the second quarter of 2011, a fire occurred at the Company s Scotland EMS manufacturing facility. The fire damaged approximately $1.6 million of inventory and $0.2 million of machinery and equipment at net book value. Property insurance coverage with a $0.1 million deductible had substantially covered the costs of repairing and/or replacing the damaged inventory and machinery and equipment. Business interruption insurance had substantially covered the lost sales impact and related fixed costs in 2011.

In the first nine months of 2012, CTS recovered approximately $1.0 million from the Company s insurance carriers and recorded a recovery of approximately $0.9 million for business interruption, after deducting approximately $0.1 million for certain expenses, in CTS Condensed Consolidated Statements of Earnings for the nine months ended September 30, 2012. These recoveries reflect the final settlement with CTS insurance carrier.

Thailand EMS Manufacturing Facility Flood

During the fourth quarter of 2011, CTS Thailand EMS manufacturing facility was flooded. Based on preliminary estimates, the flood damaged approximately $0.5 million of inventory and $0.5 million of fixed assets at net book value. The Company also incurred approximately $2.5 million of fixed costs at this facility. Local and global property insurance coverage covered the costs of repairing and/or replacing the damaged inventory and machinery and equipment. CTS also has business interruption insurance under these policies that covers the lost sales impact and fixed costs.

During the third quarter of 2012, CTS received cash of approximately $4.2 million from the Company s insurance carriers. All of the proceeds received were for business interruption and accordingly, CTS recorded a recovery of $4.2 million for business interruption for the quarter ended September 30, 2012 in the Company s Consolidated Statements of Earnings.

In the first nine months of 2012, CTS received cash of approximately $18.9 million from the Company s insurance carriers. Out of the $18.9 million cash, approximately $15.8 million was for business interruption and the remaining $3.1 million was for the reimbursement of costs related to property damage. Part of the cash received was to relieve the insurance receivable balance of $2.4 million recorded at December 31, 2011.

Accordingly, CTS recorded a recovery of approximately $14.4 million for business interruption and $1.8 million for property damage in CTS Condensed Consolidated Statements of Earnings for the nine months ended September 30, 2012. CTS continues to process the insurance claim related to the flood for increased expenses and lost sales impact.

NOTE I Fair Value Measurement

Goodwill represents the excess of the cost of businesses acquired over the fair value of the assets acquired and liabilities assumed. CTS does not amortize goodwill, but tests it for impairment annually using a fair value approach at the reporting unit level. A reporting unit is the operating segment, or a business one level below that operating segment or the component level if discrete financial information is prepared and regularly reviewed by senior management. However, components are aggregated as a single reporting unit if they have similar economic characteristics.

The table below summarizes the non-financial assets that were measured and recorded at fair value on a non-recurring basis as of September 30, 2012 and the loss recorded during the nine months ended September 30, 2012 on those assets:

($ in thousands)

Description	**Carrying Value at September 30, 2012**	**Quoted Prices in Active Markets for Identical (Level 1)**	**Significant Other Observable Inputs (Level 2)**	**Significant Unobservable Inputs (Level 3)**	**Loss for Nine Months Ended September 30, 2012**
Goodwill	$ **6,759**	$	$	$ **6,759**	$
Intangible assets, other than goodwill	$ **30,346**	$	$	$ **30,346**	$
Long-lived assets	$ **89,721**	$	$	$ **89,721**	$ **1,435**

The fair value of these assets were measured and recorded using an income approach. Projected future cash flows related to these assets were used under this approach to determine their fair values. CTS recorded an impairment charge of approximately $1,435,000 for the nine months ended September 30, 2012. The impairment charge was recorded under Restructuring and Impairment Charge on the Company s Condensed Consolidated Statements of Earnings.

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The following table reconciles the beginning and ending balance of CTS goodwill for the period ended September 30, 2012:

($ in thousands)	C&S	EMS	Total
Balance at January 1, 2012	$	$ 500	$ 500
2012 activity Note C, Acquisitions	6,259		6,259
Balance at September 30, 2012	$ 6,259	$ 500	$ 6,759

See Note L, Goodwill and Other Intangible Assets, for further discussion.

The following table reconciles the beginning and ending balances of CTS intangible assets, other than goodwill for the period ended September 30, 2012:

($ in thousands)	Total
Balance at January 1, 2012	$ 29,886
2012 addition Note C, Acquisitions	2,820
2012 amortization expense	(2,210)
2012 intangible asset write-off	(150)
Balance at September 30, 2012	$ **30,346**

See Note L, Goodwill and Other Intangible Assets, for further discussion.

The following table reconciles the beginning and ending balances of CTS long-lived assets for the period ended September 30, 2012:

($ in thousands)	Total
Balance at January 1, 2012	$ 84,860
Capital expenditures	9,779
Capital expenditures to replace property, plant & equipment damaged in Thailand flood	2,859
Fixed assets acquired in Valpey-Fisher acquisition Note C	6,231
Depreciation expense	(12,373)
Transfer to asset held for sale	(350)
Impairment charge	(1,435)
Foreign exchange impact and other	150
Balance at September 30, 2012	$ 89,721

The table below summarizes the financial liability that was measured at fair value on a recurring basis as of September 30, 2012:

($ in thousands)	Carrying Value at September 30, 2012	Quoted Prices in Active Markets for Identical (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Loss for Nine Months Ended September 30, 2012
Interest rate swap cash flow hedge	$ **1,547**	$	$ **1,547**	$	$

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. $198,000 of the fair value of these swaps are classified as Accrued liabilities and the remaining $1,349,000 are classified as Other liabilities on CTS Consolidated Balance Sheets.

CTS long-term debt consists of a revolving debt agreement. 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.

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NOTE J Earnings Per Share

The table below provides a reconciliation of the numerator and denominator of the basic and diluted earnings per share (EPS) computations. Basic earnings per share is calculated using the weighted average number of common shares outstanding as the denominator and net earnings as the numerator. Diluted earnings per share is calculated by adding all potentially dilutive shares to the weighted average number of common shares outstanding for the numerator. All anti-dilutive shares are excluded from the computation of diluted earnings per share. The calculations below provide net earnings, weighted average common shares outstanding, and earnings per share for both basic and diluted EPS for the three and nine month periods ended September 30, 2012 and October 2, 2011.

($ in thousands, except per share amounts)	**Net Earnings (Numerator)**	**Shares (in thousands) (Denominator)**	**Per Share Amount**
Third Quarter 2012			
Basic EPS	$ **5,917**	**33,923**	**0.17**
Effect of dilutive securities:			
Equity-based compensation plans		**548**	
Diluted EPS	$ **5,917**	**34,471**	**0.17**
Third Quarter 2011			
Basic EPS	$ 5,863	34,375	$ 0.17
Effect of dilutive securities:			
Equity-based compensation plans		619	
Diluted EPS	$ 5,863	34,994	$ 0.17
First Nine Months of 2012			
Basic EPS	$ **11,501**	**34,017**	**0.34**
Effect of dilutive securities:			
Equity-based compensation plans		**571**	
Diluted EPS	$ **11,501**	**34,588**	**0.33**
First Nine Months of 2011			
Basic EPS	$ 15,111	34,347	$ 0.44
Effect of dilutive securities:			
Equity-based compensation plans		679	
Diluted EPS	$ 15,111	35,026	$ 0.43

The following table shows the potentially dilutive securities which have been excluded from the three and nine-month periods 2012 and 2011 dilutive earnings per share calculation because they are either anti-dilutive, or the exercise price exceeds the average market price.

(Number of Shares in Thousands)	**Three Months Ended**	**Nine Months Ended**

	September 30, 2012	October 2, 2011	September 30, 2012	October 2, 2011
Stock options where the assumed proceeds exceed the average market price	**387**	548	**387**	548

NOTE K Treasury Stock

Common stock held in treasury totaled 21,389,445 shares with a cost of $307.1 million at September 30, 2012 and 20,724,106 shares with a cost of $300.6 million at December 31, 2011. Approximately 7.6 million shares are available for future issuances.

In May 2008, CTS Board of Directors authorized a program to repurchase up to one million shares of its common stock in the open market at a maximum price of $13 per share. The authorization has no expiration. Reacquired shares will be used to support equity-based compensation programs and for other corporate purposes. During the first nine months of 2012, 574,153 shares were repurchased. This repurchase program was completed in July 2012.

In August 2012, CTS Board of Directors authorized a program to repurchase up to one million shares of its common stock in the open market at a maximum price of $13 per share. The authorization has no expiration. Reacquired shares will be used to support equity-based compensation programs and for other corporate purposes. During the third quarter of 2012, 91,186 shares were repurchased.

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NOTE L Goodwill and Other Intangible Assets

CTS has the following other intangible assets and goodwill as of:

	September 30, 2012		December 31, 2011	
($ in thousands)	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
Amortized intangible assets:				
Customer lists/relationships	**$ 53,344**	**$ (24,349)**	$ 51,424	$ (22,390)
Patents	**10,319**	**(10,319)**	10,319	(10,319)
Other intangibles	**1,620**	**(589)**	1,220	(368)
Total definite lived intangible assets	**65,283**	**(35,257)**	62,963	(33,077)
In-process research & development	**320**			
Goodwill	**6,759**		500	
Total	**$ 72,362**	**$ (35,257)**	$ 63,463	$ (33,077)

Of the net intangible assets excluding goodwill and in-process research and development at September 30, 2012, $24.8 million relates to the Components and Sensors segment and $5.2 million relates to the EMS segment. The in-process research and development intangible at September 30, 2012 relates to the Components and Sensors Segment. Of the goodwill at September 30, 2012, $6.3 million relates to Components and Sensors segment and $0.5 million relates to the EMS segment. The goodwill at December 31, 2011 relates to the EMS segment. CTS recorded amortization expense of $0.9 million and $2.2 million during the three and nine-month periods ended September 30, 2012, respectively. CTS recorded amortization expense of $0.7 million and $1.9 million during the three and nine-month periods ended October 2, 2011, respectively. The weighted average remaining amortization period for the amortizable intangible assets is 13.3 years. The weighted average remaining amortization period for customer lists/relationships is 13.6 years and for the other intangibles is 3.9 years. CTS estimates remaining amortization expense of $0.7 million in 2012, $2.9 million in 2013, $2.8 million in 2014, $2.7 million in 2015, $2.6 million in 2016 and $18.3 million thereafter.

NOTE M Restructuring Charges

During June of 2012, CTS initiated certain restructuring actions to reorganize certain operations to further improve its cost structure. These actions will result in the elimination of approximately 250 positions. These actions are expected to be substantially complete by the fourth quarter of 2012. 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 September 30, 2012:

($ in millions) **June 2012 Plan**	Planned Costs	Actual incurred through September 30, 2012
Workforce reduction	$ 2.1	**$ 1.9**
Asset impairment charge	1.2	**1.4**
Other charge	0.1	**0.1**
Restructuring and impairment charges	$ 3.4	**$ 3.4**
Inventory write-down	$ 0.6	**$ 0.7**
Equipment relocation	0.5	**0.2**
Other charges	0.5	**0.4**
Restructuring-related charges	$ 1.6	**$ 1.3**

Total restructuring and restructuring-related charges	5.0	**4.7**

Of the restructuring and restructuring-related charges incurred, $1.6 million relates to the Components and Sensors segment and $3.1 million relates to the EMS segment. Restructuring and impairment charges are reported on a separate line on the Unaudited Consolidated Statements of Earnings. Restructuring-related charges are reported as a component of Cost of Goods Sold on the Unaudited Consolidated Statements of Earnings.

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The following table displays the restructuring reserve activity related to the realignment for the period ended September 30, 2012:

($ in millions) **June 2012 Plan**	
Restructuring liability at April 1, 2012	$
Restructuring and restructuring-related charges, excluding asset impairments and write-offs	2.6
Cost paid	(2.3)
Restructuring liability at September 30, 2012	$ 0.3

Included in the restructuring activities discussed above, CTS will consolidate its operations from the United Kingdom (UK) EMS manufacturing facility and the Tucson, AZ Components and Sensors facility into other facilities. The EMS operations at the UK EMS facility are currently being transferred to CTS EMS facilities located in Londonderry, New Hampshire and Matamoros, Mexico. The Components and Sensors operations at the Tucson, AZ facility are currently being transferred to CTS Components and Sensors facility located in Albuquerque, New Mexico.

During April of 2011, CTS initiated certain restructuring actions to reorganize certain operations to further improve its cost structure. These actions resulted in the elimination of approximately 30 positions. 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 September 30, 2012:

($ in millions) **April 2011 Plan**	**Planned Costs**	**Actual incurred through September 30, 2012**
Workforce reduction	$ 0.8	**$** 0.7
Total restructuring and impairment charge	$ 0.8	**$** 0.7

Of the restructuring charges incurred, $0.5 million relates to the Components and Sensors segment and $0.2 million relates to the EMS segment. Restructuring charges are reported on a separate line on the Unaudited Consolidated Statements of Earnings. These restructuring actions ended in second quarter 2011.

The following table displays the restructuring reserve activity related to the realignment for the period ended September 30, 2012:

($ in millions) **April 2011 Plan**	
Restructuring liability at January 1, 2011	**$**
Restructuring and restructuring-related charges, excluding asset impairments and write-offs	0.7
Cost paid	(0.7)
Restructuring liability at September 30, 2012	**$**

Note N Recent Accounting Pronouncements

ASU 2012-02 Testing Indefinite-Lived Intangible Assets for Impairment

In July 2012, the FASB issued Accounting Standards Update 2012-02, Testing Indefinite-Lived Intangible Assets for Impairment (ASU 2012-02) which amends the guidance in Accounting Standards Codification Topic 350-30 Intangibles Goodwill and Other General Intangibles Other than Goodwill (ASC 350-30) on testing indefinite-lived intangible assets, other than goodwill, for impairment. Under ASU 2012-02, an entity testing an indefinite-lived intangible asset for impairment has the option of performing a qualitative assessment before calculating the fair value of the asset. If the entity determines, on the basis of qualitative factors, that the fair value of the indefinite-lived intangible asset is not more likely than not impaired, the entity would not need to calculate the fair value of the asset. The ASU does not revise the requirement to test indefinite-lived intangible assets annually for impairment. These provisions are effective for annual and interim impairment tests performed for fiscal years beginning after September 15, 2012, although early adoption is permitted. The provisions of ASU 2012-02 are not expected to have a material impact on CTS consolidated financial statements.

ASU 2012-03 Technical Amendments and Corrections to SEC Sections

In August 2012, the FASB issued Accounting Standards Update 2012-03 Technical Amendments and Corrections to SEC Sections (ASU 2012-03) which amends a number of SEC sections in the FASB Accounting Standards Codification as a result of (1) the issuance of Staff Accounting Bulletin No. 114 (SAB 114), (2) the issuance of SEC Final Rule 33-9250 Technical Amendments to Commission Rules and Forms Related to the FASB s Accounting Standards Codification , and (3) corrections related to Accounting Standards Update 2010-22, Accounting for Various Topics Technical Corrections to SEC Paragraphs (ASU 2010-22). The provisions are effective upon issuance. The provisions of ASU 2012-03 are not expected to have a material impact on CTS consolidated financial statements.

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ASU 2012-04 Technical Corrections and Improvements

In October 2012, the FASB issued Accounting Standards Update 2012-04, Technical Corrections and Improvements (ASU 2012-04) which makes certain technical corrections and conforming fair value amendments to the FASB Accounting Standards Codification. The amendments affect various Codification topics and apply to all reporting entities within the scope of those topics. The technical corrections (Section A) are divided into three main categories: (1) Source literature amendments amendments to carry forward the original intent of certain pre-Codification authoritative literature that was inadvertently altered during the Codification process, (2) Guidance clarification and reference corrections changes in wording and references to avoid misapplication or misinterpretation of guidance, and (3) Relocated guidance moving guidance from one part of the Codification to another to correct instances in which the scope of pre-Codification guidance may have been unintentionally narrowed or broadened during the Codification process. The purpose of Section B of ASU 2012-04 is to conform the use of the term fair value throughout the Codification to fully reflect the fair value measurement and disclosure requirements of Accounting Standards Codification Topic 820 Fair Value Measurement (ASC 820). These provisions are effective upon issuance, except for amendments that are subject to transition guidance, which will be effective for fiscal periods beginning after December 15, 2012. The provisions of ASU 2012-04 are not expected to have a material impact on CTS consolidated financial statements.

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

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 businesses in which CTS operates; 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 such as the Japan earthquake and the Thailand flood; the ability to protect our intellectual property; pricing pressures and demand for our products; 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 1.A of our Annual Report on Form 10-K for the fiscal year ended December 31, 2011. 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.

Overview

CTS Corporation (we , our , us) is a global manufacturer of components and sensors used primarily in the automotive, communications, and defense and aerospace markets. We also provide electronic manufacturing solutions, including design and supply chain management functions, primarily serving the defense and aerospace, communications, industrial and medical markets under contract arrangements with original equipment manufacturers.

As discussed in more detail throughout the MD&A:

- Net sales in the third quarter of 2012 of $137.4 million were reported through two segments, Components and Sensors and Electronic Manufacturing Services (EMS). Net sales decreased by $8.7 million, or 6.0%, in the third quarter of 2012 from the third quarter of 2011 as net sales in the Components and Sensors segment increased by 9.4% and net sales in the EMS segment decreased by 19.7%.

- Gross margin as a percent of net sales was 19.4% in the third quarter of 2012 compared to 18.8% in the third quarter of 2011. The increase in gross margin resulted from favorable segment mix as the Components and Sensors segment percent of total sales increased to 55.0% of consolidated sales from 47.3% in the same period of 2011 and lower commodity prices.

- Insurance recovery for business interruption primarily due to the flood at our Thailand facility totaled $4.2 million in the third quarter of 2012. The third quarter of 2011 included $1.1 million insurance recovery for business interruption due to a fire at our Scotland facility.

- Selling, general and administrative (SG&A) and Research and development (R&D) expenses were $23.7 million, or 17.3% of net sales, in the third quarter of 2012 versus $23.5 million, or 16.1% of net sales, in the third quarter of 2011.

- During the second quarter of 2012 we initiated certain restructuring actions to reorganize certain operations to further improve our cost structure. The charge recognized in the third quarter as a result of these actions was $0.9 million.

- Interest and other income was $0.6 million in the third quarter of 2012 compared to expense of $0.3 million in the same quarter of 2011.

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Income tax expense was $1.5 million and the effective tax rate was 20.1% in the third quarter of 2012 versus expense of $1.6 million and effective tax rate of 21.8% in the same quarter of 2011.

Net earnings of $5.9 million, or $0.17 per diluted share, in the third quarter of 2012 were the same as in the third quarter of 2011.

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Critical Accounting Policies

MD&A discusses our unaudited condensed consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period.

Management believes that judgment and estimates related to the following critical accounting policies could materially affect our consolidated financial statements:

- Inventory valuation, the allowance for doubtful accounts, and other accrued liabilities
- Long-lived and intangible assets valuation, and depreciation/amortization periods
- Income taxes
- Retirement plans
- Equity-based compensation

In the third quarter of 2012, there were no changes in the above critical accounting policies.

Results of Operations

Comparison of Third Quarter 2012 and Third Quarter 2011

Segment Discussion

Refer to Note G, Segments, for a description of our segments.

The following table highlights the segment results for the quarters ended September 30, 2012 and October 2, 2011:

($ in thousands)	**Components and Sensors**	**EMS**	**Total**
Third Quarter of 2012			
Net sales to external customers	**$ 75,565**	**$ 61,792**	**$ 137,357**
Segment operating earnings before corporate and shared services charges	**$ 9,492**	**$ 4,202**	**$ 13,694**
Corporate and shared services charges	**(4,185)**	**(1,827)**	**(6,012)**
Segment operating earnings	**$ 5,307**	**$ 2,375**	**$ 7,682**
% of Net sales	**7.0%**	**3.8%**	**5.6%**

Third Quarter of 2011			
Net sales to external customers	$ 69,089	$ 76,981	$ 146,070
Segment operating earnings before corporate and shared services charges	$ 7,738	$ 5,870	$ 13,608
Corporate and shared services charges	(3,557)	(2,297)	(5,854)
Segment operating earnings[(1)]	$ 4,181	$ 3,573	$ 7,754
% of Net sales	6.1%	4.6%	5.3%

(1) EMS segment s operating earnings of $3,573 includes $2,687 of insurance recovery for property damage related to the fire at CTS Scotland s manufacturing facility.

Net sales in the Components and Sensors segment increased $6.5 million, or 9.4%, from the third quarter of 2011. The increase in net sales was primarily attributable to higher electronic component sales of $4.6 million driven by piezoceramics for the computer market and incremental sales from the acquisition of Valpey-Fisher Corporation (Valpey-Fisher), and higher net sales of $1.9 million in the automotive market as our Japanese customers recovered from last year s earthquake and we launched new actuator products.

The Components and Sensors segment recorded operating earnings of $5.3 million in the third quarter of 2012 versus $4.2 million in the third quarter of 2011. The favorable earnings change resulted primarily from higher net sales volume and lower commodity prices partially offset by unfavorable product mix and a shift from pension income to pension expense.

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Net sales in the EMS segment decreased $15.2 million, or 19.7%, in the third quarter of 2012 from the third quarter of 2011. The lower net sales by market were $11.0 million in the defense and aerospace market, $6.6 million in the communications market and $1.5 million in the computer market partially offset by higher net sales of $3.6 million in the industrial market and $0.3 million in the medical market.

EMS segment operating earnings were $2.4 million in the third quarter of 2012 versus $3.6 million in the third quarter of 2011. The unfavorable earnings change was primarily due to lower net sales volume resulting from the generally weak global economy partially offset by $0.9 million lower SG&A expenses primarily due to cost savings resulting from the recent restructuring actions.

Total Company Discussion

The following table highlights changes in significant components of the Unaudited Condensed Consolidated Statements of Earnings for the quarters ended September 30, 2012 and October 2, 2011:

	Quarter ended		
($ in thousands, except net earnings per share)	**September 30, 2012**	**October 2, 2011**	**Increase (Decrease)**
Net sales	$ **137,357**	$ 146,070	$ (8,713)
Restructuring-related costs	$ **633**	$	$ 633
% of net sales	**0.5%**	%	0.4%
Gross margin	$ **26,594**	$ 27,460	$ (866)
% of net sales	**19.4%**	18.8%	0.6%
Insurance recovery for business interruption	$ **(4,192)**	$ (1,113)	$ (3,079)
Operating expenses:			
Selling, general and administrative expenses	$ **19,387**	$ 18,343	$ 1,044
% of net sales	**14.1%**	12.6%	1.5%
Research and development expenses	$ **4,350**	$ 5,163	$ (813)
% of net sales	**3.2%**	3.5%	(0.3)%
Restructuring and impairment charge	$ **245**	$	$ 245
Insurance recovery for property damage	$	$ (2,687)	$ 2,687
Operating earnings	$ **6,804**	$ 7,754	$ (950)
% of net sales	**5.0%**	5.3%	(0.3)%
Interest and other income / (expense)	$ **604**	$ (255)	$ 859
% of net sales	**0.4%**	(0.2)%	0.6%
Income tax expense	$ **1491**	$ 1,636	$ (145)
Net earnings	$ **5,917**	$ 5,863	$ 54
% of net sales	**4.3%**	4.0%	0.3%
Net earnings per diluted share	$ **0.17**	$ 0.17	$

Net sales of $137.4 million in the third quarter of 2012 decreased $8.7 million, or 6.0%, from the third quarter of 2011 attributable to lower EMS segment net sales of $15.2 million offset by higher Components and Sensors segment net sales of $6.5 million.

Gross margin as a percent of net sales was 19.4% in the third quarter of 2012 compared to 18.8% in the third quarter of 2011. The increase in gross margin resulted from favorable segment mix as the Components and Sensors segment percent of total sales increased to 55.0% of consolidated sales from 47.3% in the same period of 2011 and lower commodity prices.

Insurance recovery for business interruption primarily due to the flood at our Thailand facility totaled $4.2 million in the third quarter of 2012. The third quarter of 2011 included $1.1 million insurance recovery for business interruption due to a fire at our Scotland facility. The recoveries offset related expenses that have negatively impacted our gross margins. We continue to work with our insurance carrier to process our claim for expenses and lost margin. The timing of insurance recoveries generally lag the actual incurrence of expenses or margin losses by several months.

SG&A expenses were $19.4 million, or 14.1% of net sales, in the third quarter of 2012 versus $18.3 million, or 12.6% of net sales, in the third quarter of 2011. SG&A expenses as a percentage of net sales increased primarily due to the higher royalty expenses and a shift from pension income to pension expense.

R&D expenses were $4.4 million, or 3.2% of net sales, in the third quarter of 2012 compared to $5.2 million, or 3.5% of net sales, in the third quarter of 2011. The decrease was primarily driven by the timing of customer reimbursements. R&D expenses are incurred by the Components and Sensors segment and are primarily focused on expanded applications of existing products and new product development, as well as current product and process enhancements. R&D expenses were 5.8% of Components and Sensors net sales in the third quarter of 2012 compared to 7.5% of Components and Sensors net sales in the third quarter of 2011.

Operating earnings were $6.8 million in the third quarter of 2012, including a restructuring and restructuring-related charge of $0.9 million, compared to $7.8 million in the third quarter of 2011.

Interest and other income was $0.6 million in the third quarter of 2012 versus expense of $0.3 million in the same quarter of 2011. The favorable impact of $0.9 million was due to foreign exchange gains in 2012 as the United States (U.S.) currency weakened during the period compared to the currencies in which we do business versus 2011 when the U.S. currency strengthened during the period compared to the same currencies.

The effective tax rate in the third quarter of 2012 was 20.1% compared to 21.8% in the third quarter of 2011. Despite an increase in rate due to changes in the mix of earnings by jurisdiction, the quarterly tax rate decreased due to the impact of a non-taxable capital gain in a foreign jurisdiction.

We continue to evaluate our deferred income taxes on a quarterly basis taking into account all available evidence, both positive and negative, to determine if valuation allowances are required or should be adjusted. To date, we have recorded tax benefits on the net operating losses generated in certain foreign jurisdictions based upon our ability to generate sufficient taxable income within the carry-forward periods provided in each jurisdiction. If it appears that we will not generate such taxable income we may need to record a valuation allowance against the related deferred tax asset in a future period.

Net earnings were $5.9 million, or $0.17 per diluted share, in the third quarter of 2012 and the third quarter of 2011.

Comparison of First Nine Months 2012 and First Nine Months 2011

Segment Discussion

The following table highlights the segment results for the nine-month periods ended September 30, 2012 and October 2, 2011:

($ in thousands)	Components and Sensors	EMS	Total
First Nine Months of 2012			
Net sales to external customers	**$ 228,806**	**$ 209,814**	**$ 438,620**
Segment operating earnings before corporate and shared services charges	**$ 25,233**	**$ 10,744**	**$ 35,977**
Corporate and shared services charges	**(11,543)**	**(5,276)**	**(16,819)**
Segment operating earnings(1)	**$ 13,690**	**$ 5,468**	**$ 19,158**
% of Net sales	**6.0%**	**2.6%**	**4.4%**

First Nine Months of 2011			
Net sales to external customers	$ 209,158	$ 235,349	$ 444,507
Segment operating earnings before corporate and shared services charges	$ 26,388	$ 9,960	$ 36,348
Corporate and shared services charges	(11,601)	(6,013)	(17,614)
Segment operating earnings(2)	$ 14,787	$ 3,947	$ 18,734
% of Net sales	7.1%	1.7%	4.2%

(1) *EMS segment s operating earnings of $5,468 includes $1,769 of insurance recover for property damage related to the flood at CTS Thailand s manufacturing facility.*

(2) *EMS segment s operating earnings of $3,947 includes $2,687 of insurance recovery for property damage related to the fire at CTS Scotland s manufacturing facility.*

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Net sales in the Components and Sensors segment increased $19.6 million, or 9.4% from the first nine months of 2011, primarily due to higher net sales of $10.7 million in the automotive market primarily as our Japanese customers recovered from last year s earthquake, and higher net sales in electronic components of $8.9 million driven by incremental sales from the acquisition of Valpey-Fisher and piezoceramics for the computer market which were partially offset by lower sales of certain other electronic components.

The Components and Sensors segment operating earnings were $13.7 million in the first nine months of 2012 versus $14.8 million in the first nine months of 2011. The unfavorable earnings change resulted primarily from a $2.5 million shift from pension income to pension expense, unfavorable product mix, and higher research and development costs partially offset by higher sales volume and lower commodity prices.

Net sales in the EMS segment decreased $25.5 million, or 10.9%, in the first nine months of 2012 from the first nine months of 2011. The decrease in net sales was primarily due to the impact of the October 2011 flood at our Thailand EMS manufacturing facility and the generally weak global economy. The lower net sales by market were $21.8 million in the communications market, $15.3 million in the defense and aerospace market, and $9.9 million in the computer market, partially offset by higher net sales of $18.4 million in the industrial market and $3.0 million in the medical market.

EMS segment operating earnings were $5.5 million in the first nine months of 2012 versus $3.9 million in the first nine months of 2011. The favorable earnings change was primarily due to the timing of insurance recoveries related to the flood at our Thailand facility.

Total Company Discussion

The following table highlights changes in significant components of the Unaudited Condensed Consolidated Statements of Earnings for the nine-month periods ended September 30, 2012 and October 2, 2011:

	Nine months ended		
($ in thousands, except net earnings per share)	**September 30, 2012**	**October 2, 2011**	**Increase (Decrease)**
Net sales	$ **438,620**	$ 444,507	$ (5,887)
Restructuring-related costs	$ **1,325**	$	$ 1,325
% of net sales	**0.3%**	%	0.3%
Gross margin	$ **74,581**	$ 84,011	$ (9,430)
% of net sales	**17.0%**	18.9%	(1.9)%
Insurance recovery for business interruption	$ **(15,242)**	$ (1,892)	(13,350)
Operating expenses:			
Selling, general and administrative expenses	$ **58,169**	$ 55,074	$ 3,095
% of net sales	**13.3%**	12.4%	0.9%
Research and development expenses	$ **15,590**	$ 14,782	$ 808
% of net sales	**3.6%**	3.3%	0.3%
Restructuring and impairment charge	$ **3,384**	$ 694	$ 2,690
Insurance recovery for property damage	$ **(1,769)**	$ (2,687)	$ 918
Operating earnings	$ **14,449**	$ 18,040	$ (3,591)
% of net sales	**3.3%**	4.1%	(0.8)%
Interest and other (expense)/income	$ **(231)**	$ 1,087	$ (1,318)
% of net sales	**(0.1)%**	0.2%	(0.3)%
Income tax expense	$ **2,717**	$ 4,016	$ (1,299)
Net earnings	$ **11,501**	$ 15,111	$ (3,610)
% of net sales	**2.6%**	3.4%	(0.8)%
Net earnings per diluted share	$ **0.33**	$ 0.43	$ (0.10)

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Net sales of $438.6 million in the first nine months of 2012 decreased $5.9 million, or 1.3%, from the first nine months of 2011 attributable to lower EMS segment net sales of $25.5 million, mostly offset by higher Components and Sensors segment net sales of $19.6 million.

Gross margin as a percent of net sales was 17.0% in the first nine months of 2012 compared to 18.9% in the first nine months of 2011. The decrease in gross margin primarily resulted from expenses and lost margin related to the flood at our Thailand facility and the fire at our Scotland facility and a shift from pension income to pension expense partially offset by lower commodity prices and favorable segment mix as the Components and Sensors segment percent of total sales increased to 52.2% of consolidated sales from 47.1% in the same period of 2011.

SG&A expenses were $58.2 million, or 13.3% of net sales, in the first nine months of 2012 versus $55.1 million, or 12.4% of net sales, in the first nine months of 2011. SG&A expenses as a percentage of net sales increased primarily due to the Valpey-Fisher acquisition and a shift from pension income to pension expense.

R&D expenses were $15.6 million, or 3.6% of net sales, in the first nine months of 2012 versus $14.8 million, or 3.3% of net sales, in the first nine months of 2011. The increase was primarily driven by spending to develop and launch new products and growth initiatives. R&D expenses are incurred by the Components and Sensors segment and are primarily focused on expanded applications of existing products and new product development, as well as current product and process enhancements. R&D expenses were 6.8% of Components and Sensors net sales in the first nine months of 2012 versus 7.1% of Components and Sensors net sales in the first nine months of 2011.

Operating earnings were $14.4 million in the first nine months of 2012, including a restructuring and restructuring-related charge of $4.7 million, compared to $18.0 million in the first nine months of 2011 which included a restructuring charge of $0.7 million.

Interest and other expense in the first nine months of 2012 was $0.2 million versus income of $1.1 million in the same period of 2011 due to lower foreign exchange gains. The unfavorable impact of $1.3 million was primarily due to foreign exchange gains in 2011 when the U.S. currency weakened during the period compared to the currencies in which we do business.

The effective tax rate for the first nine months of 2012 was 19.1% compared to 21.0% in the first nine months of 2011. Despite an increase in rate due to changes in the mix of earnings by jurisdiction, the overall tax rate decreased due to the impact of a nontaxable capital gain and $0.7 million discrete tax benefit recorded during the first quarter of 2012. Both of these favorable adjustments relate to activity in foreign jurisdictions.

We continue to evaluate our deferred income taxes on a quarterly basis taking into account all available evidence, both positive and negative, to determine if valuation allowances are required or should be adjusted. To date, we have recorded tax benefits on the net operating losses generated in certain foreign jurisdictions based upon our ability to generate sufficient taxable income within the carry-forward periods provided in each jurisdiction. If it appears that we will not generate such taxable income we may need to record a valuation allowance against the related deferred tax asset in a future period.

Net earnings were $11.5 million, or $0.33 per diluted share, in the first nine months of 2012 compared with $15.1 million, or $0.43 per share, in the first nine months of 2011.

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Scotland EMS Manufacturing Facility Fire

During the second quarter of 2011, a fire occurred at our Scotland EMS manufacturing facility. The fire damaged approximately $1.6 million of inventory and $0.2 million of machinery and equipment at net book value. Property insurance coverage with a $0.1 million deductible had substantially covered the costs of repairing and/or replacing the damaged inventory and machinery and equipment. Business interruption insurance had substantially covered the lost sales impact and related fixed costs in 2011.

In the first nine months of 2012, we recovered approximately $1.0 million from our insurance carriers and recorded a recovery of approximately $0.9 million for business interruption, after deducting approximately $0.1 million for certain expenses, in our Condensed Consolidated Statements of Earnings for the nine months ended September 30, 2012. These recoveries reflect the final settlement with our insurance carrier.

Thailand EMS Manufacturing Facility Flood

During the fourth quarter of 2011, our Thailand EMS manufacturing facility was flooded. Based on preliminary estimates, the flood damaged approximately $0.5 million of inventory and $0.5 million of fixed assets at net book value. We also incurred approximately $2.5 million of fixed costs at this facility. Local and global property insurance coverage covered the costs of repairing and/or replacing the damaged inventory and machinery and equipment. We also have business interruption insurance under these policies that covers the lost sales impact and fixed costs.

During the third quarter of 2012, we received cash of approximately $4.2 million from our insurance carriers. All of the proceeds received were for business interruption and, accordingly, we recorded a recovery of $4.2 million for business interruption for the quarter ended September 30, 2012 in our Consolidated Statements of Earnings.

In the first nine months of 2012, we received cash of approximately $18.9 million from our insurance carriers. Out of the $18.9 million cash, approximately $15.8 million was for business interruption and the remaining $3.1 million was for the reimbursement of costs related to property damage. Part of the cash received was to relieve the insurance receivable balance of $2.4 million recorded at December 31, 2011.

Accordingly, we recorded a recovery of approximately $14.4 million for business interruption and $1.8 million for property damage in our Condensed Consolidated Statements of Earnings for the nine months ended September 30, 2012. We continue to process our insurance claim related to the flood for increased expenses and lost sales impact.

Acquisition

In January 2012, we acquired 100% of the common stock of Valpey-Fisher, a publicly held company located in Hopkinton, Massachusetts, for approximately $14.7 million, net of cash acquired. Valpey-Fisher is a recognized technology leader in the design and manufacture of precision frequency crystal oscillators. This acquisition expands our technology, and brings strong engineering capabilities and management leadership to support strategic initiatives in our Components and Sensors segment. This acquisition is expected to be accretive in full-year 2012.

2012 Outlook

As a result of continued weak global economic conditions and the negative impact of the Japan/China territory dispute, management is lowering full-year sales guidance to essentially flat from a range of 4% to 7% increase over 2011. Accordingly, management is also changing full-year 2012 adjusted earnings per share guidance to $0.70 to $0.75, from a range of $0.75 to $0.80 per share.

Liquidity and Capital Resources

Overview

Cash and cash equivalents were $88.6 million at September 30, 2012 and $76.4 million at December 31, 2011. Total debt on September 30, 2012 was $94.5 million compared to $74.4 million at December 31, 2011, as we increased debt primarily for the Valpey-Fisher acquisition. Total debt as a percentage of total capitalization was 25.8% at the end of the third quarter of 2012, compared with 22.0% at December 31, 2011. 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 $13.9 million at September 30, 2012 versus year-end 2011, primarily due to a decrease in accounts payable of $21.3 million and an increase in cash and cash equivalents of $12.2 million partially offset by a decrease in inventory of $17.5 million. Our successful effort to reduce inventory was primarily responsible for the decrease in accounts payable.

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Cash Flow

Operating Activities

Net cash provided by operating activities was $25.0 million during the first nine months of 2012. Components of net cash provided by operating activities included net earnings of $11.5 million, depreciation and amortization expense of $14.6 million, restructuring and asset impairment charges of $3.4 million and other non-cash items such as equity-based compensation, amortization of retirement benefit and net insurance recovery totaling $8.9 million which were partially offset by net changes in assets and liabilities of $7.5 million and an increase in the prepaid pension asset of $5.1 million. The changes in assets and liabilities were primarily due to decreased accounts payable and accrued liabilities of $38.2 million partially offset by decreased inventories of $19.5 million and decreased accounts receivable of $10.0 million.

Net cash provided by operating activities was $13.4 million during the first nine months of 2011. Components of net cash provided by operating activities included net earnings of $15.1 million, non-cash adjustments of depreciation and amortization expense of $13.2 million, amortization of retirement benefits of $4.4 million and equity-based compensation expense of $3.4 million which were partially offset by a change in our prepaid pension assets of $6.5 million and change in all other assets and liabilities of $16.1 million. The net changes in assets and liabilities were primarily due to increased inventories of $14.2 million, decreased accounts payable and accrued liabilities of $4.8 million, and increased other current assets of $1.8 million, which were partially offset by decreased accounts receivable of $6.6 million.

Investing Activities

Net cash used in investing activities for the first nine months of 2012 was $24.6 million primarily for the Valpey-Fisher acquisition of $14.7 million, net of cash acquired, capital expenditures of $9.8 million, and capital expenditures to replace casualty-damaged property of $2.9 million partially offset by insurance proceeds for casualty-damaged property of $2.3 million.

Net cash used in investing activities for the first nine months of 2011 was $13.0 million, of which $10.2 million was for capital expenditures and $2.9 million was for the acquisition of certain assets of Fordahl SA.

Financing Activities

Net cash provided by financing activities for the nine months of 2012 was $11.8 million, consisting primarily of a net increase in long-term debt of $20.1 million, offset by $6.6 million in treasury stock purchases and $3.6 million in dividend payments. The additional debt was primarily used to fund the Valpey-Fisher acquisition and to meet usual working capital requirements.

Net cash provided by financing activities for the first nine months of 2011 was $16.0 million, consisting primarily of a net increase in long-term debt of $19.7 million, offset by $3.1 million in dividend payments. The additional debt was primarily used to meet domestic working capital requirements.

Capital Resources

Refer to Note E, Debt, to our unaudited consolidated financial statements for further discussion.

Our principal sources of liquidity have been cash flow from operations and from our credit agreements. We historically have accessed various funding sources, including short-term and long-term unsecured bank lines of credit as well as the debt markets in the United States. We expect to have sufficient sources of liquidity to meet our future funding needs due to the multiple funding sources that have been, and continue to be, available to us.

On January 10, 2012, we amended our November 18, 2010 unsecured revolving credit agreement. This amendment provided for an increase in our revolving credit facility to $200 million and increased the accordion feature, whereby we can expand the facility to $300 million, subject to participating banks approval. Additionally, among other covenants, the amendment reduced the applicable margin by 25 basis points, increased the total consideration we may pay for non-U.S. based acquisitions, and extended the term of the credit agreement through January 10, 2017.

Long-term debt was comprised of the following:

($ in thousands)	September 30, 2012	December 31, 2011
Revolving credit agreement, weighted-average interest rate of 1.8% (2012), and 1.9% (2011) due in 2017 and 2015, respectively	$ **94,500**	$ 74,400

There was $94.5 million outstanding under the $200 million revolving credit agreement at September 30, 2012, and $74.4 million outstanding under the $150 million revolving credit agreement at December 31, 2011. We had $102.9 million available under the $200 million credit agreement at September 30, 2012, net of standby letters of credit of $2.6 million, and $72.8 million available under the $150 million credit agreement at December 31, 2011, net of standby letters of credit of $2.8 million. Interest rates on the revolving credit agreement fluctuate based upon London Interbank Offered Rate and our quarterly total leverage ratio. We pay a commitment fee on the undrawn portion of the revolving credit agreement. The commitment fee varies based on the quarterly leverage ratio and was 0.30 percent per annum at September 30, 2012. The revolving credit agreement requires, among other things, that we comply with a maximum total leverage ratio and a minimum fixed charge coverage ratio. Our failure to comply with these covenants could reduce the borrowing availability under the revolving credit agreement. We were in compliance with all debt covenants at September 30, 2012. The revolving credit agreement requires us 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 agreement contains restrictions limiting our 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 our subsidiaries and affiliates; and make stock repurchases and dividend payments.

CTS uses interest rate swaps to convert the line of credit s variable rate of interest into a fixed rate. During the second quarter of 2012, CTS entered into four separate interest rate swap agreements to fix interest rates on $50 million of long-term debt for the periods January 2013 to January 2017. In the third quarter of 2012, we entered into four separate interest rate swap agreements to fix interest rates on $25 million 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 agreement will be recognized as an adjustment to interest expense for the related line of credit when settled.

These swaps are treated as cash flow hedges and, consequently, the changes in fair value were recorded in Other Comprehensive Income. An unrealized loss of approximately $715,000 and $1,547,000 were recorded in Other Comprehensive Income for the three and nine months ended September 30, 2012, respectively. Accordingly, approximately $198,000 was recorded as accrued liabilities and $1,349,000 recorded as a non-current liability in Other Long-term Obligations on the Condensed Consolidated Balance Sheets.

As a result of the use of these derivative instruments, we are exposed to the risk that counterparties to derivative contracts will fail to meet their contractual obligations. To mitigate the counterparty credit risk, we have a policy of only entering into contracts with carefully selected major financial institutions based upon their credit ratings and other factors. Our established policies and procedures for mitigating credit risk on principal transactions include reviewing and establishing limits for credit exposure and continually assessing the creditworthiness of counterparties.

In May 2008, our Board of Directors authorized a program to repurchase up to one million shares of CTS common stock in the open market at a maximum price of $13 per share. The authorization had no expiration. Reacquired shares will be used to support equity-based compensation programs and for other corporate purposes. During the first nine months of 2012, 574,153 shares were repurchased at a cost of approximately $5.7 million or $9.85 per share. This repurchase program was completed in July 2012.

In August 2012, our Board of Directors authorized a program to repurchase up to one million shares of CTS common stock in the open market at a maximum price of $13 per share. The authorization has no expiration. Reacquired shares will be used to support equity-based compensation programs and for other corporate purposes. During the third quarter of 2012, 91,186 shares were repurchased at a cost of approximately $0.9 million or $9.77 per share.

We have historically funded our capital and operating needs primarily through cash flows from operating activities, supported by available credit under our bank credit agreements. We believe that expected positive 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/or debt financing to provide additional liquidity and/or fund acquisitions.

Recent Accounting Pronouncements

ASU 2012-02 Testing Indefinite-Lived Intangible Assets for Impairment

In July 2012, the FASB issued Accounting Standards Update 2012-02, Testing Indefinite-Lived Intangible Assets for Impairment (ASU 2012-02) which amends the guidance in Accounting Standards Codification Topic 350-30 Intangibles Goodwill and Other General Intangibles Other than Goodwill (ASC 350-30) on testing indefinite-lived intangible assets, other than goodwill, for impairment. Under ASU 2012-02, an entity testing an indefinite-lived intangible asset for impairment has the option of performing a qualitative assessment before calculating the fair value of the asset. If the entity determines, on the basis of qualitative factors, that the fair value of the indefinite-lived intangible asset is not more likely than not impaired, the entity would not need to calculate the fair value of the asset. The ASU does not revise the requirement to test indefinite-lived intangible assets annually for impairment. These provisions are effective for annual and interim impairment tests performed for fiscal years beginning after September 15, 2012, although early adoption is permitted. The provisions of ASU 2012-02 are not expected to have a material impact on our consolidated financial statements.

ASU 2012-03 Technical Amendments and Corrections to SEC Sections

In August 2012, the FASB issued Accounting Standards Update 2012-03 Technical Amendments and Corrections to SEC Sections (ASU 2012-03) which amends a number of SEC sections in the FASB Accounting Standards Codification as a result of (1) the issuance of Staff Accounting Bulletin No. 114 (SAB 114), (2) the issuance of SEC Final Rule 33-9250 Technical Amendments to Commission Rules and Forms Related to the FASB s Accounting Standards Codification , and (3) corrections related to Accounting Standards Update 2010-22, Accounting for Various Topics Technical Corrections to SEC Paragraphs (ASU 2010-22). The provisions are effective upon issuance. The provisions of ASU 2012-03 are not expected to have a material impact on our consolidated financial statements.

ASU 2012-04 Technical Corrections and Improvements

In October 2012, the FASB issued Accounting Standards Update 2012-04, Technical Corrections and Improvements (ASU 2012-04) which makes certain technical corrections and conforming fair value amendments to the FASB Accounting Standards Codification. The amendments affect various Codification topics and apply to all reporting entities within the scope of those topics. The technical corrections (Section A) are divided into three main categories: (1) Source literature amendments amendments to carry forward the original intent of certain pre-Codification authoritative literature that was inadvertently altered during the Codification process, (2) Guidance clarification and reference corrections changes in wording and references to avoid misapplication or misinterpretation of guidance, and (3) Relocated guidance moving guidance from one part of the Codification to another to correct instances in which the scope of pre-Codification guidance may have been unintentionally narrowed or broadened during the Codification process. The purpose of Section B of ASU 2012-04 is to conform the use of the term fair value throughout the Codification to fully reflect the fair value measurement and disclosure requirements of Accounting Standards Codification Topic 820 Fair Value Measurement (ASC 820). These provisions are effective upon issuance, except for amendments that are subject to transition guidance, which will be effective for fiscal periods beginning after December 15, 2012. The provisions of ASU 2012-04 are not expected to have a material impact on our consolidated financial statements.

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Item 3. Quantitative and Qualitative Disclosures About Market Risk

There have been no other material changes in our market risk since December 31, 2011.

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 September 30, 2012, provided that the evaluation did not include an evaluation of the effectiveness of the internal control over financial reporting for the acquired business, as described further below.

Since the date of acquisition of Valpey-Fisher Corporation, our management has not completed an evaluation of the business s internal controls over financial reporting for the acquired entity, whose results are included in the financial statements and notes filed in this Form 10-Q.

Changes in Internal Control Over Financial Reporting

Other than the changes resulting from the acquisition described above, there were no changes in our internal control over financial reporting for the quarter ended September 30, 2012 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 pedal recall and associated events have led to us being named as a co-defendant with Toyota in certain litigation.

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. 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 named as co-defendant with Toyota in approximately thirty-seven open lawsuits; we have been dismissed as a defendant from an additional thirty 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 Unites 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 processes in the manufacture of our current and past products create hazardous waste by-products as currently defined by federal and state laws and regulations. We have been notified by the U.S. Environmental Protection Agency, state environmental agencies, and in some cases, generator groups, that we are or may be a potentially responsible party regarding hazardous waste remediation at several non-CTS sites. In addition to these non-CTS sites, we have an ongoing practice of providing reserves for probable remediation activities at certain of our manufacturing locations and for claims and proceedings against us with respect to other environmental matters. In the opinion of management, based upon all present available information relating to all such matters, either adequate provisions for probable costs has been made, or the ultimate costs resulting will not materially affect our consolidated financial position, results of operations, or cash flows.

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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.

Item 1A. Risk Factors

There have been no significant changes to our risk factors since December 31, 2011.

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

The following table summarizes the repurchases of CTS common stock made by the Company during the three-month period ending September 30, 2012:

	(a) Total Number of Shares Purchased	(b) Average Price Paid per Share	(c) Total Number of Shares Purchased as Part of Plans or Programs *(1)*	(d) Maximum Number of Shares That May Yet Be Purchased Under the Plans or Programs
				1,001,666
July 2, 2012 July 29, 2012	**1,666**	**$ 9.42**	**1,666**	**1,000,000**
July 30, 2012 August 26, 2012	**30,400**	**$ 9.65**	**30,400**	**969,600**
August 27, 2012 September 30, 2012	**60,786**	**$ 9.84**	**60,786**	**908,814**
Total	**92,852**		**92,852**	

Item 3. Defaults Upon Senior Securities

Not applicable

Item 4. Mine Safety Disclosures

Not applicable

Item 5. Other Information

Not applicable

Item 6. Exhibits

(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

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101.LAB*	XBRL Taxonomy Extension Label Linkbase Document
101.PRE*	XBRL Taxonomy Extension Presentation Linkbase Document

* XBRL (Extensible Business Reporting Language) information is furnished and not filed herewith, is not part of a registration statement or Prospectus for purposes of sections 11 or 12 of the Securities Act of 1933, is deemed not filed for purposes of section 18 of the Securities Exchange Act of 1934, and otherwise is not subject to liability under these sections.

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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.

CTS Corporation	**CTS Corporation**
/s/ John R. Dudek John R. Dudek	*/s/ Thomas A. Kroll* Thomas A. Kroll
Vice President, General Counsel and Secretary	Vice President and Chief Financial Officer
Dated: October 24, 2012	Dated: October 24, 2012