

NORTECH SYSTEMS INC  
Form 10-Q  
August 03, 2016  
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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

Washington, D. C. 20549

**FORM 10-Q**

(Mark One)

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

For the quarterly period ended June 30, 2016

OR

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

For the transition period from            to

**NORTECH SYSTEMS INCORPORATED**

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Commission file number **0-13257**

State of Incorporation: **Minnesota**

IRS Employer Identification No. **41-1681094**

Executive Offices: **7550 Meridian Circle N., Suite # 150, Maple Grove, MN 55369**

Telephone number: **(952) 345-2244**

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

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

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

Large Accelerated Filer

Accelerated Filer

Non-accelerated Filer

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

Number of shares of \$.01 par value common stock outstanding at July 29, 2016 - 2,747,831

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	THREE MONTHS ENDED JUNE 30		SIX MONTHS ENDED JUNE 30	
	2016	2015	2016	2015
Net Sales	\$ 28,945,135	\$ 26,801,473	\$ 57,895,177	\$ 53,341,095
Cost of Goods Sold	25,822,428	24,371,349	51,393,909	48,044,816
Gross Profit	3,122,707	2,430,124	6,501,268	5,296,279
Operating Expenses				
Selling Expenses	1,310,335	1,310,355	2,613,825	2,673,797
General and Administrative Expenses	1,922,308	1,603,129	3,776,431	3,307,443
Total Operating Expenses	3,232,643	2,913,484	6,390,256	5,981,240
Income (Loss) From Operations	(109,936)	(483,360)	111,012	(684,961)
Other Expense				
Interest Expense	(139,247)	(112,002)	(271,269)	(207,188)
Loss Before Income Taxes	(249,183)	(595,362)	(160,257)	(892,149)
Income Tax Benefit	(69,000)	(217,000)	(43,000)	(321,000)
Net Loss	\$ (180,183)	\$ (378,362)	\$ (117,257)	\$ (571,149)
Loss Per Common Share:				
Basic	\$ (0.07)	\$ (0.14)	\$ (0.04)	\$ (0.21)
Weighted Average Number of Common Shares Outstanding - Basic	2,747,700	2,746,325	2,747,012	2,745,183
Diluted	\$ (0.07)	\$ (0.14)	\$ (0.04)	\$ (0.21)
Weighted Average Number of Common Shares Outstanding - Diluted	2,747,700	2,746,325	2,747,012	2,745,183



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## NORTECH SYSTEMS INCORPORATED AND SUBSIDIARIES

## CONSOLIDATED BALANCE SHEETS

	JUNE 30 2016 (Unaudited)	DECEMBER 31 2015
<b>ASSETS</b>		
Current Assets		
Cash	\$ 13,536	\$ 887
Accounts Receivable, Less Allowance for Uncollectible Accounts	18,101,914	18,431,746
Inventories, Less Reserve for Excess and Obsolete	21,520,434	20,185,445
Prepaid Expenses	1,228,148	1,452,656
Income Taxes Receivable	446,962	302,005
Total Current Assets	41,310,994	40,372,739
Property and Equipment, Net	10,808,026	10,507,748
Other Intangible Assets, Net	1,957,092	2,052,420
Goodwill	3,283,454	3,283,454
Deferred Tax Assets	307,671	341,000
Other Assets	7,726	7,726
Total Assets	\$ 57,674,963	\$ 56,565,087
<b>LIABILITIES AND SHAREHOLDERS EQUITY</b>		
Current Liabilities		
Current Maturities of Long-Term Debt	\$ 1,508,921	\$ 1,495,513
Accounts Payable	14,164,865	13,041,377
Accrued Payroll and Commissions	3,196,883	3,139,698
Other Accrued Liabilities	1,753,644	1,987,740
Income Taxes Payable	54,180	7,382
Total Current Liabilities	20,678,493	19,671,710
Long-Term Liabilities		
Line of Credit	\$ 8,539,994	\$ 7,691,237
Long-Term Debt, Net of Current Maturities	5,461,237	5,954,669
Other Long-Term Liabilities	860,033	975,615
Total Long-Term Liabilities	14,861,264	14,621,521
Total Liabilities	35,539,757	34,293,231
Shareholders Equity		
Preferred Stock, \$1 par value; 1,000,000 Shares Authorized: 250,000 Shares Issued and Outstanding	250,000	250,000
Common Stock - \$0.01 par value; 9,000,000 Shares Authorized: 2,747,831 Shares Issued and Outstanding at June 30, 2016, 2,746,325 Shares Issued and Outstanding at December 31, 2015	27,478	27,463
Additional Paid-In Capital	15,746,605	15,766,013
Accumulated Other Comprehensive Loss	(62,936)	(62,936)
Retained Earnings	6,174,059	6,291,316
Total Shareholders Equity	22,135,206	22,271,856
Total Liabilities and Shareholders Equity	\$ 57,674,963	\$ 56,565,087

See Accompanying Condensed Notes to Consolidated Financial Statements





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## NORTECH SYSTEMS INCORPORATED AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF CASH FLOWS

(UNAUDITED)

	SIX MONTHS ENDED JUNE 30	
	2016	2015
<b>Cash Flows From Operating Activities</b>		
Net Loss	\$ (117,257)	\$ (571,149)
Adjustments to Reconcile Net Loss to Net Cash Provided by (Used in) Operating Activities		
Depreciation	1,029,106	1,062,951
Amortization	95,329	2,646
Compensation on Stock-Based Awards	994	(669)
Compensation on Equity Appreciation Rights	(6,422)	(58,310)
Deferred Taxes	33,830	
Loss on Disposal of Property and Equipment		1,129
Changes in Current Operating Items		
Accounts Receivable	329,832	710,817
Inventories	(1,334,989)	(2,076,663)
Prepaid Expenses	224,508	(491,585)
Income Taxes Receivable	(145,458)	(376,870)
Income Taxes Payable	46,798	
Accounts Payable	1,175,815	1,998,289
Accrued Payroll and Commissions	57,185	(353,581)
Other Accrued Liabilities	(330,457)	16,225
Net Cash Provided by (Used in) Operating Activities	1,058,814	(136,770)
<b>Cash Flows from Investing Activities</b>		
Purchases of Property and Equipment	(1,389,942)	(1,214,489)
Net Cash Used in Investing Activities	(1,389,942)	(1,214,489)
<b>Cash Flows from Financing Activities</b>		
Net Change in Line of Credit	848,757	472,858
Proceeds from Long-Term Debt	250,000	1,352,159
Principal Payments on Long-Term Debt	(734,593)	(427,752)
Debt Issuance Costs		(54,838)
Excess Tax Benefits from Stock-Based Compensation	(25,209)	911
Proceeds from Issuance of Common Stock	4,822	10,333
Net Cash Provided by Financing Activities	343,777	1,353,671
Net Increase in Cash	12,649	2,412
Cash - Beginning	887	66,371
Cash - Ending	\$ 13,536	\$ 68,783
<b>Supplemental Disclosure of Cash Flow Information Cash Paid During the Period for Interest</b>		
	\$ 260,644	\$ 200,645
<b>Supplemental Noncash Investing and Financing Activities Capital Expenditures in Accounts Payable</b>		
	1,740	19,604

See Accompanying Condensed Notes to Consolidated Financial Statements



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**CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**

**NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

*Basis of Presentation*

The accompanying unaudited consolidated financial statements for the interim periods have been prepared in accordance with Generally Accepted Accounting Principles in the United States of America ( GAAP ) for interim financial information and pursuant to the rules and regulations of the Securities and Exchange Commission. Accordingly, they do not include all of the financial information and footnotes required by GAAP for complete financial statements, although we believe the disclosures are adequate to make the information presented not misleading. It is suggested that these consolidated financial statements be read in conjunction with the consolidated financial statements and the notes thereto included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2015. The operating results for the interim periods presented are not necessarily indicative of the results expected for the full year or for any other interim period. In our opinion, all adjustments (consisting of normal recurring adjustments) considered necessary for a fair presentation have been included.

The preparation of financial statements in conformity with GAAP requires us 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 reporting period. In preparing these consolidated financial statements, we have made our best estimates and judgments of certain amounts included in the consolidated financial statements, giving due consideration to materiality. Changes in the estimates and assumptions used by us could have a significant impact on our financial results, since actual results could differ from those estimates.

*Principles of Consolidation*

The consolidated financial statements include the accounts of Nortech Systems Incorporated and its wholly owned subsidiaries, Manufacturing Assembly Solutions of Monterrey, Inc. and Nortech Systems Hong Kong Company, Limited. All significant intercompany accounts and transactions have been eliminated.

*Revenue Recognition*

We recognize manufacturing revenue when we ship goods or the goods are received by our customer, when title has passed, all contractual obligations have been satisfied, the price is fixed or determinable and collection of the resulting receivable is reasonably assured. Generally, there are no formal substantive customer acceptance requirements or further obligations related to manufacturing services. If such requirements or obligations exist, then we recognize the related revenues at the time when such requirements are completed and the obligations are fulfilled. We also provide engineering services separate from the manufacture of a product. Revenue for engineering services is generally recognized on a time and material basis or upon completion of the engineering process. In addition, we have another separate source of revenue that comes from short-term repair services, which are recognized when the repairs are completed and the repaired products are shipped back to the customer. Our net sales for services were less than 10% of our total sales for all periods presented, and accordingly, are included in net sales in the consolidated

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statement of operations. Shipping and handling costs charged to our customers are included in net sales, while the corresponding shipping expenses are included in cost of goods sold.

Table of Contents**Stock Options**

Following is the status of all stock options as of June 30, 2016, including changes during the six-month period then ended:

	Shares	Weighted-Average Exercise Price Per Share	Weighted-Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value
Outstanding - January 1, 2016	139,750	\$ 6.66		
Exercised	(1,507)	3.20		
Cancelled	(59,493)	7.18		
Outstanding - June 30, 2016	78,750	\$ 6.33	2.44	\$ 7,685
Exercisable - June 30, 2016	78,750	\$ 6.33	2.44	\$ 7,685

The total intrinsic value of options exercised during the three and six months ended June 30, 2016 and 2015 was \$964 and \$8,166, respectively. Cash received from options exercised during the three and six months ended June 30, 2016 and 2015 was \$4,822 and \$10,333, respectively. There were no stock options granted during the three and six months ended June 30, 2016 and 2015.

Total compensation expense (income) related to stock options for the three months ended June 30, 2016 and 2015 was \$0 and (\$4,338), respectively. Total compensation expense (income) related to stock options for the six months ended June 30, 2016 and 2015 was \$994 and (\$669), respectively. As of June 30, 2016, there was no remaining unrecognized compensation.

**Equity Appreciation Rights Plan**

In November 2010, the Board of Directors approved the adoption of the Nortech Systems Incorporated Equity Appreciation Rights Plan ( 2010 Plan ). The total number of Equity Appreciation Right Units ( Units ) the Plan can issue shall not exceed an aggregate of 1,000,000 Units as amended and restated on March 11, 2015. The 2010 Plan provides that Units issued shall fully vest three years from the base date as defined in the agreement unless terminated earlier. Units give the holder a right to receive a cash payment equal to the appreciation in book value per share of common stock from the base date, as defined, to the redemption date. Unit redemption payments under this plan shall be paid in cash within 90 days after we determine the book value of the Units as of the calendar year immediately preceding the redemption date.

During the three and six months ended June 30, 2016, no additional Units were granted.

Total compensation expense (income) related to the vested outstanding Units based on the estimated appreciation over their remaining terms was approximately \$3,300 and (\$46,000) for the three months ended June 30, 2016 and 2015, respectively and (\$6,400) and (\$58,000) for the six months ended June 30, 2016 and 2015, respectively. The income for the six months ended June 30, 2016 and the three and six months ended June 30, 2015 was the result of a change in the estimate of the appreciation of book value per share of common stock.

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As of June 30, 2016 and December 31, 2015, approximately \$75,000 and \$143,000 is accrued under this plan, respectively. As of June 30, 2016, approximately \$50,000 of this balance is included in other accrued liabilities and the remaining \$25,000 balance was included in other long-term liabilities. As of December 31, 2015, approximately \$61,000 of this balance is included in other accrued liabilities and the remaining \$82,000 balance was included in other long-term liabilities.

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*Earnings per Common Share*

For the three and six months ended June 30, 2016 and 2015, the effect of all stock options is antidilutive due to the net loss incurred and, therefore, were not included in the computation of per-share amounts.

*Segment Reporting Information*

All of our operations fall under the Contract Manufacturing segment within the Electronic Manufacturing Services industry. We strategically direct production between our various manufacturing facilities based on a number of considerations to best meet our customers' requirements. We share resources for sales, marketing, engineering, supply chain, information services, human resources, payroll, and all corporate accounting functions. Consolidated financial information is available that is evaluated regularly by the chief operating decision maker in assessing performance and allocating resources.

*Accounts Receivable and Allowance for Doubtful Accounts*

We grant credit to customers in the normal course of business. Accounts receivable are unsecured and are presented net of an allowance for doubtful accounts. The allowance for doubtful accounts was approximately \$371,000 and \$320,000 at June 30, 2016 and December 31, 2015, respectively. We determine our allowance by considering a number of factors, including the length of time accounts receivable are past due, our previous loss history, the customers' current ability to pay their obligations to us, and the condition of the general economy and the industry as a whole. We write-off accounts receivable when they become uncollectible, and payments subsequently received on such receivables are credited to the allowance for uncollectible accounts.

*Inventories*

Inventories are stated at the lower of cost (first-in, first-out method) or market (based on the lower of replacement cost or net realizable value). Costs include material, labor, and overhead required in the warehousing and production of our products. Inventory reserves are maintained for the estimated value of the inventories that may have a lower value than stated or quantities in excess of future production needs.

Inventories are as follows:

	<b>June 30 2016</b>	<b>December 31 2015</b>
Raw Materials	\$ 14,504,054	\$ 13,782,411

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Work in Process	4,941,600	4,674,223
Finished Goods	2,868,189	2,478,423
Reserve	(793,409)	(749,612)
Total	\$ 21,520,434	\$ 20,185,445



Table of Contents*Other Intangible Assets*

Other intangible assets at June 30, 2016 and December 31, 2015 are as follows:

	Remaining Lives (Years)	June 30, 2016		
		Gross Carrying Amount	Accumulated Amortization	Net Book Value
Customer Relationships	8	\$ 1,302,000	\$ 144,665	\$ 1,157,335
Trade Names	19	\$ 814,000	\$ 40,700	\$ 773,300
Bond Issue Costs	5	\$ 79,373	\$ 52,916	\$ 26,457
Totals		\$ 2,195,373	\$ 238,281	\$ 1,957,092

	Remaining Lives (Years)	December 31, 2015		
		Gross Carrying Amount	Accumulated Amortization	Net Book Value
Customer Relationships	9	\$ 1,302,000	\$ 72,333	\$ 1,229,667
Trade Names	20	\$ 814,000	\$ 20,350	\$ 793,650
Bond Issue Costs	6	\$ 79,373	\$ 50,270	\$ 29,103
Totals		\$ 2,195,373	\$ 142,953	\$ 2,052,420

Amortization expense for the three and six months ended June 30, 2016 was \$47,666 and \$95,329, respectively. Amortization expense for the three and six months ended June 30, 2015 was \$1,323 and \$2,646, respectively.

Estimated future amortization expense related to these assets is approximately as follows:

Remainder of 2016	\$	95,000
2017		191,000
2018		191,000
2019		191,000
2020		191,000
Thereafter		1,098,092
Total	\$	1,957,092

*Impairment of Goodwill and Other Intangible Assets*

In accordance with ASC 350, *Goodwill and Other Intangible Assets*, goodwill is not amortized but is required to be reviewed for impairment at least annually or when events or circumstances indicate that carrying value may exceed fair value. We test impairment annually as of October 1st. No events were identified during the three and six months ended June 30, 2016 that would require us to test for impairment.



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***Impairment Analysis***

We evaluate long-lived assets, primarily property and equipment, as well as the related depreciation periods, whenever current events or changes in circumstances indicate that the carrying amount of an asset or asset group may not be recoverable. Recoverability for assets to be held and used is based on our projection of the undiscounted future operating cash flows of the underlying assets. To the extent such projections indicate that future undiscounted cash flows are not sufficient to recover the carrying amounts of related assets, a charge might be required to reduce the carrying amount to equal estimated fair value. No impairment expense was recorded during the three and six months ended June 30, 2016.

***Recent Accounting Pronouncements***

In March 2016, the Financial Accounting Standards Board ( FASB ) issued Accounting Standards Update ( ASU ) 2016-09, *Compensation - Stock Compensation: Improvements to Employee Share-Based Payment Accounting*, which changes how companies account for certain aspects of share-based payments to employees. The new guidance requires all income tax effects of awards to be recognized in the income statement when the awards vest or are settled, allows an employer to repurchase more of an employee's shares than previously allowed for tax withholding purposes without triggering liability accounting, allows a company to make a policy election to account for forfeitures as they occur, and eliminates the requirement that excess tax benefits be realized before companies can recognize them. The new guidance also requires excess tax benefits and tax shortfalls to be presented on the cash flow statement as an operating activity rather than as a financing activity, and clarifies that cash paid to a tax authority when shares are withheld to satisfy its statutory income tax withholding obligation are to be presented as a financing activity. The standard is effective for our financial statements issued for fiscal years beginning after December 15, 2016, and interim periods within those fiscal years. Early adoption is permitted. We are currently evaluating the impact of adoption of this ASU on our consolidated financial statements.

During February 2016, the FASB issued ASU No. 2016-02, *Leases*. ASU No. 2016-02 was issued to increase transparency and comparability among organizations by recognizing all lease transactions (with terms in excess of 12 months) on the balance sheet as a lease liability and a right-of-use asset (as defined). ASU No. 2016-02 is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years, with earlier application permitted. Upon adoption, the lessee will apply the new standard retrospectively to all periods presented or retrospectively using a cumulative effect adjustment in the year of adoption. We are currently assessing the effect that ASU No. 2016-02 will have on its results of operations, financial position and cash flows.

In May 2014, the FASB issued ASU 2014-09, *Revenue from Contracts with Customers (Topic 606)*. This standard outlines a single comprehensive model for companies to use in accounting for revenue arising from contracts with customers and supersedes most current revenue recognition guidance, including industry-specific guidance. The core principle of the revenue model is that revenue is recognized when a customer obtains control of a good or service. A customer obtains control when it has the ability to direct the use of and obtain the benefits from the good or service. Transfer of control is not the same as transfer of risks and rewards, as it is considered in current guidance. We will also need to apply new guidance to determine whether revenue should be recognized over time or at a point in time. This standard will be effective for the first interim period within annual reporting periods beginning after December 15, 2017, with no early adoption permitted, using either of two methods: (a) retrospective to each prior reporting period presented with the option to elect certain practical expedients as defined within ASU 2014-09; or (b) retrospective with the cumulative effect of initially applying ASU 2014-09 recognized at the date of initial application and providing certain additional disclosures as defined in ASU 2014-09. We have not yet selected a transition method and are currently evaluating the impact of the pending adoption of ASU 2014-09 on the consolidated financial statements.



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**NOTE 2. CONCENTRATION OF CREDIT RISK AND MAJOR CUSTOMERS**

Financial instruments that potentially subject us to concentrations of credit risk consist principally of cash and accounts receivable. With regard to cash, we maintain our excess cash balances in checking accounts at two high-credit quality financial institutions. These accounts may at times exceed federally insured limits. We grant credit to customers in the normal course of business and do not require collateral on our accounts receivable.

Our largest customer has two divisions that together accounted for 10% or more of our net sales during the three and six months ended June 30, 2016 and 2015. One division accounted for approximately 20% and 19% of net sales for the three and six months ended June 30, 2016, respectively, and approximately 17% of net sales for the three and six months ended June 30, 2015. The second division accounted for approximately 4% and 5% of net sales for the three and six months ended June 30, 2016, respectively, and approximately 8% of net sales for the three and six months ended June 30, 2015. Together they accounted for approximately 24% of net sales for the three and six months ended June 30, 2016 and approximately 25% of net sales for the three and six months ended June 30, 2015. Accounts receivable from the customer at June 30, 2016 and December 31, 2015 represented approximately 18% and 17% of our total accounts receivable, respectively.

Export sales represented approximately 13% of net sales for the three months ended June 30, 2016 and 2015, respectively. Export sales represented 12% of net sales for the six months ended June 30, 2016 and 2015, respectively.

**NOTE 3. FINANCING ARRANGEMENTS**

We have a credit agreement with Wells Fargo Bank ( WFB ) which was most recently amended on February 22, 2016 and provides for a line of credit arrangement of \$15.0 million that expires, if not renewed, on May 31, 2018. The credit arrangement also has a \$1.8 million real estate term note outstanding with a maturity date of March 31, 2027, an additional \$1.7 million real estate term note outstanding that is due, if not renewed, on December 31, 2027, an equipment loan for \$2.7 million and a term loan facility of up to \$1.0 million for capital expenditures, both with maturity dates of May 31, 2018.

Under the credit agreement, both the line of credit and real estate term notes are subject to variations in the LIBOR rate. Our line of credit bears interest at three-month LIBOR + 2.25% (approximately 2.9% at June 30, 2016) while our real estate term notes bear interest at three-month LIBOR + 2.75% (approximately 3.4% at June 30, 2016). The weighted-average interest rate on our line of credit was 3.1% and 3.0% for the three and six months ended June 30, 2016, respectively. We had borrowing on our line of credit of \$8,539,994 and \$7,691,237 outstanding as of June 30, 2016 and December 31, 2015, respectively. The line of credit requires a lock box arrangement; however there are no acceleration clauses that would accelerate the maturity of our outstanding borrowings.

The credit agreement contains certain covenants which, among other things, require us to adhere to regular reporting requirements, abide by annual shareholder dividend limitations, maintain certain financial performance, and limit the amount of annual capital expenditures.

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The availability under the line is subject to borrowing base requirements, and advances are at the discretion of the lender. At June 30, 2016, we have net unused availability under our line of credit of approximately \$6,135,006. The line is secured by substantially all of our assets.

As part of the July 1, 2015 Devicix acquisition we entered into two unsecured subordinated promissory notes payable to the seller in the principal amounts of \$1.0 million and \$1.3 million. The \$1.0 million promissory note has a four-year term, bearing interest at 4% per annum, requiring monthly principal and interest payments of \$22,579 and is subject to offsets if certain revenue levels are not met. The \$1.3 million promissory note has a four year term and bears interest at 4% per annum, requiring monthly principal and interest payments of \$29,353 and is not subject to offset.

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Long-term debt at June 30, 2016 and December 31, 2015 consisted of the following:

	June 30 2016	December 31 2015
Term notes payable - Wells Fargo Bank, N.A.		
Real estate term notes bearing interest at three month LIBOR + 2.75% maturing March 31, 2027, and December 31, 2027 with combined monthly payments of approximately \$19,000 plus interest, secured by substantially all assets.	\$ 2,530,461	\$ 2,645,495
Equipment notes bearing interest at three month LIBOR + 2.75% maturing May 2018 with a combined monthly payments of approximately \$46,000 plus interest, secured by substantially all assets	2,592,093	2,633,740
Industrial revenue bond payable to the City of Blue Earth, Minnesota which bears a variable interest rate (approx. 0.25% at March 31, 2016), and has a maturity date of June 1, 2021, with principal of \$80,000 payable annually on June 1	200,000	280,000
Devicix Acquisition Note 1 payable to DeLange Holdings bears interest rate of 4.0% per annum, maturing July 1, 2019	784,733	903,128
Devicix Acquisition Note 2 payable to DeLange Holdings bears interest rate of 4.0% per annum, maturing July 1, 2019	1,020,153	1,174,066
	7,127,440	7,636,429
Discount on Devicix Notes Payable	(122,247)	(142,072)
Debt issuance Costs	(35,035)	(44,175)
Total long-term debt	6,970,158	7,450,182
Current maturities of long-term debt	(1,508,921)	(1,495,513)
Long-term debt - net of current maturities	\$ 5,461,237	\$ 5,954,669

#### **NOTE 4. INCOME TAXES**

On a quarterly basis, we estimate what our effective tax rate will be for the full fiscal year and record a quarterly income tax provision based on the anticipated rate. As the year progresses, we refine our estimate based on the facts and circumstances, including discrete events, by each tax jurisdiction. Our effective tax rate for the three and six months ended June 30, 2016 was 28% and 27%, respectively. Our effective tax rate for the three and six months ended June 30, 2015 was 36%. The effective tax rate for the year ended December 31, 2016 is expected to be 33% compared to 36% for the year ended December 31, 2015. The decrease is due mainly to the impact of the federal research and development credit.

The differences between federal income taxes computed at the federal statutory rate and reported income taxes for the three and six months ended June 30, 2016 and 2015 are as follows:





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	Three Months Ended June 30		Six Months Ended June 30	
	2016	2015	2016	2015
Statutory federal tax benefit	\$ (89,000)	\$ (188,000)	\$ (55,000)	\$ (270,000)
State income taxes (benefits)	13,000	(16,000)	16,000	(26,000)
Income tax credits	(17,000)	(12,000)	(40,000)	(25,000)
Other	24,000	(1,000)	36,000	
Income tax benefit	\$ (69,000)	\$ (217,000)	\$ (43,000)	\$ (321,000)

At June 30, 2016, we had \$54,000 of net uncertain tax benefit positions remaining in other long-term liabilities related to research and development credits that would increase our effective income tax rate if recognized. At December 31, 2015, we had \$51,000 of net uncertain tax benefit positions recorded in other long-term liabilities that would reduce our effective income tax rate if recognized.

In November 2015, the FASB issued ASU 2015-17, *Income Taxes (Topic 740) Balance Sheet Classification of Deferred Taxes* which requires that deferred tax assets and liabilities be classified as noncurrent in a classified balance sheet. The amendment takes effect for public entities for fiscal years beginning after December 15, 2016, with early adoption available. We have adopted the standard in this report and reclassified comparative periods for consistency.

**NOTE 5. COMMITMENTS AND CONTINGENCIES**

We have various operating leases for production and office equipment, office space, and buildings under non-cancelable lease agreements expiring on various dates through 2022.

Rent expense for the three months ended June 30, 2016 and 2015 amounted to approximately \$294,000 and \$183,000, respectively. Rent expense for the six months ended June 30, 2016 and 2015 amounted to approximately \$593,000 and \$363,000, respectively.

Approximate future minimum lease payments under non-cancelable leases subsequent to June 30, 2016 are as follows:

Years Ending December 31,	Amount
2016	\$ 432,000
2017	862,000
2018	766,000
2019	609,000
2020	364,000
Thereafter	310,000
Total	\$ 3,343,000

**NOTE 6. ACQUISITIONS**

On July 1, 2015, we completed the acquisition of substantially all of the assets of Devicix, LLC upon the terms and conditions contained in an Asset Purchase Agreement entered into on June 17, 2015. The asset purchase agreement includes earnout consideration payable within 90 days of the completion of each of the first four 12-month periods after July 1, 2015. The earnout will be equal to 15% of eligible engineering revenue over a \$6,000,000 threshold and 3% of eligible production revenue. The maximum dollar amount of earnout payments under the Asset Purchase Agreement is \$2,500,000. As of the acquisition date, we estimated the fair value of

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the contingent consideration to be \$851,000, using a probability weighted discounted cash flow model. This fair value measurement is based on significant inputs not observable in the market and thus represents a level 3 measurement as defined in ASC 820. The first revenue target, assessed at June 30, 2016, was only partially met. Based on actual results to date and current project updates, the Company revised its related revenue forecast resulting in a \$45,000 reduction of the remaining contingent liability. The offset to this reduction was recorded in general and administrative expenses in the Company's consolidated statement of operations for the three and six month period ended June 30, 2016. The revised estimated fair value of the contingent consideration is \$806,000 at June 30, 2016, and is included in other accrued liabilities on the balance sheet, using a probability weighted discounted cash flow model.

The table below reflects our unaudited pro forma combined results of operations as if the acquisition had taken place as of January 1, 2015:

	<b>Pro Forma Three Months Ended June 30, 2015 (unaudited)</b>	<b>Pro Forma Six Months Ended June 30, 2015 (unaudited)</b>
Net Sales	\$ 28,251,574	\$ 55,900,560
Loss from Operations	\$ (334,360)	\$ (488,231)
Net Loss	\$ (235,726)	\$ (381,822)
<b>Basic &amp; Diluted</b>		
Loss per Common Share	\$ (0.09)	\$ (0.14)

The pro forma unaudited results do not purport to be indicative of the results which would have been obtained had the acquisition been completed as of the beginning of the earliest period presented. In addition they do not include any benefits that may result from the acquisition due to synergies that may be derived from the elimination of any duplicative costs.

Pro forma results presented above reflect: (1) amortization adjustments relating to fair value estimates of intangible assets and (2) incremental interest expense on assumed pro forma adjustments described above have been tax effected using the effective rate during the respective periods.

**NOTE 7. SUBSEQUENT EVENT**

On August 1, 2016 the Company announced plans to close its manufacturing operations in Augusta, Wis., by the end of 2016. Nortech has operated a facility in Augusta since 1992, serving mainly an industrial customer base and defense overflow production that aligned with their custom cable capabilities. Nortech will consolidate operations at its other facilities, continuing to serve customers without interruption. This consolidation will increase Nortech's overall asset utilization and cost leveraging. Approximately 50 employees at the Augusta facility will be affected.

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**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

**Overview**

We are a Maple Grove, Minnesota based full-service electronics manufacturing services ( EMS ) contract manufacturer of wire and cable assemblies, printed circuit board assemblies, higher-level assemblies and box builds for a wide range of industries. We provide value added engineering services and technical support including design, testing, prototyping and supply chain management to customers mainly in the aerospace and defense, medical, and industrial equipment markets. We maintain facilities in Bemidji, Blue Earth, Eden Prairie, Mankato, Merrifield, and Milaca, Minnesota; Augusta, Wisconsin; Monterrey, Mexico; and Suzhou, China. All of our facilities are certified to one or more of the ISO standards, including 9001 and 13485, with most having additional certifications based on the needs of the customers they serve.

Our 2016 second quarter revenue increased by 8% over the prior year, led by our medical customers in both manufacturing and engineering services. Our strategic investment in engineering services helped our growth in the medical market and we believe prospects are good for continued future growth. Our defense revenue continues to stabilize and is showing signs of recovery, while our industrial customers lost some momentum that was building over the past several quarters. Our 90 day backlog as of June 30, 2016, also increased 12% since the start of the quarter.

We are continuing to transform our business model with more early-engagement opportunities and value-added services: engineering design, quick-turn prototyping and additional box-build solutions. Our customers also appreciate our competitive One Nortech global manufacturing options.

Operating profits improvements for the second quarter of 2016 over the prior year's second quarter were aided by the revenue increase and a 170 basis point improvement in gross margin, due to product and service mix. Included in cost of goods sold and negatively impacting the operating profits in the second quarter of 2016 is more than \$200,000 in startup costs for our new Asia manufacturing facility.

Increases to working capital in the first six months of 2016 resulted in cash provided by operating activities of \$1.1 million.

**Summary of Results**

Revenue increased in the second quarter of 2016 by \$2.1 million or 8%, as compared to the second quarter of the prior year. The medical market increased by \$3.6 million or 40%, in the second quarter of 2016 as compared to the same period last year, but was partially offset by decreases in the industrial market. Revenue from the aerospace and defense markets increased by 20% in the second quarter of 2016 as compared to the second quarter of 2015.

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Revenue for the medical market sector increased primarily due to increases in demand and engineering services, including \$2.0 million related to additional Devicix engineering service in the second quarter of 2016.

The net decrease in the industrial market sector of \$2.1 million in the second quarter of 2016 as compared to the same quarter of 2015, resulted primarily from lower demand levels. Our semiconductor and transportation equipment customers were the main reasons for the decrease.

The defense market returned to growth in 2016. The increase is due to increased demand in molded wire and cable product. We have worked diligently with our customers to reflect our value and unique capabilities in custom molded cable assembly technology.

Our second quarter gross profit increased to 10.8% of sales versus 9.1% in the second quarter of the prior year. Our gross profit percentage for the six months ended June 30, 2016 was 11.2% compared to 9.9% for the six

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months ended June 30, 2015. Impacting gross profit in both the second quarter and the first half of the year were volume, product and service mix and the inclusion of Devicix engineering services.

Selling, general and administrative expenses increased approximately \$320,000 to 11.2% of sales in the second quarter of 2016, compared to 10.9% of sales in the same quarter of the prior year. The increase in selling, general and administrative expense was primarily due to the addition of Devicix expenses and the related amortization expense, not reflected in the prior year due to being acquired in the third quarter of 2015.

Second quarter 2016 loss from operations was approximately \$110,000 as compared to a loss from operations of approximately \$483,000 for the second quarter in 2015. For the first six months of the year ended 2016, income from operations was approximately \$111,000 as compared to a loss from operations of \$685,000 for the same period last year. An improvement of approximately \$373,000 for the quarter and approximately \$776,000 for the six months was due to the increased revenue and an improved gross margin product and service mix.

Net loss for the three months ended June 30, 2016 was approximately \$180,000 or \$0.07 loss per basic and diluted common share, compared to net loss for the three months ended June 30, 2015 of approximately \$378,000 or \$0.14 loss per basic and diluted common share. Net loss for the first six months of 2016 was approximately \$117,000 or \$0.04 loss per basic and diluted common share, compared to net loss of approximately \$571,000 or \$0.21 loss per basic and diluted common share for the same period in 2015.

Cash provided by operating activities for the first six months of 2016 was approximately \$1,059,000, as compared to cash flow used by operations in the first six months of 2015 of approximately \$137,000. The noncash addback of depreciation and amortization positively impacted cash flows along with increases in accounts payable through the extension of terms and conditions, offset by increases in inventory.

**Results of Operations**

The following table presents statements of operations data as percentages of total net sales for the periods indicated:

	Three Months Ended June 30		Six Months Ended June 30	
	2016	2015	2016	2015
Net Sales	100.0%	100.0%	100.0%	100.0%
Cost of Goods Sold	89.2	90.9	88.8	90.1
Gross Profit	10.8	9.1	11.2	9.9
Selling Expenses	4.5	4.9	4.5	5.0
General and Administrative Expenses	6.7	6.0	6.5	6.2
Income (Loss) from Operations	(0.4)	(1.8)	0.2	(1.3)
Other Expenses, Net	(0.4)	(0.4)	(0.5)	(0.4)
Loss Before Income Taxes	(0.8)	(2.2)	(0.3)	(1.7)

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Income Tax Benefit	(0.2)	(0.8)	(0.1)	(0.6)
Net Loss	(0.6)%	(1.4)%	(0.2)%	(1.1)%

**Net Sales**

We reported net sales of approximately \$28.9 and \$26.8 million for the three months ended June 30, 2016 and 2015, respectively. We reported net sales of \$57.9 and \$53.3 million for the six months ended June 30, 2016 and 2015, respectively.

For the second quarter of 2016, our medical and defense customers led the increase in revenue, up 40% and 20%, respectively, over the prior year's second quarter, and was up 33% and 25%, respectively, for the six

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months ended June 30, 2016, as compared to the six months ended June 30, 2015. Our Devicix acquisition accounted for \$2.0 million and \$3.6 million of increase in medical revenue for the three and six month periods ended June 30, 2016, respectively. These increases were offset by a decrease in revenue from our industrial customers of 15% for the second quarter of 2016, as compared to the second quarter of 2015, and 11% for the six months ended June 30, 2016, as compared to the six months ended June 30, 2015. Our industrial customers in the transportation and semi-conductor market sectors are being impacted by a sluggish overall economy in the first half of 2016.

Net sales by our major EMS industry markets for the three and six month periods ended June 30, 2016 and 2015 were as follows:

(in thousands)	Three Months Ended June 30			Six Months Ended June 30		
	2016 \$	2015 \$	% Change	2016 \$	2015 \$	% Change
Aerospace and Defense	4,376	3,639	20	8,396	6,691	25
Medical	12,613	9,027	40	24,209	18,192	33
Industrial	11,956	14,135	(15)	25,290	28,458	(11)
Total Sales	28,945	26,801	8	57,895	53,341	9

### **Backlog**

Our 90-day order backlog as of June 30, 2016 was \$22.7 million, an increase of 17% over the prior year and 12% from the beginning of the quarter. Backlog for our medical customers has increased 86% over prior year and 28% over the prior quarter. The Devicix medical device engineering backlog was approximately \$0.9 million as of June 30, 2016, and approximately the same amount at the start of the quarter. There was no backlog related to Devicix in the prior year numbers due to the acquisition taking place in the third quarter of 2015.

The aerospace and defense backlog is down slightly from the beginning of the quarter and our industrial customers backlog increased slightly from prior quarter, however, remains much lower than prior year as we continue to see softness in the transportation, semi conductor equipment and oil and gas industries and costs impacting these customers. Our backlog consists of firm purchase orders and we expect a major portion of the current 90 day backlog to be realized as revenue during the following quarter.

90 day backlog by our major EMS industry markets are as follows:

(in thousands)	Backlog as of the Quarter Ended		
	June 30 2016	March 31 2016	June 30 2015
Aerospace and Defense	\$ 4,791	\$ 5,334	\$ 4,307
Medical	11,428	8,922	6,143
Industrial	6,526	5,980	8,990
Total Backlog	\$ 22,745	\$ 20,236	\$ 19,440



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Our 90 day backlog varies due to order size, manufacturing delays, contract terms and conditions and timing from customer delivery schedules and releases. These variables cause inconsistencies in comparing the backlog from one period to the next.

### **Gross Profit**

Gross profit as a percent of net sales for the three months ended June 30, 2016 and 2015 was 10.8% and 9.1%, respectively. Gross profit as a percentage of net sales for the six months ended June 30, 2016 and 2015 was

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11.2% and 9.9%, respectively. Impacting gross profit in the second quarter and the first half of the year were volume, product and service mix and the inclusion of Devicix engineering services.

**Selling Expense**

Selling expense for the three months ended June 30, 2016 and 2015 was approximately \$1.3 million or 4.5% of sales and approximately \$1.3 million or 4.9% of sales, respectively. Selling expense for the six months ended June 30, 2016 and 2015 was \$2.6 million or 4.5% of sales and \$2.7 million or 5.0% of sales, respectively. The decrease is due to the timing of expenses. We expect to continue funding at an increased rate for business development activities and marketing initiatives to maintain and stimulate sales growth.

**General and Administrative Expense**

General and administrative expenses for the three months ended June 30, 2016 and 2015 were approximately \$1.9 million or 6.7% of sales and approximately \$1.6 million or 6.0% of sales, respectively. General and administrative expenses for the six months ended June 30, 2016 and 2015 were \$3.8 million or 6.5% of sales and \$3.3 million or 6.2% of sales, respectively. The increase in administrative expense was primarily due to the addition of Devicix expenses and the related amortization expense, not reflected in the first half of 2016 as it was acquired in the third quarter of 2015.

**Income Taxes**

On a quarterly basis, we estimate what our effective tax rate will be for the full fiscal year and record a quarterly income tax provision based on the anticipated rate. As the year progresses, we refine our estimate based on the facts and circumstances, including discrete events, by each tax jurisdiction. Our effective tax rate for the three and six months ended June 30, 2016 was 28% and 27%, respectively. Our effective tax rate for the three and six months ended June 30, 2015 was 36%. The effective tax rate for the year ended December 31, 2016 is expected to be 33% compared to 36% for the year ended December 31, 2015. The decrease is due mainly to the impact of the federal research and development credit.

The differences between federal income taxes computed at the federal statutory rate and reported income taxes for the three months ended June 30, 2016 and 2015 are as follows:

	Three Months Ended June 30		Six Months Ended June 30	
	2016	2015	2016	2015
Statutory federal tax benefit	\$ (89,000)	\$ (188,000)	\$ (55,000)	\$ (270,000)
State income taxes (benefits)	13,000	(16,000)	16,000	(26,000)
Income tax credits	(17,000)	(12,000)	(40,000)	(25,000)
Other	24,000	(1,000)	36,000	

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Income tax benefit	\$	(69,000)	\$	(217,000)	\$	(43,000)	\$	(321,000)
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### Liquidity and Capital Resources

We have satisfied our liquidity needs over the past several years with cash flows generated from operations and an operating line of credit through WFB. We also have real estate and equipment term loans. We have a credit agreement with WFB which was most recently amended on February 22, 2016 and provides for a line of credit arrangement of \$15.0 million that expires, if not renewed, on May 31, 2018. The credit arrangement also has a \$1.8 million real estate term note outstanding with a maturity date of March 31, 2027, an additional \$1.7 million real estate term note outstanding that is due, if not renewed, on December 31, 2027, an equipment loan for \$2.7 million and a term loan facility of up to \$1.0 million for capital expenditures, both with maturity dates of May 31, 2018.

Both the line of credit and real estate term notes are subject to fluctuations in the LIBOR rates. The line of credit, real estate term notes, and equipment loans with WFB contain certain covenants which, among other things, require us to adhere to regular reporting requirements, abide by annual shareholder dividend limitations,

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maintain certain financial performance, and limit the amount of annual capital expenditures. The availability under our line is subject to borrowing base requirements, and advances are at the discretion of the lender. The line of credit is secured by substantially all of our assets.

On June 30, 2016, we had outstanding advances of \$8.5 million under the line of credit and unused availability of \$6.1 million supported by our borrowing base. We believe our financing arrangements and cash flows to be provided by operations will be sufficient to satisfy our future working capital needs. Our working capital was \$20.6 and \$20.7 million as of June 30, 2016 and December 31, 2015, respectively.

Our credit agreement with WFB requires us to maintain a minimum fixed charge coverage ratio of not less than 1.15 to 1.00. The fixed charge coverage ratio at June 30, 2016 was 1.21 to 1.00. We believe our performance will be sufficient to comply with this covenant going forward.

Net cash provided by operating activities for the six months ended June 30, 2016 was \$1.1 million. The noncash addback of depreciation and amortization positively impacted cash flows along with increases in accounts payable through the extension of terms and conditions, offset by increases in inventory.

Net cash used in investing activities of \$1.4 million for the six months ended June 30, 2016 is comprised of property and equipment purchases to support the business.

Cash conversion cycle:

	Six Months Ended	
	June 30, 2016	June 30, 2015
Days in trade accounts receivable	52	53
Days in inventory	78	78
Days in accounts payable	(47)	(35)
Cash conversion cycle	83	96

We calculate days in accounts receivable as accounts receivable for the respective quarter divided by annualized sales for the respective quarter by day. We calculate days in inventory and accounts payable as each balance sheet line item for the respective quarter divided by annualized cost of sales for the respective quarter by day. We calculate cash conversion cycle as the sum of days in receivable and inventory less days in accounts payable. Items which may cause the cash conversion cycle in a particular period to differ include, but are not limited to, changes in business mix, changes in payment terms and the timing of revenue recognition and inventory purchases within the period. The decrease in our cash conversion cycle is the result of increased accounts payable. Days in accounts payable for the six months ended June 30, 2016 increased twelve days compared to the six months ended June 30, 2015 as a result of extending vendor terms and conditions.

We do not believe that inflation has had a material impact on our business and operating results during the periods presented.

**Off-Balance Sheet Arrangements**

We have not engaged in any off-balance sheet activities as defined in Item 303(a)(4) of Regulation S-K.

**Critical Accounting Policies and Estimates**

Our significant accounting policies and estimates are summarized in Management's Discussion and Analysis of Financial Condition and Results of Operations in our Annual Report on Form 10-K for the year ended December 31, 2015. There have been no significant changes in these critical accounting policies since December 31, 2015. Some of our accounting policies require us to exercise significant judgment in selecting the appropriate assumptions for calculating financial estimates. Such judgments are

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subject to an inherent degree of uncertainty. These judgments are based on our historical experience, known trends in our industry, terms of existing contracts and other information from outside sources, as appropriate. Actual results could differ from these estimates.

**Recent Accounting Pronouncements**

In March 2016, the Financial Accounting Standards Board ( FASB ) issued Accounting Standards Update ( ASU ) 2016-09, *Compensation - Stock Compensation: Improvements to Employee Share-Based Payment Accounting*, which changes how companies account for certain aspects of share-based payments to employees. The new guidance requires all income tax effects of awards to be recognized in the income statement when the awards vest or are settled, allows an employer to repurchase more of an employee's shares than previously allowed for tax withholding purposes without triggering liability accounting, allows a company to make a policy election to account for forfeitures as they occur, and eliminates the requirement that excess tax benefits be realized before companies can recognize them. The new guidance also requires excess tax benefits and tax shortfalls to be presented on the cash flow statement as an operating activity rather than as a financing activity, and clarifies that cash paid to a tax authority when shares are withheld to satisfy its statutory income tax withholding obligation are to be presented as a financing activity. The standard is effective for our financial statements issued for fiscal years beginning after December 15, 2016, and interim periods within those fiscal years. Early adoption is permitted. We are currently evaluating the impact of adoption of this ASU on our consolidated financial statements.

During February 2016, the FASB issued ASU No. 2016-02, *Leases*. ASU No. 2016-02 was issued to increase transparency and comparability among organizations by recognizing all lease transactions (with terms in excess of 12 months) on the balance sheet as a lease liability and a right-of-use asset (as defined). ASU No. 2016-02 is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years, with earlier application permitted. Upon adoption, the lessee will apply the new standard retrospectively to all periods presented or retrospectively using a cumulative effect adjustment in the year of adoption. We are currently assessing the effect that ASU No. 2016-02 will have on its results of operations, financial position and cash flows.

In November 2015, the FASB issued ASU 2015-17, *Income Taxes (Topic 740) Balance Sheet Classification of Deferred Taxes* which requires that deferred tax assets and liabilities be classified as noncurrent in a classified balance sheet. The amendment takes effect for public entities for fiscal years beginning after December 15, 2016, with early adoption available. We have adopted the standard in this report and reclassified comparative periods for consistency.

In May 2014, the FASB issued ASU 2014-09, *Revenue from Contracts with Customers (Topic 606)*. This standard outlines a single comprehensive model for companies to use in accounting for revenue arising from contracts with customers and supersedes most current revenue recognition guidance, including industry-specific guidance. The core principle of the revenue model is that revenue is recognized when a customer obtains control of a good or service. A customer obtains control when it has the ability to direct the use of and obtain the benefits from the good or service. Transfer of control is not the same as transfer of risks and rewards, as it is considered in current guidance. We will also need to apply new guidance to determine whether revenue should be recognized over time or at a point in time. This standard will be effective for the first interim period within annual reporting periods beginning after December 15, 2017, with no early adoption permitted, using either of two methods: (a) retrospective to each prior reporting period presented with the option to elect certain practical expedients as defined within ASU 2014-09; or (b) retrospective with the cumulative effect of initially applying ASU 2014-09 recognized at the date of initial application and providing certain additional disclosures as defined in ASU 2014-09. We have not yet selected a transition method and are currently evaluating the impact of the pending adoption of ASU 2014-09 on the consolidated financial statements.



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**Forward-Looking Statements**

Those statements in the foregoing report that are not historical facts are forward-looking statements made pursuant to the safe-harbor provisions of the Private Securities Litigation Reform Act of 1995. Such statements generally will be accompanied by words such as anticipate, believe, estimate, expect, forecast, intend, possible, potential, predict, project, or other similar words that convey the uncertainty of future outcomes. Although we believe these forward-looking statements are reasonable, they are based upon a number of assumptions concerning future conditions, any or all of which may ultimately prove to be inaccurate. Forward-looking statements involve a number of risks and uncertainties. Important factors that could cause actual results to differ materially from the forward-looking statements include, without limitation:

- Volatility in the marketplace which may affect market supply and demand for our products;
- Increased competition;
- Changes in the reliability and efficiency of operating facilities or those of third parties;
- Risks related to availability of labor;
- Increase in certain raw material costs such as copper;
- Commodity and energy cost instability;
- General economic, financial and business conditions that could affect our financial condition and results of operations; and
- Availability of raw material components.

The factors identified above are believed to be important factors (but not necessarily all of the important factors) that could cause actual results to differ materially from those expressed in any forward-looking statement made by us. Unpredictable or unknown factors not discussed herein could also have material adverse effects on forward-looking statements. All forward-looking statements included in this Form 10-Q are expressly qualified in their entirety by the foregoing cautionary statements. We undertake no obligations to update publicly any forward-looking statement (or its associated cautionary language) whether as a result of new information or future events.

Please refer to forward-looking statements and risks as previously disclosed in our Annual Report on Form 10-K for the fiscal year ended December 31, 2015.

**ITEM 4. CONTROLS AND PROCEDURES**



**Evaluation of Disclosure Controls and Procedures**

In accordance with Rule 13a-15(b) of the Securities Exchange Act of 1934 (the Exchange Act), as of the end of the period covered by this Quarterly Report on Form 10-Q, our management evaluated, with the participation of our Chief Executive Officer and Chief Financial Officer, the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rule 13a-15(e) and Rule 15d-15(e) under the Exchange Act). These controls and procedures are designed to ensure that information required to be disclosed in the Company's Exchange Act reports is (1) recorded, processed, summarized and reported in a timely manner, and (2) accumulated and communicated to management, including the Company's Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. Based upon their evaluation of these disclosure controls and procedures as of the date of the evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the disclosure controls and procedures were effective.

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**Changes in Internal Control Over Financial Reporting**

There was no change in our internal control over financial reporting that occurred during the period covered by this Quarterly Report on Form 10-Q that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

**PART II**

**ITEM 1. LEGAL PROCEEDINGS**

We are subject to various legal proceedings and claims that arise in the ordinary course of business.

**ITEM 5. OTHER INFORMATION**

On August 1, 2016 the Company announced plans to close its manufacturing operations in Augusta, Wis., by the end of 2016. Nortech has operated a facility in Augusta since 1992, serving mainly an industrial customer base and defense overflow production that aligned with their custom cable capabilities. Nortech will consolidate operations at its other facilities, continuing to serve customers without interruption. This consolidation will increase Nortech's overall asset utilization and cost leveraging. Approximately 50 employees at the Augusta facility will be affected.

**ITEM 6. EXHIBITS**

**Exhibits**

- |       |  |
|-------|--|
| 31.1* | Certification of the Chief Executive Officer pursuant to Rule 13a-14(a) and Rule 15d-14(a), promulgated under the Securities Exchange Act of 1934, as amended.   |
| 31.2* | Certification of the Chief Financial Officer pursuant to Rule 13a-14(a) and Rule 15d-14(a), promulgated under the Securities Exchange Act of 1934, as amended.   |
| 32*   | Certification of the Chief Executive Officer and Chief Financial Officer, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.  |
| 101*  | Financial statements from the quarterly report on Form 10-Q for the quarter ended June 30, 2016, formatted in XBRL: (i) Consolidated Balance Sheets, (ii) Consolidated Statements of Income, (iii) Consolidated Statements of Cash Flows, and (iv) the Condensed Notes to Consolidated Financial Statements. |

\*Filed herewith

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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.

Nortech Systems Incorporated and Subsidiaries

Date: August 3, 2016

by /s/ Richard G. Wasielewski

Richard G. Wasielewski  
Chief Executive Officer and President  
Nortech Systems Inc.

Date: August 3, 2016

by /s/ Paula M. Graff

Paula M. Graff  
Vice President and Chief Financial Officer  
Nortech Systems Inc.