

DATA I/O CORP  
Form 10-Q  
August 13, 2014

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, 2014**

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: **0-10394**

**DATA I/O CORPORATION**

(Exact name of registrant as specified in its charter)

Washington  
(State or other jurisdiction of incorporation or organization)

91-0864123  
(I.R.S. Employer Identification No.)

**6464 185<sup>th</sup> Ave NE, Suite 101, Redmond, Washington, 98052**

(Address of principal executive offices, including zip code)

**(425) 881-6444**

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes  No

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

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

Large accelerated filer  Accelerated filer  Non-accelerated filer  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

Shares of Common Stock, no par value, outstanding as of August 1, 2014:

7,843,526

**DATA I/O CORPORATION**  
**FORM 10-Q**  
**For the Quarter Ended June 30, 2014**

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**PART I - FINANCIAL INFORMATION****Item 1.                    Financial Statements**

**DATA I/O CORPORATION  
CONSOLIDATED BALANCE SHEETS  
(in thousands, except share data)  
(UNAUDITED)**

|   | <b>June 30,<br/>2014</b> | <b>December 31,<br/>2013</b> |
|---|--------------------------|------------------------------|
| <b>ASSETS</b>   |                          |                              |
| CURRENT ASSETS:   |                          |                              |
| Cash and cash equivalents   | \$8,220                  | \$10,426                     |
| Trade accounts receivable, net of allowance for<br>doubtful accounts of \$107 and \$87,<br>respectively | 5,171                    | 1,980                        |
| Inventories   | 3,952                    | 3,770                        |
| Other current assets  | 331                      | 395                          |
| <b>TOTAL CURRENT ASSETS</b>   | <b>17,674</b>            | <b>16,571</b>                |
| Property, plant and equipment – net   | 1,090                    | 843                          |
| Other assets  | 88                       | 88                           |
| <b>TOTAL ASSETS</b>   | <b>\$18,852</b>          | <b>\$17,502</b>              |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>   |                          |                              |
| CURRENT LIABILITIES:  |                          |                              |
| Accounts payable  | \$1,315                  | \$720                        |
| Accrued compensation  | 1,194                    | 1,107                        |
| Deferred revenue  | 2,077                    | 1,170                        |
| Other accrued liabilities   | 773                      | 597                          |
| Accrued costs of business restructuring   | 273                      | 723                          |
| Income taxes payable  | 27                       | 10                           |
| <b>TOTAL CURRENT LIABILITIES</b>  | <b>5,659</b>             | <b>4,327</b>                 |
| Long-term other payables  | 236                      | 313                          |
| <b>COMMITMENTS</b>  | <b>-</b>                 | <b>-</b>                     |
| <b>STOCKHOLDERS' EQUITY</b>   |                          |                              |
| Preferred stock -<br>Authorized, 5,000,000 shares, including  |                          |                              |

|  |          |          |
|--|----------|----------|
| 200,000 shares of Series A Junior Participating<br>Issued and outstanding, none  | -        | -        |
| Common stock, at stated value -<br>Authorized, 30,000,000 shares<br>Issued and outstanding, 7,843,526 shares as of<br>June 30,<br>2014 and 7,786,053 shares as of December 31,<br>2013 | 18,530   | 18,343   |
| Accumulated earnings (deficit)   | (6,938)  | (7,042)  |
| Accumulated other comprehensive income   | 1,365    | 1,561    |
| TOTAL STOCKHOLDERS' EQUITY   | 12,957   | 12,862   |
| TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY   | \$18,852 | \$17,502 |

*See notes to consolidated financial statements*

**DATA I/O CORPORATION**  
**CONSOLIDATED STATEMENTS OF OPERATION**  
(in thousands, except per share amounts)  
**(UNAUDITED)**

|  | <b>Three Months Ended</b> |             | <b>Six Months Ended</b> |             |
|--|---------------------------|-------------|-------------------------|-------------|
|  | <b>June 30,</b>           |             | <b>June 30,</b>         |             |
|  | <b>2014</b>               | <b>2013</b> | <b>2014</b>             | <b>2013</b> |
| Net Sales                                | \$5,599                   | \$5,271     | \$10,418                | \$10,029    |
| Cost of goods sold                       | 2,577                     | 2,332       | 4,901                   | 4,549       |
| Gross margin                             | 3,022                     | 2,939       | 5,517                   | 5,480       |
| Operating expenses:                      |                           |             |                         |             |
| Research and development                 | 1,173                     | 1,117       | 2,323                   | 2,321       |
| Selling, general and administrative      | 1,456                     | 1,785       | 3,144                   | 3,592       |
| Provision for business restructuring     | -                         | 642         | 13                      | 642         |
| Total operating expenses                 | 2,629                     | 3,544       | 5,480                   | 6,555       |
| Operating income (loss)                  | 393                       | (605)       | 37                      | (1,075)     |
| Non-operating income (expense):          |                           |             |                         |             |
| Interest income                          | 53                        | 56          | 72                      | 74          |
| Foreign currency transaction gain (loss) | 8                         | (55)        | 27                      | (57)        |
| Total non-operating income (expense)     | 61                        | 1           | 99                      | 17          |
| Income (loss) before income taxes        | 454                       | (604)       | 136                     | (1,058)     |
| Income tax (expense) benefit             | (7)                       | (20)        | (32)                    | (25)        |
| Net income (loss)                        | \$447                     | (\$624)     | \$104                   | (\$1,083)   |
| <br>                                     |                           |             |                         |             |
| Basic earnings (loss) per share          | \$0.06                    | (\$0.08)    | \$0.01                  | (\$0.14)    |
| Diluted earnings (loss) per share        | \$0.06                    | (\$0.08)    | \$0.01                  | (\$0.14)    |
| Weighted-average basic shares            | 7,814                     | 7,762       | 7,801                   | 7,756       |
| Weighted-average diluted shares          | 7,899                     | 7,762       | 7,892                   | 7,756       |

*See notes to consolidated financial statements*

**DATA I/O CORPORATION**  
**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)**  
(in thousands)  
**(UNAUDITED)**

|  | <b>Three Months Ended</b> |             | <b>Six Months Ended</b> |             |
|--|---------------------------|-------------|-------------------------|-------------|
|  | <b>June 30,</b>           |             | <b>June 30,</b>         |             |
|  | <b>2014</b>               | <b>2013</b> | <b>2014</b>             | <b>2013</b> |
| Net Income (loss)                        | \$447                     | (\$624)     | \$104                   | (\$1,083)   |
| Other comprehensive income:              |                           |             |                         |             |
| Foreign currency translation gain (loss) | 24                        | 71          | (196)                   | (8)         |
| Comprehensive income (loss)              | \$471                     | (\$553)     | (\$92)                  | (\$1,091)   |

*See notes to consolidated financial statements*

**DATA I/O CORPORATION**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(in thousands, except share amounts)  
**(UNAUDITED)**

|   | <b>For the Six Months<br/>Ended<br/>June 30,</b> |             |
|---|--|-------------|
|   | <b>2014</b>                                      | <b>2013</b> |
| <b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>  |  |             |
| Net income (loss)   | \$104  | (\$1,083)   |
| Adjustments to reconcile net income (loss)<br>to net cash provided by (used in) operating activities: |  |             |
| Depreciation and amortization   | 320  | 343         |
| Equipment transferred to cost of goods sold   | 140  | (5)         |
| Share-based compensation  | 211  | 206         |
| Net change in:  |  |             |
| Trade accounts receivable   | (3,189)  | (559)       |
| Inventories   | (165)  | 640         |
| Other current assets  | 67   | 182         |
| Accrued cost of business restructuring  | (502)  | 503         |
| Accounts payable and accrued liabilities  | 872  | 99          |
| Deferred revenue  | 915  | 2           |
| Other long-term liabilities   | (35)   | (27)        |
| Deposits and other long-term assets   | -  | 1           |
| Net cash provided by (used in) operating activities   | (1,262)  | 302         |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>  |  |             |
| Purchases of property, plant and equipment  | (707)  | (236)       |
| Cash provided by (used in) investing activities   | (707)  | (236)       |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>  |  |             |
| Proceeds from issuance of common stock, net of tax withholding  | (25)   | 5           |
| Repurchase of common stock  | -  | (5)         |
| Cash provided by (used in) financing activities   | (25)   | -           |
| Increase/(decrease) in cash and cash equivalents  | (1,994)  | 66          |
| Effects of exchange rate changes on cash  | (212)  | (6)         |
| Cash and cash equivalents at beginning of period  | 10,426   | 10,528      |
| Cash and cash equivalents at end of period  | \$8,220  | \$10,588    |
| <b>Supplemental disclosure of cash flow information:</b>  |  |             |
| Cash paid (received) during the period for:   |  |             |
| Income Taxes  | \$15   | (\$39)      |



*See notes to consolidated financial statements*

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**DATA I/O CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**(UNAUDITED)**

**NOTE 1 - FINANCIAL STATEMENT PREPARATION**

Data I/O Corporation (“Data I/O”, “We”, “Our”, “Us”) prepared the financial statements as of June 30, 2014 and June 30, 2013 according to the rules and regulations of the Securities and Exchange Commission (“SEC”). These statements are unaudited but, in the opinion of management, include all adjustments (consisting of normal recurring adjustments and accruals) necessary to present fairly the results for the periods presented. The balance sheet at December 31, 2013 has been derived from the audited financial statements at that date. We have condensed or omitted certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America according to such SEC rules and regulations. Operating results for the three and six months ended June 30, 2014 are not necessarily indicative of the results that may be expected for the year ending December 31, 2014. These financial statements should be read in conjunction with the annual audited financial statements and the accompanying notes included in our Form 10-K for the year ended December 31, 2013.

Revenue Recognition

We recognize revenue at the time the product is shipped. We have determined that our programming equipment has reached a point of maturity and stability such that product acceptance can be assured by testing at the factory prior to shipment and that the installation meets the criteria to be considered a separate element. These systems are standard products with published product specifications and are configurable with standard options. The evidence that these systems could be deemed as accepted was based upon having standardized factory production of the units, results from batteries of tests of product performance to our published specifications, quality inspections and installation standardization, as well as past product operation validation with the customer and the history provided by our installed base of products upon which the current versions were based.

The revenue related to products requiring installation that is perfunctory is recognized at the time of shipment. Installation that is considered perfunctory includes any installation that can be performed by other parties, such as distributors, other vendors, or in most cases the

customers themselves. This takes into account the complexity, skill and training needed as well as customer expectations regarding installation.

We enter into multiple deliverables arrangements that arise during the sale of a system that includes an installation component, a service and support component and a software maintenance component. We allocate the value of each element based on relative selling prices. Relative selling price is based on the selling price of the standalone system. For the installation and service and support components, we use what we charge to distributors who perform these components. For software maintenance components, we use what we charge for annual software maintenance renewals after the initial year the system is sold. Revenue is recognized on the system sale based on shipping terms, installation revenue is recognized after the installation is performed, and hardware service and support and software maintenance revenue is recognized ratably over the term of the agreement, typically one year.

When we sell software separately, we recognize software revenue upon shipment provided that only inconsequential obligations remain on our part and substantive acceptance conditions, if any, have been met.

We recognize revenue when persuasive evidence of an arrangement exists, shipment has occurred, the price is fixed or determinable, the buyer has paid or is obligated to pay, collectability is reasonably assured, substantive acceptance conditions, if any, have been met, the obligation is not contingent on resale of the product, the buyer's obligation would not be changed in the event of theft, physical destruction or damage to the product, the buyer acquiring the product for resale has economic substance apart from us and we do not have significant obligations for future performance to directly bring about the resale of the product by the buyer. We establish a reserve for sales returns based on historical trends in product returns and estimates for new items.

We transfer certain products out of service from their internal use and make them available for sale. The products transferred are our standard products in one of the following areas: service loaners, rental or test units; engineering test units; or sales demonstration equipment. Once transferred, the equipment is sold by our regular sales channels as used equipment inventory. These product units often involve refurbishing and an equipment warranty, and are conducted as sales in our normal and ordinary course of business. The transfer amount is the product unit's net book value and the sale transaction is accounted for as revenue and cost of goods sold.

### Stock-Based Compensation Expense

We measure and recognize compensation expense as required for all share-based payment awards, including employee stock options and restricted stock unit awards, based on estimated fair values on the grant dates.

### Income Tax

Historically when accounting for uncertainty in income taxes, we have not incurred any interest or penalties associated with tax matters and no interest or penalties were recognized during the three months and six months ended June 30, 2014. However, we have adopted a policy whereby amounts related to penalties associated with tax matters are classified as general and administrative expense when incurred and amounts related to interest associated with tax matters are classified as interest income or interest expense.

We have incurred net operating losses in the current and certain past years. We continue to maintain a valuation allowance for the full amount of the net deferred tax asset balance associated with our net operating losses and credit carryforwards, as sufficient uncertainty exists regarding our ability to realize such tax assets in the future. There was \$192,000 and \$132,000 unrecognized tax benefits related to uncertain tax positions and related valuation allowance as of June 30, 2014 and 2013, respectively.

Tax years that remain open for examination include 2010, 2011, 2012 and 2013 in the United States of America. In addition, tax years from 2000 to 2009 may be subject to examination in the event that we utilize the net operating losses and credit carryforwards from those years in our current or future year tax returns.

### Recent Accounting Pronouncements

In May 2014, the FASB issued ASU 2014-09, "*Revenue from Contracts with Customers*," (ASU 2014-09). The standard provides companies with a single model for accounting for revenue

arising from contracts with customers and supersedes current revenue recognition guidance, including industry-specific revenue guidance. The core principle of the model is to recognize revenue when control of the goods or services transfers to the customer, as opposed to recognizing revenue when the risks and rewards transfer to the customer under the existing revenue guidance. ASU 2014-09 is effective for annual reporting periods beginning after December 15, 2016. Early adoption is not permitted. The guidance permits companies to either apply the requirements retrospectively to all prior periods presented, or apply the requirements in the year of adoption, through a cumulative adjustment. The Company is in the process of evaluating the impact of adoption on its consolidated financial statements.

In April 2014, the FASB issued ASU 2014-08, *“Presentation of Financial Statements and Property, Plant, and Equipment,”* (ASU 2014-08). This ASU changes the threshold for reporting discontinued operations and adds new disclosures. The new guidance defines a discontinued operation as a disposal of a component or group of components that is disposed of or is classified as held for sale and “represents a strategic shift that has (or will have) a major effect on our operations and financial results.” For disposals of individually significant components that do not qualify as discontinued operations, we must disclose pre-tax earnings of the disposed component. This guidance is effective for us prospectively for all disposals (or classifications as held for sale) of components of an entity that occur within annual periods beginning on or after December 15, 2014, and interim periods within those years. Early adoption is permitted, but only for disposals (or classifications as held for sale) that have not been reported in financial statements previously issued or available for issuance. We do not expect the adoption of this guidance to have a material impact on our consolidated financial statements.

**NOTE 2 – INVENTORIES**

Inventories consisted of the following components:

| (in thousands)  | Jun. 30,<br>2014 | Dec. 31,<br>2013 |
|-----------------|------------------|------------------|
| Raw material    | \$2,353          | \$1,988          |
| Work-in-process | 1,260            | 1,309            |
| Finished goods  | 339              | 473              |
| Inventories     | \$3,952          | \$3,770          |

**NOTE 3 – PROPERTY, PLANT AND EQUIPMENT, NET**

Property and equipment consisted of the following components:

| (in thousands)                | Jun. 30,<br>2014 | Dec. 31,<br>2013 |
|-------------------------------|------------------|------------------|
| Leasehold improvements        | \$481            | \$484            |
| Equipment                     | 7,295            | 7,015            |
|                               | 7,776            | 7,499            |
| Less accumulated depreciation | 6,686            | 6,656            |
| Property and equipment, net   | \$1,090          | \$843            |

**NOTE 4 – BUSINESS RESTRUCTURING**

As a result of the business downturn we experienced in late 2011, 2012, and continuing in 2013, as well as the uncertain business outlook at those times, we took additional restructuring actions in the second quarter of 2013 and fourth quarter of 2013 to reduce quarterly operating expenses and production costs.

During the second and fourth quarters of 2013, we took restructuring actions to reduce our excess office space and eliminate certain job positions. These actions resulted in restructuring costs of \$642,000 for the second quarter and \$541,000 in the fourth quarter of 2013. A true up of estimates resulted in a \$13,000 charge during the first quarter of 2014. The positions eliminated allow us to have the flexibility to add other critical positions or change fixed to variable costs through outsourcing. These actions have been fully implemented. At June 30, 2014, the remaining portion of the reserve expected to be paid over the next twelve months is \$273,000 and the long term portion is \$98,000 and relates to the lease abandonment payments that are expected to be completely paid by July 2016.

An analysis of the business restructuring is as follows:

|                                | Reserve<br>Balance<br>Dec. 31,<br>2012 | 2013<br>Expense | 2013<br>Payments/<br>Write-Offs | Reserve<br>Balance<br>Dec. 31,<br>2013 | 2014<br>Expense | 2014<br>Payments/<br>Write-Offs | Reserve<br>Balance<br>Jun. 30,<br>2014 |
|--------------------------------|--|-----------------|---------------------------------|--|-----------------|---------------------------------|--|
| (in thousands)                 |  |                 |                                 |  |                 |                                 |  |
| Downsizing US operations:      |  |                 |                                 |  |                 |                                 |  |
| Employee severance             | \$0                                    | \$457           | \$227                           | \$230                                  | (\$16)          | \$194                           | \$20                                   |
| Other costs                    | -                                      | 273             | 33                              | 240                                    | 25              | 46                              | 219                                    |
| Downsizing foreign operations: |  |                 |                                 |  |                 |                                 |  |
| Employee severance             | 25                                     | 405             | 58                              | 372                                    | 16              | 256                             | 132                                    |
| Other costs                    | -                                      | 48              | 17                              | 31                                     | (12)            | 19                              | -                                      |
| Total                          | \$25                                   | \$1,183         | \$335                           | \$873                                  | \$13            | \$515                           | \$371                                  |

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**NOTE 5 – OTHER ACCRUED LIABILITIES**

Other accrued liabilities consisted of the following components:

| (in thousands)            | Jun. 30,<br>2014 | Dec. 31,<br>2013 |
|---------------------------|------------------|------------------|
| Product warranty          | \$296            | \$281            |
| Sales return reserve      | 55               | 50               |
| Other taxes               | 197              | 112              |
| Other                     | 225              | 154              |
| Other accrued liabilities | \$773            | \$597            |

The changes in Data I/O's product warranty liability for the six months ending June 30, 2014 are as follows:

| (in thousands)               | Jun. 30,<br>2014 |
|------------------------------|------------------|
| Liability, beginning balance | \$281            |
| Net expenses                 | 366              |
| Warranty claims              | (366)            |
| Accrual revisions            | 15               |
| Liability, ending balance    | \$296            |

**NOTE 6 – OPERATING LEASE COMMITMENTS**

We have commitments under non-cancelable operating leases and other agreements, primarily for factory and office space, with initial or remaining terms of one year or more as follows:

For the years ending December 31:

| (in thousands)   | Operating<br>Leases |
|------------------|---------------------|
| 2014 (remaining) | \$613               |
| 2015             | 1,040               |
| 2016             | 620                 |
| 2017             | 41                  |
| 2018             | 10                  |
| Thereafter       | 4                   |
| Total            | \$2,328             |



Of the \$2,328,000, \$210,000 has been accrued as restructure liability related to abandoned lease space.

During the first quarter of 2014, we renewed our lease agreement for our Munich, Germany facility effective February 1, 2015 and extending the term through January 2018 and lowering the square footage to approximately 4,306 square feet. Effective June 1, 2014, the excess space abandoned as part of Q2 2013 restructure actions, was leased to another tenant by the landlord & the lease term was revised to begin June 1, 2014 and extend through May 31, 2017.

#### **NOTE 7 - OTHER COMMITMENTS**

We have purchase obligations for inventory and production costs as well as other obligations such as capital expenditures, service contracts, marketing, and development agreements. Arrangements are considered purchase obligations if a contract specifies all significant terms, including fixed or minimum quantities to be purchased, a pricing structure and approximate timing of the transaction. Most arrangements are cancelable without a significant penalty, and with short notice, typically less than 90 days. At June 30, 2014, the purchase commitments and other obligations totaled \$986,000 of which all but \$28,000 are expected to be paid over the next twelve months.

**NOTE 8 – CONTINGENCIES**

As of June 30, 2014, we were not a party to any legal proceedings or aware of any indemnification agreement claims, the adverse outcome of which in management's opinion, individually or in the aggregate, would have a material adverse effect on our results of operations or financial position.

**NOTE 9 – EARNINGS PER SHARE**

Basic earnings per share is calculated based on the weighted average number of common shares outstanding during each period. Diluted earnings per share is calculated based on these same weighted average shares outstanding plus the effect of potential shares issuable upon assumed exercise of stock options based on the treasury stock method. Potential shares issuable upon the exercise of stock options are excluded from the calculation of diluted earnings per share to the extent their effect would be anti-dilutive.

The following table sets forth the computation of basic and diluted earnings per share:

|   | Three Months Ended |                  | Six Months Ended |                  |
|---|--------------------|------------------|------------------|------------------|
|   | Jun. 30,<br>2014   | Jun. 30,<br>2013 | Jun. 30,<br>2014 | Jun. 30,<br>2013 |
| (in thousands except per share data)  |                    |                  |                  |                  |
| Numerator for basic and diluted earnings (loss) per share:                            |                    |                  |                  |                  |
| Net income (loss)   | \$447              | (\$624)          | \$104            | (\$1,083)        |
| Denominator for basic earnings (loss) per share:                                      |                    |                  |                  |                  |
| weighted-average shares   | 7,814              | 7,762            | 7,801            | 7,756            |
| Employee stock options and awards   | 85                 | -                | 91               | -                |
| Denominator for diluted earnings (loss) per share: adjusted weighted-average shares & |                    |                  |                  |                  |

|   |        |          |        |          |
|---|--------|----------|--------|----------|
| assumed conversions of<br>stock options         | 7,899  | 7,762    | 7,892  | 7,756    |
| Basic and diluted<br>earnings (loss) per share: |        |          |        |          |
| Total basic earnings<br>(loss) per share        | \$0.06 | (\$0.08) | \$0.01 | (\$0.14) |
| Total diluted earnings<br>(loss) per share      | \$0.06 | (\$0.08) | \$0.01 | (\$0.14) |

Options to purchase 557,435 and 863,843 shares were outstanding as of June 30, 2014 and 2013, respectively, but were excluded from the computation of diluted earnings per share for the periods then ended because the options were anti-dilutive.

#### **NOTE 10 – SHARE-BASED COMPENSATION**

For share-based awards granted, we have recognized compensation expense based on the estimated grant date fair value method. For these awards we have recognized compensation expense using a straight-line amortization method reduced for estimated forfeitures.

The impact on our results of operations of recording share-based compensation, net of forfeitures, for the three and six months ended June 30, 2014 and 2013, respectively, was as follows:

|                                     | Three Months Ended |                  | Six Months Ended |                  |
|-------------------------------------|--------------------|------------------|------------------|------------------|
|                                     | Jun. 30,<br>2014   | Jun. 30,<br>2013 | Jun. 30,<br>2014 | Jun. 30,<br>2013 |
| (in thousands)                      |                    |                  |                  |                  |
| Cost of goods sold                  | \$5                | \$13             | \$1              | \$24             |
| Research and development            | 25                 | 28               | 40               | 48               |
| Selling, general and administrative | 95                 | 95               | 170              | 134              |
| Total share-based compensation      | \$125              | \$136            | \$211            | \$206            |
| Impact on net earnings per share:   |                    |                  |                  |                  |
| Basic and diluted                   | (\$0.02)           | (\$0.02)         | (\$0.03)         | (\$0.03)         |

Stock option grants during the three and six months ended June 30, 2014 and 2013 were as follows:

|                       | Three Months Ended |                  | Six Months Ended |                  |
|-----------------------|--------------------|------------------|------------------|------------------|
|                       | Jun. 30,<br>2014   | Jun. 30,<br>2013 | Jun. 30,<br>2014 | Jun. 30,<br>2013 |
| Stock Options Granted | 3,000              | 3,000            | 3,000            | 33,000           |

The fair value of share-based awards for employee stock options was estimated using the Black-Scholes valuation model. The following weighted average assumptions were used to calculate the fair value of stock options granted during the three and six months ended June 30, 2014 and 2013:

|                          | Three Months Ended |                  | Six Months Ended |                  |
|--------------------------|--------------------|------------------|------------------|------------------|
|                          | Jun. 30,<br>2014   | Jun. 30,<br>2013 | Jun. 30,<br>2014 | Jun. 30,<br>2013 |
| Risk-free interest rates | 1.31%              | 0.50%            | 1.31%            | 0.66%            |

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|                                      |      |      |      |      |
|--------------------------------------|------|------|------|------|
| Volatility factors                   | 0.51 | 0.54 | 0.51 | 0.54 |
| Expected life of the option in years | 4.00 | 4.00 | 4.00 | 4.00 |
| Expected dividend yield              | None | None | None | None |

The remaining unamortized expected future equity compensation expense and remaining amortization period associated with unvested option grants, restricted stock awards and restricted stock unit awards at June 30, 2014 are:

|   |                  |
|---|------------------|
|   | Jun. 30,<br>2014 |
| Unamortized future equity compensation expense          | \$1,084,585      |
| Remaining weighted average amortization period in years | 2.96             |

**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

General

**Forward-Looking Statements**

This Quarterly Report on Form 10-Q includes forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. This Act provides a “safe harbor” for forward-looking statements to encourage companies to provide prospective information about themselves as long as they identify these statements as forward-looking and provide meaningful cautionary statements identifying important factors that could cause actual results to differ from the projected results. All statements other than statements of historical fact made in this Quarterly Report on Form 10-Q are forward-looking. In particular, statements herein regarding industry prospects or trends; expected revenues; expected level of expense; future results of operations; reversals of tax valuation allowances; restructuring implications; breakeven point, or financial position; changes in gross margin; economic conditions and capital spending outlook; market acceptance of our newly introduced or upgraded products; development, introduction and shipment of new products; sales channels and any other guidance on future periods are forward-looking statements. Forward-looking statements reflect management’s current expectations and are inherently uncertain. Although we believe that the expectations reflected in these forward-looking statements are reasonable, we cannot guarantee future results, levels of activity, performance, achievements, or other future events. Moreover, neither we nor anyone else assumes responsibility for the accuracy and completeness of these forward-looking statements. We are under no duty to update any of these forward-looking statements after the date of this report. The reader should not place undue reliance on these forward-looking statements. The discussions above and in the section in Item 1A., Risk Factors “Cautionary Factors That May Affect Future Results” in our Annual report on Form 10-K for the year ended December 31, 2013 describe some, but not all, of the factors that could cause these differences.

**OVERVIEW**

We have renewed our focus on managing the core programming business to return to profitability, while developing and enhancing products to drive future revenue and earnings growth. Part of the strategy is to gain market share and to expand addressable markets. Our challenge continues to be operating in a cyclical and rapidly evolving industry environment.

Starting in December 2013 and continuing through the second quarter, we saw strong orders of our new PSV7000 which led our sales growth. This trend has continued during the first part of the third quarter. Looking forward, our backlog and deferred revenue should position us well for sequential growth in sales in the second half of 2014. We are continuing our efforts to balance business geography shifts, increasing costs and strategic investments in our business with the level of demand and mix of business we expect.

We are focusing our research and development efforts in our strategic growth markets, namely new programming technology, automated programming systems for the manufacturing environment and software. We continue to focus on extending the capabilities and support for our product lines and supporting the latest semiconductor devices, including NAND Flash, e-MMC, and microcontrollers on our newer products. During 2014, we have added media and handling options and software features for our new PSV7000, Data I/O's most advanced programming system introduced in the fall of 2013, which can cut the cost of programming by up to 50% and represents new capabilities to handle and program small parts. We announced in July 2014 our new PSV3000 automated programming system with a cost effective entry point which was developed for the Asian market and is now available.

Our customer focus has been on strategic high volume manufacturers in key market segments like automotive electronics, wireless and consumer electronics, industrial controls and programming centers.

## **BUSINESS RESTRUCTURING PROGRESS**

As a result of the business downturn we experienced in late 2011, 2012, and continuing in 2013, as well as the uncertain business outlook at those times, we took additional restructuring actions in the second quarter of 2013 and fourth quarter of 2013 to reduce quarterly operating expenses and production costs.

During the second and fourth quarters of 2013, we took restructuring actions to reduce our excess office space and eliminate certain job positions. These actions resulted in restructuring costs of \$642,000 for the second quarter and \$541,000 in the fourth quarter of 2013. A true up of estimates resulted in a \$13,000 charge during the first quarter of 2014. The positions eliminated allow us to have the flexibility to add other critical positions or change fixed to variable costs through outsourcing. These actions have been fully implemented. At June 30, 2014 the remaining portion of the reserve expected to be paid over the next twelve months is \$273,000 and the long term portion is \$98,000 and relates to the lease abandonment payments that are expected to be completely paid by July 2016.





## **cRITICAL aCCOUNTING pOLICY jUDGMENTS AND eSTIMATES**

The preparation of financial statements in accordance with accounting principles generally accepted in the United States of America requires that we make estimates and judgments, which affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosures of contingent assets and liabilities. On an on-going basis, we evaluate our estimates, including those related to revenue recognition, estimating the percentage-of-completion on fixed-price professional engineering service contracts, sales returns, bad debts, inventories, investments, intangible assets, income taxes, warranty obligations, restructuring charges, contingencies such as litigation, and contract terms that have multiple elements and other complexities typical in the capital equipment industry. We base our estimates on historical experience and other assumptions that we believe are reasonable under the circumstances. Actual results may differ from these estimates under different assumptions or conditions.

We believe the following critical accounting policies affect the more significant judgments and estimates used in the preparation of our financial statements:

**Revenue Recognition:** We recognize revenue at the time the product is shipped. We have determined that our programming equipment has reached a point of maturity and stability such that product acceptance can be assured by testing at the factory prior to shipment and that the installation meets the criteria to be considered a separate element. These systems are standard products with published product specifications and are configurable with standard options. The evidence that these systems could be deemed as accepted was based upon having standardized factory production of the units, results from batteries of tests of product performance to our published specifications, quality inspections and installation standardization, as well as past product operation validation with the customer and the history provided by our installed base of products upon which the current versions were based.

The revenue related to products requiring installation that is perfunctory is recognized at the time of shipment. Installation that is considered perfunctory includes any installation that can be performed by other parties, such as distributors, other vendors, or in most cases the customers themselves. This takes into account the complexity, skill and training needed as well as customer expectations regarding installation.

We enter into multiple deliverables arrangements that arise during the sale of a system that includes an installation component, a service and support component and a software maintenance component. We allocate the value of each element based on relative selling prices. Relative selling price is based on the selling price of the standalone system. For the installation and service and support components, we use what we charge to distributors who perform these components. For software maintenance components, we use what we charge for annual software maintenance renewals after the initial year the system is sold. Revenue is recognized on the system sale based on shipping terms, installation revenue is recognized after the installation is performed, and hardware service and support and software maintenance revenue is recognized ratably over the term of the agreement, typically one year.

When we sell software separately, we recognize software revenue upon shipment provided that only inconsequential obligations remain on our part and substantive acceptance conditions, if any, have been met.

We recognize revenue when persuasive evidence of an arrangement exists, shipment has occurred, the price is fixed or determinable, the buyer has paid or is obligated to pay, collectability is reasonably assured, substantive acceptance conditions, if any, have been met, the obligation is not contingent on resale of the product, the buyer's obligation would not be changed in the event of theft, physical destruction or damage to the product, the buyer acquiring the product for resale has economic substance apart from us and we do not have significant obligations for future performance to directly bring about the resale of the product by the buyer. We establish a reserve for sales returns based on historical trends in product returns and estimates for new items.

We transfer certain products out of service from their internal use and make them available for sale. The products transferred are our standard products in one of the following areas: service loaners, rental or test units; engineering test units; or sales demonstration equipment. Once transferred, the equipment is sold by our regular sales channels as used equipment inventory. These product units often involve refurbishing and an equipment warranty, and are conducted as sales in our normal and ordinary course of business. The transfer amount is the product unit's net book value and the sale transaction is accounted for as revenue and cost of goods sold.

**Allowance for Doubtful Accounts:** We base the allowance for doubtful accounts receivable on our assessment of the collectability of specific customer accounts and the aging of accounts receivable. If there is deterioration of a major customer's credit worthiness or actual defaults are higher than historical experience, our estimates of the recoverability of amounts due to us could be adversely affected.

**Inventory:** Inventories are stated at the lower of cost or market. Adjustments are made to standard cost, which approximates actual cost on a first-in, first-out basis. We estimate reductions to inventory for obsolete, slow-moving, excess and non-salable inventory by reviewing current transactions and forecasted product demand. We evaluate our inventories on an item by item basis and record inventory adjustments accordingly. If there is a significant decrease in demand for our products, uncertainty during product line transitions, or a higher risk of inventory obsolescence because of rapidly changing technology and customer requirements, we may be required to increase our inventory adjustments and our gross margin could be adversely affected.

**Warranty Accruals:** We accrue for warranty costs based on the expected material and labor costs to fulfill our warranty obligations. If we experience an increase in warranty claims, which are higher than our historical experience, our gross margin could be adversely affected.

**Tax Valuation Allowances:** Given the uncertainty created by our loss history, as well as the current uncertain economic outlook for our industry and capital spending, we expect to continue to limit the recognition of net deferred tax assets and accounting for uncertain tax positions and maintain the tax valuation allowances. At the current time, we expect, therefore, that reversals of the tax valuation allowance will take place only as we are able to take advantage of the underlying tax loss or other attributes in carry forward. The transfer pricing and expense or cost sharing arrangements are complex areas where judgments, such as the determination of arms-length arrangements, can be subject to challenges by different tax jurisdictions.

**Share-based Compensation:** We account for share-based awards made to our employees and directors, including employee stock option awards and restricted stock unit awards, using the estimated grant date fair value method of accounting. For options, we estimate the fair value using the Black-Scholes valuation model, which requires the input of highly subjective assumptions, including the option's expected life and the price volatility of the underlying stock. The expected stock price volatility assumption was determined using the historical

volatility of our common stock. Changes in the subjective assumptions required in the valuation model may significantly affect the estimated value of the awards, the related stock-based compensation expense and, consequently, our results of operations.

## Results of Operations

### **Net Sales**

| Net sales by product line<br>(in thousands) | Three Months Ended |        |                  | Six Months Ended |        |                  |
|---|--------------------|--------|------------------|------------------|--------|------------------|
|   | Jun. 30,<br>2014   | Change | Jun. 30,<br>2013 | Jun. 30,<br>2014 | Change | Jun. 30,<br>2013 |
| Automated programming systems               | \$3,834            | 8.2%   | \$3,543          | \$7,027          | 8.4%   | \$6,484          |
| Non-automated programming systems           | 1,765              | 2.1%   | 1,728            | 3,391            | (4.3%) | 3,545            |
| Total programming systems                   | \$5,599            | 6.2%   | \$5,271          | \$10,418         | 3.9%   | \$10,029         |

| Net sales by location<br>(in thousands) | Three Months Ended |        |                  | Six Months Ended |        |                  |
|---|--------------------|--------|------------------|------------------|--------|------------------|
|   | Jun. 30,<br>2014   | Change | Jun. 30,<br>2013 | Jun. 30,<br>2014 | Change | Jun. 30,<br>2013 |
| United States                           | \$603              | 20.4%  | \$501            | \$1,163          | 40.0%  | \$831            |
| % of total                              | 10.8%              |        | 9.5%             | 11.2%            |        | 8.3%             |
| International                           | \$4,996            | 4.7%   | \$4,770          | \$9,255          | 0.6%   | \$9,198          |
| % of total                              | 89.2%              |        | 90.5%            | 88.8%            |        | 91.7%            |

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Net sales in the second quarter of 2014 were \$5.6 million, up 6% compared with \$5.3 million in the second quarter of 2013 and sequentially up 16% compared with \$4.8 million in the first quarter of 2013. On a regional basis, net sales increased 155% in Europe, while declining, in part due to systems in deferred revenue and backlog, in Asia and the Americas compared to the second quarter of 2013. Sequentially, net sales in the second quarter compared to the first quarter of 2014 were up 29% in Europe, 19% in Asia, and flat in the Americas. International sales were 89% of total sales for the second quarter of 2014 compared to 91% for the second quarter of 2013. A sales breakdown by type for the second quarter of 2014 was 61% equipment, 27% adapters and 12% software and maintenance.

Orders for the second quarter of 2014 were \$6.3 million, down 7%, compared with \$6.7 million in the second quarter of 2013, and sequentially up 8.5% compared to the first quarter of 2014. In the second quarter of 2013 we had the large consumer product order for systems in Asia. The difference in sales versus order amounts and percentages is due to changes in backlog and deferred revenue. We ended the quarter with a backlog of \$2.7 million, compared to \$2.4 million at June 30, 2013 and \$2.6 million at March 31, 2014. We saw an increase of approximately 20% in adapter orders in the second quarter of 2014 compared to the same quarter in 2013, which we believe reflects a higher equipment utilization by our installed base.

For the six months ending June 30, 2014, compared to the same period in 2013, the sales increase was primarily due to incremental sales of our new PSV7000 automated programming system, as well as increased sales of PS388 systems and adapters. During the second quarter of 2014, we sold to a broader base of customers and in particular, we sold PSV7000 systems to many new automated customers and previously inactive customers who had not purchased equipment in five years. Sales were especially strong in the automotive space. Looking forward, our backlog and deferred revenue should position us well for sequential growth in sales in the second half of 2014.

## Gross Margin

|                         | Three Months Ended |        |                  | Six Months Ended |        |                  |
|-------------------------|--------------------|--------|------------------|------------------|--------|------------------|
|                         | Jun. 30,<br>2014   | Change | Jun. 30,<br>2013 | Jun. 30,<br>2014 | Change | Jun. 30,<br>2013 |
| (in thousands)          |                    |        |                  |                  |        |                  |
| Gross margin            | \$3,022            | 2.8%   | \$2,939          | \$5,517          | 0.7%   | \$5,480          |
| Percentage of net sales | 54.0%              |        | 55.8%            | 53.0%            |        | 54.6%            |

Gross margin as a percentage of sales in the second quarter of 2014 was 54.0%, compared with 55.8% in the second quarter of 2013. The gross margin decrease as a percentage of sales for the second quarter was primarily due to a less favorable product mix and unfavorable variances.

For the first six months of 2014 compared to the same period in 2013, the decrease in gross margin was due to the same general factors discussed above for the second quarter.

### Research and Development

|                          | Three Months Ended |        |                  | Six Months Ended |        |                  |
|--------------------------|--------------------|--------|------------------|------------------|--------|------------------|
|                          | Jun. 30,<br>2014   | Change | Jun. 30,<br>2013 | Jun. 30,<br>2014 | Change | Jun. 30,<br>2013 |
| (in thousands)           |                    |        |                  |                  |        |                  |
| Research and development | \$1,173            | 5.0%   | \$1,117          | \$2,323          | 0.1%   | \$2,321          |
| Percentage of net sales  | 21.0%              |        | 21.2%            | 22.3%            |        | 23.1%            |

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Research and development (“R&D”) increased \$56,000 in the second quarter of 2014 compared to the same period in 2013, primarily due to personnel additions and higher incentive compensation.

For the first six months of 2014 compared to the same period in 2013, the increase in R&D expense was primarily related to higher incentive compensation and recruiting costs, offset in part by savings from 2013 restructuring actions, cost controls and lower R&D materials.

### Selling, General and Administrative

|                                   | Three Months Ended |         |                  | Six Months Ended |         |                  |
|-----------------------------------|--------------------|---------|------------------|------------------|---------|------------------|
|                                   | Jun. 30,<br>2014   | Change  | Jun. 30,<br>2013 | Jun. 30,<br>2014 | Change  | Jun. 30,<br>2013 |
| (in thousands)                    |                    |         |                  |                  |         |                  |
| Selling, general & administrative | \$1,456            | (18.4%) | \$1,785          | \$3,144          | (12.5%) | \$3,592          |
| Percentage of net sales           | 26.0%              |         | 33.9%            | 30.2%            |         | 35.8%            |

Selling, General and Administrative expenses decreased \$329,000 in the second quarter of 2014 compared to the same period in 2013, primarily related to savings from personnel reductions due to restructuring actions and cost controls, lower commissions, consulting & depreciation offset in part by higher incentive compensation.

For the first six months of 2014 compared to the same period in 2013, the decrease in SG&A expense was due to the same general factors discussed above for the second quarter.

### Interest

|                | Three Months Ended |        |                  | Six Months Ended |        |                  |
|----------------|--------------------|--------|------------------|------------------|--------|------------------|
|                | Jun. 30,<br>2014   | Change | Jun. 30,<br>2013 | Jun. 30,<br>2014 | Change | Jun. 30,<br>2013 |
| (in thousands) |                    |        |                  |                  |        |                  |

|                 |      |        |      |      |        |      |
|-----------------|------|--------|------|------|--------|------|
| Interest income | \$53 | (5.4%) | \$56 | \$72 | (2.7%) | \$74 |
|-----------------|------|--------|------|------|--------|------|

Interest income decreased slightly in the second quarter of 2014 compared to the same period in 2013, primarily due to lower invested cash balances.

For the first six months of 2014 compared to the same period in 2013, the decrease in interest income was due to the same general factors discussed above for the second quarter.

## Income Taxes

|                              | Three Months Ended  |         |                     | Six Months Ended    |        |                     |
|------------------------------|---------------------|---------|---------------------|---------------------|--------|---------------------|
|                              | Jun.<br>30,<br>2014 | Change  | Jun.<br>30,<br>2013 | Jun.<br>30,<br>2014 | Change | Jun.<br>30,<br>2013 |
| (in thousands)               |                     |         |                     |                     |        |                     |
| Income tax (expense) benefit | (\$7)               | (65.0%) | (\$20)              | (\$32)              | 28.0%  | (\$25)              |

Income tax expense decreased \$13,000 in the second quarter of 2014 compared to the same period in 2013, with both period's expense resulting primarily from foreign income taxes on foreign subsidiary income.

For the first six months of 2014 compared to the same period in 2013, the increase in income tax expense was due to the same general factors discussed above for the second quarter.

The effective tax rate differed from the statutory tax rate primarily due to the effect of valuation allowances, as well as foreign taxes. We have a valuation allowance of \$12.2 million as of June 30, 2014. Our deferred tax assets and valuation allowance have been reduced by approximately \$192,000 and \$132,000 associated with the requirements of accounting for uncertain tax positions as of June 30, 2014 and 2013, respectively. Given the uncertainty created by our past loss history and the cyclical nature of the industry in which we operate, we expect to continue to limit the recognition of net deferred tax assets and maintain the tax valuation allowances.



Financial Condition**Liquidity and Capital Resources**

| (in thousands)  | Jun. 30,<br>2014 | Change  | Dec. 31,<br>2013 |
|-----------------|------------------|---------|------------------|
| Working capital | \$12,015         | (\$229) | \$12,244         |

During the second quarter of 2014, cash declined \$556,000 primarily attributed to the increase in accounts receivable resulting from the increase of systems in deferred revenue and late in the quarter shipments offset in part by the net profit for the quarter.

Although we have no significant external capital expenditure plans currently, we expect that we will continue to make capital expenditures to support our business. We plan to increase our internally developed sales demonstration and R&D test equipment as we develop and release new products. Capital expenditures are expected to be funded by existing and internally generated funds or lease financing.

As a result of our significant product development, customer support, selling and marketing efforts, we have required substantial working capital to fund our operations. Over the last few years and again during 2013, we restructured our operations to lower our costs and operating expenditures in some geographic regions, while investing in other regions; creating headroom to hire critical product development resources; and to lower the level of revenue required for our net income breakeven point; as well as offsetting in part, costs rising over time; to preserve our cash position and to focus on profitable operations. See "Business Restructuring Progress" discussion above for future expected restructuring related payments.

We believe that we have sufficient working capital available under our operating plan to fund our operations and capital requirements through at least the next one-year period. Approximately \$7.0 million of our cash is located in foreign subsidiary accounts at June 30, 2014. Although we have no current repatriation plans, there may be tax and other impediments to repatriating the cash to the United States. Our working capital may be used to fund share repurchases and growth initiatives including acquisitions, which could reduce our liquidity. Any substantial inability to achieve our current business plan could have a

material adverse impact on our financial position, liquidity, or results of operations and may require us to reduce expenditures and/or seek additional financing.

### **OFF-Balance sheet arrangements**

Except as noted in the accompanying consolidated financial statements in Note 6, "Operating Lease Commitments" and Note 7, "Other Commitments", we have no off-balance sheet arrangements.

### **Non-Generally accepted accounting principles (GAAP) FINANCIAL Measures**

Earnings Before Interest, Taxes, Depreciation and Amortization ("EBITDA") were earnings of \$562,000 in the second quarter of 2014 compared to an EBITDA loss of \$498,000 in the second quarter of 2013. Equity compensation expense (a non-cash item) in the second quarter of 2014 and 2013 was \$125,000 and \$136,000, respectively. Adjusted EBITDA excluding equity compensation were earnings of \$687,000 in the second quarter of 2014, compared to a loss of \$362,000 in the second quarter of 2013.

Non-GAAP financial measures, such as EBITDA and adjusted EBITDA excluding equity compensation, should not be considered a substitute for, or superior to, measures of financial performance prepared in accordance with GAAP. We believe that these non-GAAP financial measures provide meaningful supplemental information regarding the Company's results and facilitate the comparison of results. A reconciliation of net income (loss) to EBITDA and adjusted EBITDA excluding equity compensation follows:

## Non-Generally accepted accounting principles (GAAP) FINANCIAL Measure RECONCILIATION

|   | Three Months Ended |                  | Six Months Ended |                  |
|---|--------------------|------------------|------------------|------------------|
|   | Jun. 30,<br>2014   | Jun. 30,<br>2013 | Jun. 30,<br>2014 | Jun. 30,<br>2013 |
| (in thousands)  |                    |                  |                  |                  |
| Net Income (loss)   | \$447              | (\$624)          | \$104            | (\$1,083)        |
| Interest (income) expense                                     | (53)               | (56)             | (72)             | (74)             |
| Taxes   | 7                  | 20               | 32               | 25               |
| Depreciation and amortization                                 | 161                | 162              | 320              | 343              |
| EBITDA earnings (loss)  | \$562              | (\$498)          | \$384            | (\$789)          |
| Equity Compensation   | 125                | 136              | 211              | 206              |
| Adjusted EBITDA earnings (loss) excluding equity compensation | \$687              | (\$362)          | \$595            | (\$583)          |

## RECENT ACCOUNTING ANNOUNCEMENTS

In May 2014, the FASB issued ASU 2014-09, *“Revenue from Contracts with Customers,”* (ASU 2014-09). The standard provides companies with a single model for accounting for revenue arising from contracts with customers and supersedes current revenue recognition guidance, including industry-specific revenue guidance. The core principle of the model is to recognize revenue when control of the goods or services transfers to the customer, as opposed to recognizing revenue when the risks and rewards transfer to the customer under the existing revenue guidance. ASU 2014-09 is effective for annual reporting periods beginning after December 15, 2016. Early adoption is not permitted. The guidance permits companies to either apply the requirements retrospectively to all prior periods presented, or apply the requirements in the year of adoption, through a cumulative adjustment. The Company is in the process of evaluating the impact of adoption on its consolidated financial statements.

In April 2014, the FASB issued ASU 2014-08, *“Presentation of Financial Statements and Property, Plant, and Equipment,”* (ASU 2014-08). This ASU changes the threshold for reporting discontinued operations and adds new disclosures. The new guidance defines a discontinued operation as a disposal of a component or group of components that is disposed of or is classified as held for sale and “represents a strategic shift that has (or will have) a

major effect on our operations and financial results.” For disposals of individually significant components that do not qualify as discontinued operations, we must disclose pre-tax earnings of the disposed component. This guidance is effective for us prospectively for all disposals (or classifications as held for sale) of components of an entity that occur within annual periods beginning on or after December 15, 2014, and interim periods within those years. Early adoption is permitted, but only for disposals (or classifications as held for sale) that have not been reported in financial statements previously issued or available for issuance. We do not expect the adoption of this guidance to have a material impact on our consolidated financial statements.

**Item 3.**                    **Quantitative and Qualitative Disclosures About Market Risk**

Not applicable.

**Item 4.**                    **Controls and Procedures**

**Evaluation of disclosure controls and procedures**

Under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, we evaluated 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) as of the end of the period covered by this report (the “Evaluation Date”). Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that, as of the Evaluation Date, our disclosure controls and procedures were effective at the reasonable level of assurance. Disclosure Controls are controls and procedures designed to reasonably assure that information required to be disclosed in our reports filed under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in the SEC’s rules and forms. Disclosure Controls are also designed to reasonably assure that such information is accumulated and communicated to our management, including the CEO and CFO, as appropriate to allow timely decisions regarding required disclosure.

## **Changes in internal controls**

There were no changes made in our internal controls during the period covered by this report 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**

From time to time, we may be involved in litigation relating to claims arising out of our operations in the normal course of business. As of June 30, 2014, we were not a party to any material pending legal proceedings.

### **Item 1A.                    Risk Factors**

In addition to the other information set forth in this report, you should carefully consider the factors discussed in Part I, "Item 1A. Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2013, which could materially affect our business, financial condition or future results. The risks described in our Annual Report on Form 10-K are not the only risks facing our Company. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition and/or operating results. There are no material changes to the Risk Factors described in our Annual Report.

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

None

### **Item 3.                    Defaults Upon Senior Securities**

None

**Item 4.**                    **Mine Safety Disclosures**

Not Applicable

**Item 5.**                    **Other Information**

None

**Item 6.**                    **Exhibits**

(a) **Exhibits**

10 **Material Contracts:**

10.31                    Form of Executive Agreement

10.32                    Letter Agreement with Joel S. Hatlen

31 **Certification pursuant to Section 302 of the Sarbanes Oxley Act of 2002:**

31.1                    Chief Executive Officer  
Certification

31.2                    Chief Financial Officer  
Certification

32 **Certification pursuant to Section 906 of the Sarbanes Oxley Act of 2002:**

32.1 Chief Executive Officer  
Certification

32.2 Chief Financial Officer Certification

101 **Interactive Data Files Pursuant to Rule 405 of Regulation S-T**

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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.

DATED: August 13, 2014

**DATA I/O CORPORATION**

(REGISTRANT)

By: //S//Anthony  
Ambrose

Anthony Ambrose

President and Chief Executive Officer

(Principal Executive Officer and Duly Authorized Officer)

By: //S//Joel S. Hatlen

Joel S. Hatlen

Vice President and Chief Financial Officer

Secretary and Treasurer

(Principal Financial Officer and Duly Authorized Officer)





Exhibit 10.31

**AMENDED AND RESTATED**  
**EXECUTIVE AGREEMENT**  
**FOR**  
**DATA I/O CORPORATION**

This Amended and Restated Executive Agreement (the "Agreement") is entered into this 30th day of July, 2014, by and between DATA I/O CORPORATION ("the Company") and \_\_\_\_\_ ("Executive"). Executive is an at-will employee of the Company. The parties wish to provide Executive with severance benefits if Executive's employment is terminated in connection with a change in control in the Company and other payments in connection with a change of control. At the time of the execution of the Agreement, the Executive contemporaneously is entering into the Company's form of Confidentiality and Non-Competition Agreement for executive officers, which is attached to this Agreement as Exhibit A.

NOW, THEREFORE, in consideration of the foregoing recitals and the covenants and conditions contained herein, the parties hereby agree as follows:

1. Change of Control.

(a) If, within the period commencing 80 days prior to the date of occurrence (the "Event Date") of a Control Event and ending on the first anniversary of the Event Date (the "Window"), the Company terminates Executive's employment (other than for Cause) or Executive resigns for Good Reason, the Company shall pay to Executive (1) the Severance Payment in immediately available funds and (2) expenses incurred, up to Twenty Thousand Dollars (\$20,000) for outplacement services or other job search expenses. If such termination occurs prior to the Control Event, the Severance Payment is due on the fifth day following the Event Date; if such termination occurs on or subsequent to the Event Date, the Severance Payment is due on the twentieth business day following the date of termination (the "Termination Date") or at a later date in order to comply with the provisions of Section 409A of the Internal Revenue Code. Outplacement expenses under Section 1(a)(2) above must be incurred and shall be paid no later than December 31st of the second calendar year following the calendar year of the Executive's termination of employment. For purposes of this Agreement, termination from employment shall mean a "separation from service" as defined under the default rules under the final Section 409A regulations.

(b) The Severance Payment shall be determined pursuant to the following formula:

$$[(B-A)/365] \times (C + D) \quad \text{where}$$

A = the number of days of continued full-time employment of Executive by the Company following the Event Date

B = 1 x 365

C = Executive's annual base salary as of the Termination Date

D = the average of all cash bonuses that Executive received or is entitled to receive regarding the three most recent fiscal years of the Company during which Executive was employed by the Company in his or her current position for the entire year;

provided however, that unless the Company, its successors or assigns gives Executive six (6) months advance written notice of termination, the Severance Payment shall not be less than the amount computed as follows:  $(0.5) \times (C + D)$ .

(c) In addition to any payments which may be required pursuant to Section 1(a), upon the occurrence of a Control Event, the Company shall pay to Executive the Control Event Payment in immediately available funds. The Control Event Payment is due on the closing of the Control Event. The Control Even Payment shall equal the product of (1) 0.5 and (2) Executive's annual base salary as of the date immediately prior to the Control Event.

(d) Each of the following shall constitute a "Control Event":

(1) the acquisition of Common Stock of the Company (the "Common Stock") by any "Person" (as such term is defined in Section 1.21 of the Rights Agreement dated as of April 4, 1998 between the Corporation and Chase Mellon Shareholder Services L.L.C. and with Amendment No.1 dated as of February 10, 1999 and Amendment No. dated as of April 3, 2008 (the "Rights Plan"), together with all Affiliates and Associates (as such terms are defined in Section 1.5 of the Rights Plan) of such Person, such that such Person becomes, after the date of this Agreement, the Beneficial Owner (as defined in the Rights Plan) of a majority of the shares of Common Stock then outstanding, but shall not include the Company, any subsidiary of the Company, any employee benefit plan of the Company or of any subsidiary of the Company, or any Person or entity organized, appointed or established by the Company for or pursuant to the terms of any such employee benefit plan; or

(2) the approval by the Company's shareholders (or, if later, approval by the shareholders of any Person) of any merger, consolidation, reorganization or other transaction providing for the conversion or exchange of more than fifty percent (50%) of the outstanding shares of Common Stock into securities of any Person, or cash, or property, or a combination of any of the foregoing; and

(e) Each of the following shall constitute "Good Reason", provided that it occurs during the Window, and provided further that Executive must provide notice to the Company within sixty (60) days of the existence of such condition and the Company will have thirty (30) days from receipt of such notice to remedy the condition. If the condition is not remedied within such 30 day period, the following conditions will constitute "Good Reason":

(1) the material diminution of Executive's position, duties, responsibilities or status with the Company or its successor, as compared with the position, duties, responsibilities or status of Executive with the Company immediately prior to the Event Date, except in connection with the termination of Executive for Cause;

(2) the Company's assignment of Executive on a substantially full-time basis to work at a location where the distance between the new location and Executive's principal residence is at least 35 miles greater than the distance between the former location and such

residence; provided, however, that this paragraph shall not apply to travel in the furtherance of the Company's business to an extent substantially consistent with Executive's business travel obligations as of the date hereof;

(3) the Company's failure to obtain an assumption of the obligations of the Company to perform this Agreement by any successor to the Company;

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(4) any material reduction in Executive's base salary, or a material reduction in benefits payable to Executive or failure of the Company to pay Executive any earned salary, bonus or benefits except with the prior written consent of Executive;

(5) the exclusion or limitation of Executive from participating in some form of variable compensation plan which provides the Executive the opportunity to achieve a level of total compensation (base salary plus variable compensation) consistent with what the Executive had the opportunity to earn at the Event Date; or

(6) any demand by any director or officer of the Company that Executive take any action or refrain from taking any action where such action or inaction, as the case may be, would violate any law, rule, regulation or other governmental pronouncement, court order, decree or judgment, or breach any agreement or fiduciary duty.

(f) Each of the following shall constitute "Cause":

(1) any violation by Executive of any material obligation under this Agreement or the attached Confidentiality and Non-Disclosure Agreement;

(2) any action or failure to act by Executive which causes the Company to incur significant monetary damages;

(3) conviction for commitment of a felony;

(4) any violation of law which has a material, adverse effect on the Company;

(5) habitual abuse of alcohol or a controlled substance;

(6) theft or embezzlement from the Company;

(7) repeated unexcused absence from work for reasons unrelated to short-term illnesses;

(8) the failure by Executive substantially to achieve personal performance goals reasonably established by the board of directors or any officer to whom he/she reports other than where such failure is substantially attributable to factors beyond control of Executive;

(9) Disability of Executive (as defined below); and

(10) repeated failure or refusal by Executive to carry out the reasonable directives, orders or resolutions of the Company's Board of Directors or any officer to whom he/she reports.

(g) "Disability" shall mean any physical, mental or other health condition which substantially impairs Executive's ability to perform his/her assigned duties for 90 days or more in any 180 day period or that can be expected to result in death. Any disagreement as to whether Executive is disabled shall be resolved by a physician selected by the Company after an examination of Executive. Executive hereby consents to such physical examination and to

the examination of all medical records of Executive necessary, in the judgment of the examining physician, to make the determination of disability.

(h) Notwithstanding any other provision of this Agreement to the contrary, in the event that any severance or other payment, benefit or right payable or accruing to Executive hereunder or under the Company's 2000 Stock Compensation Incentive Plan or Amended and Restated 1986 Stock Option Plan ("Option Plan") would constitute a "parachute payment" as defined in Section 280G(b)(2) of the Internal Revenue Code of 1986, as amended (the "Code"), then the total amount of severance and other payments or benefits payable to Executive hereunder and under the Option Plan which is deemed to constitute a "parachute payment" shall not exceed and shall, if necessary, be reduced to an amount (the "Revised Severance Payment") equal to 2.99 times Executive's "base amount" as defined in Code Section 28G(b)(3). In the event of a disagreement between the Company and Executive as to whether the provisions of Code section 280G are applicable or the amount of the Revised Severance Payment, such determination shall be made by the Company's independent public accountants or, if such firm is unable or unwilling to render such a determination, then by a law firm mutually acceptable to Executive and the Company. All costs relating to such determination shall be borne by the Company. The Company and the Executive shall cooperate in good faith to make the determination required by this Section 1(h) by mutual agreement not later than the later of: (i) the fifth day preceding the date that the Severance Payment is or would be due or (ii) the earlier of (x) the tenth day following the expiration of any period of accelerated vesting of options to purchase the Company's Common Stock provided by Section 5(n) of the Option Plan or (y) the tenth day following the date of exercise by Executive of his or her last remaining option which was exercisable solely due to the application of Section 5(n) of the Option Plan. Pending the final calculation of the Severance Payment or Revised Severance Payment, the Company shall pay the amounts described under subsection (b) above at the time and in the manner provided herein; provided that, pending such determination, such payments shall be reduced by such amounts as the Company estimates in good faith to be necessary to satisfy its tax (including excise tax) withholding obligations and effect the reduction in the amount of the Severance Payment, as contemplated by this Subsection 1(h). The aggregate amount of any compensation actually paid or provided to Executive under the terms of this Agreement and in excess of the Revised Severance Payment shall be deemed, to the extent of such excess, a loan to Executive payable upon demand and bearing interest at the rate of 8% per annum.

2. Confidentiality and Non-Competition Agreement. In consideration of the obligations undertaken by the Company pursuant to this Agreement, contemporaneously with the execution of this Agreement, Executive and the Company have entered into the form of Confidentiality and Non-Competition Agreement attached as Exhibit A and each agreement shall be effective only if both agreements have been executed.

3. Term of Agreement.

The Company's obligations under Section 1 of this Agreement shall expire with respect to Control Events occurring on or after the third anniversary of the date of this Agreement (the "Control Events Expiration"); provided, however, that commencing on the date one (1) year after the effective date of this Agreement and on each annual anniversary of such date (such date and each anniversary of such date the "Renewal Date"), unless previously terminated, the Control Events Expiration shall be automatically extended until the third anniversary of the Renewal Date, unless the Board of Directors of the Company by a majority vote of those members of the Board who are not parties to this or a similar agreement determines the Agreement shall not be extended and the Company notifies Executive of such decision at least sixty (60) days prior to the Renewal Date.

4. At Will Employment. Unless and to the extent otherwise agreed by the Company and Executive in a separate written employment agreement, Executive's employment shall be "at will", with either party permitted to terminate the employment at any time, with or without cause. No term of any employment agreement between the Company and Executive shall be construed to conflict with, lessen or expand the obligations of the parties under this Agreement.



5. Notices. All notices and other communications called for or required by this Agreement shall be in writing and shall be addressed to the parties at their respective addresses stated below or to such other address as a party may subsequently specify by written notice and shall be deemed to have been received (i) upon delivery in person, (ii) five days after mailing it by U.S. certified or registered mail, return receipt requested and postage prepaid, or (iii) two days after depositing it with a commercial overnight carrier which provides written verification of delivery:

To the Company: 6464 185<sup>th</sup> Avenue N.E., Suite 101

Redmond, Washington 98052

Attention: General Counsel or Corporate Secretary

To Executive: \_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_

6. Withholding. Except as described in subsection 1(h) of this Agreement, all payments due to and all benefits to be provided to Executive hereunder shall be subject to reduction for any applicable withholding taxes, including excise taxes.

7. Assignment. Executive's rights and duties hereunder are personal to Executive and are not assignable to others, but Executive's obligations hereunder will bind his/her heirs, successors, and assigns. The Company may assign its rights under this Agreement in connection with any merger or consolidation of the Company or any sale of all or any portion of the Company's assets (including, without limitation, any division or product line), provided that any such successor or assignee expressly assumes in writing the Company's obligations hereunder.

8. No Duty to Mitigate. Executive shall not be required to mitigate the amount of any payment made or benefit provided hereunder. The Company may offset any payment due hereunder by the amount of damages to the Company resulting from any breach of this Agreement by Executive.

9. General. This Agreement constitutes the exclusive agreement of the parties with respect to the subject matter hereof and supersedes all prior agreements or understandings of the parties. No waiver of or forbearance to enforce any right or provision hereof shall be binding unless in writing and signed by the party to be bound, and no such waiver or forbearance in any instance shall apply to any other instance or to any other right or

provision. This Agreement will be governed by the local laws of the State of Washington without regard to its conflicts of laws rules to the contrary. The parties hereby consent to the exclusive jurisdiction and venue of the state and federal courts sitting in King County, Washington for all matters and actions arising under this Agreement. The prevailing party shall be entitled to reasonable attorneys' fees and costs incurred in connection with such litigation. No term hereof shall be construed to limit or supersede any other right or remedy of the Company under applicable law with respect to the protection of trade secrets or otherwise. If any provision of this Agreement is held to be invalid or unenforceable to any extent in any context, it shall nevertheless be enforced to the fullest extent allowed by law in that and other contexts, and the validity and force of the remainder of this Agreement shall not be affected thereby.

IN WITNESS WHEREOF, the parties have caused this Agreement to be signed as of the date first above written.

DATA I/O CORPORATION

EXECUTIVE:

By: \_\_\_\_\_

Signature: \_\_\_\_\_

Name: \_\_\_\_\_

Name: \_\_\_\_\_

Its: \_\_\_\_\_

**Exhibit A**

**CONFIDENTIALITY AND NON COMPETITION AGREEMENT  
FOR  
DATA I/O CORPORATION**

This Agreement is entered into effective this 30th day of July 2014, by and between DATA I/O CORPORATION ("the Company") and \_\_\_\_\_ ("Executive"). Executive is an at-will employee of the Company. In consideration of entering into an agreement to provide Executive with severance benefits if Executive's employment is terminated in connection with a change in control in the Company, Executive promises, on the terms set forth herein, at all times to protect the Company's proprietary information and to not compete with the Company following termination of Executive's employment in connection with a change in control.

NOW, THEREFORE, in consideration of the foregoing recitals and the covenants and conditions contained herein, the parties hereby agree as follows:

1. Intellectual Properties.

(a) All ownership, copyright, patent, trade secrecy, and other rights in all works, programs, software, fixes, routines, inventions, ideas, designs, manuals, improvements, discoveries, processes, customer lists or other properties (the "Intellectual Properties") made or conceived by Executive during the term of his/her employment by the Company shall be the rights and property solely of the Company, whether developed independently by Executive or jointly with others, and whether or not developed or conceived during regular working hours or at the Company's facilities, and whether or not the Company uses, registers, or markets the same.

(b) In accordance with the Company's policy and Washington law, this Agreement (other than Subsection 1(c)) does not apply to, and Executive has no obligation to assign to the Company, any invention for which no Company trade secrets and no equipment, supplies, or facilities of the Company were used and which was developed entirely on Executive's own time, unless: (i) the invention relates

directly to the business of the Company, (ii) the invention relates to actual or demonstrably anticipated research or development work of the Company, or (iii) the invention results from any work performed by Executive for the Company.

(c) If and to the extent that Executive makes use, in the course of his/her employment, of any items or Intellectual Properties previously developed by Executive or developed by Executive outside of the scope of this Agreement, Executive hereby grants the Company a nonexclusive, royalty-free, perpetual, irrevocable, worldwide license (with right to sublicense) to make, use, sell, copy, distribute, modify, and otherwise to practice and exploit any and all such items and Intellectual Properties.

(d) Executive will assist the Company as reasonably requested during and after the term of his/her employment to further evidence and perfect, and to enforce, the Company's rights in and ownership of the Intellectual Properties covered hereby, including without limitation, the execution of additional instruments of conveyance and assisting the Company with applications for patents or copyright or other registrations.

## 2. Trade Secrets and Confidential Information.

(a) Executive acknowledges that the Company's business and future success depends on the preservation of the trade secrets and other confidential information of the Company and its suppliers and customers (the "Secrets"). The Secrets may include, without limitation, existing and to-be-developed or acquired product designs, new product plans or ideas, market surveys, the identities of past, present or potential customers, business and financial information, pricing methods or data, terms of contracts with present or past customers, proposals or bids, marketing plans, personnel information, procedural and technical manuals and practices, servicing routines, and parts and supplier lists proprietary to the Company or its customers or suppliers, and any other sorts of items or information of the Company or its customers or suppliers which are not generally known to the public at large. Executive agrees to protect and to preserve as confidential during and after the term of his/her employment all of the Secrets at any time known to Executive or in his/her possession or control (whether wholly or partially developed by Executive or provided to Executive, and whether embodied in a tangible medium or merely remembered).

(b) Executive shall mark all items containing any of the Secrets with prominent confidentiality notices acceptable to the Company. Executive shall neither use nor allow any other person to use any of the Secrets in any way, except for the benefit of the Company and as directed by Executive's supervisor. All material containing or disclosing any portion of the Secrets shall be and remain the property of the Company, shall not be removed from the Company's premises without specific consent from an officer of the Company, and shall be returned to the Company upon the termination of Executive's employment or the earlier request Executive's supervisor. At such time, Executive shall also assemble all materials in his possession or control which contain any of the Secrets, and promptly deliver such items to the Company.

3. Authority and Non-Infringement. Executive warrants that any and all items, technology, and Intellectual Properties of any nature developed or provided by Executive under this Agreement and in any way for or related to the Company will be original to Executive and will not, as provided to the Company or when used and exploited by the Company and its contractors and customers and its and their successors and assigns, infringe in any respect on the rights or property of Executive or any third party. Executive will not, without the prior written approval of the Company, use any equipment, supplies, facilities, or proprietary information of any other party. Executive warrants that Executive is fully authorized to enter into employment with the Company and to perform under this Agreement, without conflicting with any of

Executive's other commitments, agreements, understandings or duties, whether to prior employers or otherwise. Executive will indemnify the Company for all losses, claims, and expenses (including reasonable attorneys' fees) arising from any breach of by him/her of this Agreement.

4. Non-competition and Non-solicitation.

(a) Executive agrees that during the term of his/her employment with the Company and, if Executive receives the Severance Payment (as defined below), until the first anniversary of the Termination Date (as defined below), he/she will not in any capacity directly or indirectly engage in, assist others to engage in or own a material interest in any business or activity that is, or is preparing to be, in competition with the Company with respect to any product or service sold or service provided by the Company up to the time of termination of employment in any geographical area in which at the time of termination of employment such product or service is sold or actively is engaged in. For the purposes of this Agreement, the terms "Severance Payment" and "Termination Date" shall have the meanings assigned to them in the Executive Agreement (as defined in Section 6 below).

(b) Executive further agrees that during the period stated above, he/she will not directly or indirectly call on, reveal the name of, or otherwise solicit, accept business from or attempt to entice away from the Company any actual or identified potential customer of the Company, nor will he/she assist others in doing so. Executive further agrees that he/she will not, during the period stated above, encourage or solicit any other employee or consultant of the Company to leave such employment for any reason, nor will he/she assist others to do so.

(c) Executive acknowledges that the covenants in this section are necessary and reasonable to protect the Company in the conduct of its business and that compliance with such covenants will not prevent him/her from pursuing his/her livelihood. However, should any court find that any provision of such covenants is unreasonable, invalid or unenforceable, whether in period of time, geographical area, or otherwise, then in that event the parties hereby agree that such covenants shall be interpreted and enforced to the maximum extent which the court deems reasonable.

5. Remedies. The harm to the Company from any breach of Executive's obligations under this Agreement may be difficult to determine and may be wholly or partially irreparable, and Executive agrees that such obligations may be enforced by injunctive relief and other appropriate remedies, as well as by damages. If any bond from the Company is required in connection with such enforcement, the parties agree that a reasonable value of such bond shall be \$5,000. Any amounts received by Executive or by any other through Executive in breach of this Agreement shall be held in constructive trust for the benefit of the Company.



6. Executive Agreement. In consideration of the obligations undertaken by Executive pursuant to this Agreement, contemporaneously with the execution of this Agreement, Executive and the Company shall enter into the form of Executive Agreement to which this Agreement is attached (the "Executive Agreement"), and each agreement shall be effective only if both agreements have been executed.

7. At Will Employment. Unless and to the extent otherwise agreed by the Company and Executive in a separate written employment agreement, Executive's employment shall be "at will", with either party permitted to terminate the employment at any time, with or without cause. No term of any employment agreement between the Company and Executive shall be construed to conflict with or lessen Executive's obligations under this Agreement.

8. Notices. All notices and other communications called for or required by this Agreement shall be in writing and shall be addressed to the parties at their respective addresses stated below or to such other address as a party may subsequently specify by written notice and shall be deemed to have been received (i) upon delivery in person, (ii) five days after mailing it by U.S. certified or registered mail, return receipt requested and postage prepaid, or (iii) two days after depositing it with a commercial overnight carrier which provides written verification of delivery:

To the Company: 6464 185<sup>th</sup> Avenue N.E., Suite 101

Redmond, Washington 98052

Attention: General Counsel and Corporate Secretary

To Executive: \_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_

9. Assignment. Executive's rights and duties hereunder are personal to Executive and are not assignable to others, but Executive's obligations hereunder will bind his/her heirs, successors, and assigns. The Company may assign its rights under this Agreement in connection with any merger or consolidation of the Company or any sale of all or any portion of the Company's assets (including, without limitation, any division or product line), provided that any such successor or assignee expressly assumes in writing the Company's obligations under the Executive Agreement.

10. General. This Agreement constitutes the exclusive agreement of the parties with respect to the subject matter hereof and supersedes all prior agreements or understandings of the parties. No waiver of or forbearance to enforce any right or provision hereof shall be binding unless in writing and signed by the party to be bound, and no such waiver or forbearance in any instance shall apply to any other instance or to any other right or provision. This Agreement will be governed by the local laws of the State of Washington without regard to its conflicts of laws rules to the contrary. The parties hereby consent to the exclusive jurisdiction and venue of the state and federal courts sitting in King County, Washington for all matters and actions arising under this Agreement. The prevailing party shall be entitled to reasonable attorneys' fees and costs incurred in connection with such litigation. No term hereof shall be construed to limit or supersede any other right or remedy of the Company under applicable law with respect to the protection of trade secrets or otherwise. If any provision of this Agreement is held to be invalid or unenforceable to any

extent in any context, it shall nevertheless be enforced to the fullest extent allowed by law in that and other contexts, and the validity and force of the remainder of this Agreement shall not be affected thereby.

IN WITNESS WHEREOF, the parties have caused this Agreement to be signed as of the date first above written.

DATA I/O CORPORATION

EXECUTIVE:

By: \_\_\_\_\_

Signature: \_\_\_\_\_

Name: \_\_\_\_\_

Name, printed: \_\_\_\_\_

Its: \_\_\_\_\_

Exhibit 10.32

6464 185<sup>th</sup> Ave NE, Suite 101

Redmond, WA 98052

Tel: (425) 881-6444

Fax: (425) 869-7413

August 7, 2014

Joel Hatlen

Vice President Operations & Finance / CFO

Dear Joel:,

This letter confirms that your severance arrangement if Data I/O Corporation terminates your employment without cause and unrelated to a change of control, as calculated under the Data I/O Corporation severance pay program and disclosed in the 2014 proxy statement, will continue to be \$134,351, even if the Data I/O Corporation severance pay program is changed.

Sincerely,

/s/ Anthony Ambrose

Anthony Ambrose

President and CEO

Acknowledged and Agreed:

/s/ Joel S. Hatlen

Joel Hatlen

Cc: Rachael Jackman, Human Resources

Exhibit 31.1

CERTIFICATION

I, Anthony Ambrose, certify that:

- 1) I have reviewed this quarterly report on Form 10-Q of Data I/O Corporation;
- 2) Based on my knowledge, this report does not contain any untrue statement of material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
- 3) Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
- 4) The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)), for the registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
  - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this quarterly report based on such evaluation; and
  - d) Disclosed in this quarterly report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5) The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

DATED: August 13, 2014

/s/ Anthony Ambrose

Anthony Ambrose

Chief Executive Officer

(Principal Executive Officer)



Exhibit 31.2

CERTIFICATION

I, Joel S. Hatlen, certify that:

- 1) I have reviewed this quarterly report on Form 10-Q of Data I/O Corporation;
- 2) Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
- 3) Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
- 4) The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)), for the registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
  - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this quarterly report based on such evaluation; and
  - d) Disclosed in this quarterly report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5) The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

DATED: August 13, 2014

/s/ Joel S. Hatlen

Joel S. Hatlen

Chief Financial Officer

(Principal Financial Officer)

Exhibit 32.1

Certification by Chief Executive Officer

Pursuant to 18 U.S.C. Section 1350

As Adopted Pursuant to

Section 906 of the Sarbanes-Oxley Act of 2002

In connection with the quarterly report of Data I/O Corporation (the "Company") on Form 10-Q for the period ended June 30, 2014 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Anthony Ambrose, Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 as amended; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Anthony Ambrose

Anthony Ambrose

Chief Executive Officer

(Principal Executive Officer)

August 13, 2014



Exhibit 32.2

Certification by Chief Financial Officer

Pursuant to 18 U.S.C. Section 1350

As Adopted Pursuant to

Section 906 of the Sarbanes-Oxley Act of 2002

In connection with the quarterly report of Data I/O Corporation (the "Company") on Form 10-Q for the period ended June 30, 2014 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Joel S. Hatlen, Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 as amended; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Joel S. Hatlen

Joel S. Hatlen

Chief Financial Officer

(Principal Financial Officer)

August 13, 2014