

SIGMATRON INTERNATIONAL INC

Form 10-Q

December 15, 2009

Table of Contents

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549
FORM 10-Q**

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

For the Quarterly Period Ended October 31, 2009

Commission File Number 0-23248

SigmaTron International, Inc.

(Exact Name of Registrant, as Specified in its Charter)

Delaware

36-3918470

(State or other Jurisdiction of Incorporation or
Organization)

(I.R.S. Employer
Identification Number)

2201 Landmeier Road, Elk Grove Village, Illinois

60007

(Address of Principal Executive Offices)

(Zip Code)

Registrant's Telephone Number, Including Area Code: (847) 956-8000
No Change

(Former Name, Former Address, and Former Fiscal Year, if Changed Since Last Report)

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

Indicate by check mark whether the registrant 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 definition of "accelerated filer", "large 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
(Do not check if a smaller reporting company)

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

On December 15, 2009, there were 3,822,556 shares of the Registrant's Common Stock outstanding.

SigmaTron International, Inc.
Index

	Page No.
PART 1. FINANCIAL INFORMATION:	
Item 1. Consolidated Financial Statements	
<u>Consolidated Balance Sheets – October 31, 2009 (Unaudited) and April 30, 2009</u>	3
<u>Consolidated Statements of Operations – Three and Six Months Ended October 31, 2009 and 2008</u>	4
<u>Consolidated Statements of Cash Flows – Six Months Ended October 31, 2009 and 2008</u>	5
<u>Notes to Condensed Consolidated Financial Statements</u>	6
Item 2. <u>Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>	10
Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u>	16
Item 4. <u>Controls and Procedures</u>	16
PART II OTHER INFORMATION:	
Item 1. <u>Legal Proceedings</u>	16
Item 1A. <u>Risk Factors</u>	16
Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	18
Item 3. <u>Defaults Upon Senior Securities</u>	18
Item 4. <u>Submission of Matters to a Vote of Security Holders</u>	18
Item 5. <u>Other Information</u>	18
Item 6. <u>Exhibits</u>	18
<u>EX-31.1</u>	
<u>EX-31.2</u>	
<u>EX-32.1</u>	
<u>EX-32.2</u>	
<u>EX-99.1</u>	

SigmaTron International, Inc.

Table of Contents

SigmaTron International, Inc.
Consolidated Balance Sheets

	October 31, 2009 (Unaudited)	April 30, 2009
Current assets:		
Cash	\$ 4,315,314	\$ 3,781,252
Accounts receivable, less allowance for doubtful accounts of \$150,000 at October 31, 2009 and \$167,788 at April 30, 2009	20,615,683	16,785,079
Inventories, net	31,192,825	36,230,555
Prepaid expenses and other assets	642,074	923,911
Deferred income taxes	1,565,086	1,560,425
Other receivables	60,588	341,310
Total current assets	58,391,570	59,622,532
Property, machinery and equipment, net	25,802,701	26,200,578
Other assets	621,435	699,379
Intangible assets, net of amortization of \$2,291,741 at October 31, 2009 and \$2,161,113 at April 30, 2009	478,259	608,887
Total assets	\$ 85,293,965	\$ 87,131,376
Liabilities and stockholders equity:		
Current liabilities:		
Trade accounts payable	\$ 13,268,646	\$ 10,531,553
Accrued expenses	1,584,439	1,602,913
Accrued wages	1,502,141	1,555,736
Income taxes payable	124,642	272,750
Notes payable bank	16,397,291	1,000,000
Notes payable buildings	2,591,313	140,250
Notes payable other	160,994	
Capital lease obligations	1,714,544	951,983
Total current liabilities	37,344,010	16,055,185
Notes payable bank, less current portion		19,746,696
Notes payable buildings, less current portion		2,521,188
Notes payable other, less current portion	254,906	
Capital lease obligations, less current portion	250,741	1,490,773
Deferred income taxes	1,915,649	1,915,649

Total long-term liabilities	2,421,296	25,674,306
Total liabilities	39,765,306	41,729,491

Commitments and contingencies:

Stockholders equity:

Preferred stock, \$.01 par value; 500,000 shares authorized, none issued and outstanding		
Common stock, \$.01 par value; 12,000,000 shares authorized, 3,822,556 shares issued and outstanding at October 31, 2009 and April 30, 2009	38,226	38,226
Capital in excess of par value	19,642,531	19,630,580
Retained earnings	25,847,902	25,733,079
Total stockholders equity	45,528,659	45,401,885
Total liabilities and stockholders equity	\$ 85,293,965	\$ 87,131,376

The accompanying notes to financial statements are an integral part of these statements.

Table of Contents

SigmaTron International, Inc.
Consolidated Statements Of Operations

	Three Months Ended	Three Months Ended	Six Months Ended	Six Months Ended
	October 31, 2009 Unaudited	October 31, 2008 Unaudited	October 31, 2009	October 31, 2008
Net sales	\$ 30,564,267	\$ 41,132,728	\$ 56,894,321	\$ 79,610,846
Cost of products sold	27,280,971	35,221,349	51,351,172	69,050,269
Gross profit	3,283,296	5,911,379	5,543,149	10,560,577
Selling and administrative expenses	2,368,409	3,469,956	4,945,250	6,662,459
Operating income	914,887	2,441,423	597,899	3,898,118
Other (income) expense net	(97,441)	(114,830)	(19,744)	(157,649)
Interest expense	191,307	485,864	435,403	1,007,475
Income from operations before income tax expense	821,021	2,070,389	182,240	3,048,292
Income tax expense	303,723	565,073	67,417	963,652
Net income	\$ 517,298	\$ 1,505,316	\$ 114,823	\$ 2,084,640
Earnings per share basic	\$ 0.14	\$ 0.39	\$ 0.03	\$ 0.55
Earnings per share diluted	\$ 0.13	\$ 0.39	\$ 0.02	\$ 0.54
Weighted average shares of common stock outstanding Basic	3,822,556	3,822,556	3,822,556	3,822,556
Weighted average shares of common stock outstanding Diluted	3,851,395	3,874,643	3,839,096	3,879,530

The accompanying notes to financial statements are an integral part of these statements.

Table of ContentsSigmaTron International, Inc.
Consolidated Statements of Cash Flows

	Six Months Ended October 31, 2009 Unaudited	Six Months Ended October 31, 2008 Unaudited
Operating activities:		
Net income	\$ 114,823	\$ 2,084,640
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	2,010,717	2,047,808
Stock-based compensation	11,951	19,129
Provision for doubtful accounts	(17,788)	(23,239)
Provision for inventory obsolescence	(62,440)	142,000
Deferred income taxes	(4,661)	(153,052)
Amortization of intangible assets	130,628	186,474
Gain from sale of machinery and equipment	(7,980)	(8,803)
Changes in operating assets and liabilities		
Accounts receivable	(3,812,816)	2,876,068
Inventories	5,100,170	(1,583,258)
Prepaid expenses and other assets	640,503	127,271
Trade accounts payable	2,737,093	(4,191,467)
Accrued expenses and payroll	(72,068)	(312,023)
Income taxes payable	(148,108)	(555,380)
Net cash provided by operating activities	6,620,024	656,168
Investing activities:		
Purchases of machinery and equipment	(1,170,606)	(596,900)
Proceeds from sale of machinery and equipment	8,477	18,052
Net cash used in investing activities	(1,162,129)	(578,848)
Financing activities:		
Payments under capital lease obligations	(477,471)	(959,701)
Payments under term loan	(500,000)	(500,000)
Payments under other notes payable	(26,832)	
Net (payments) proceeds under lines of credit	(3,849,405)	1,012,407
Payments under building notes payable	(70,125)	(256,809)

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Net cash used in financing activities	(4,923,833)	(704,103)
Change in cash	534,062	(626,783)
Cash at beginning of period	3,781,252	3,833,627
Cash at end of period	\$ 4,315,314	\$ 3,206,844
Supplementary disclosures of cash flow information		
Cash paid for interest	\$ 440,410	\$ 1,032,602
Cash paid for income taxes, net of (refunds)	69,057	1,634,816
Purchase of machinery and equipment financed under capital leases		358,627
Non Cash Financing Activity:		
The Company financed a licensing agreement through a note payable	\$ 442,732	
The accompanying notes to financial statements are an integral part of these statements.		

5

Table of Contents**Notes to Consolidated Financial Statements**

(Unaudited)

October 31, 2009

Note A Basis of Presentation

The accompanying unaudited consolidated financial statements of SigmaTron International, Inc. (SigmaTron), wholly-owned subsidiaries Standard Components de Mexico S.A., and AbleMex, S.A. de C.V., SigmaTron International Trading Co. and its wholly-owned foreign enterprise Wujiang SigmaTron Electronics Co. Ltd. (SigmaTron China) and its procurement branch SigmaTron Taiwan (collectively, the Company) have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X.

Accordingly, the consolidated financial statements do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring adjustments) considered necessary for a fair presentation have been included. The Company has evaluated subsequent events through December 15, 2009, which is the date the financial statements were issued. Operating results for the three and six month periods ended October 31, 2009 are not necessarily indicative of the results that may be expected for the year ending April 30, 2010. For further information, refer to the consolidated financial statements and footnotes thereto included in the Company's Annual Report on Form 10-K for the year ended April 30, 2009.

Note B Inventories

The components of inventory consist of the following:

	October 31, 2009	April 30, 2009
Finished products	\$ 8,533,339	\$ 11,644,129
Work-in-process	1,776,689	2,391,559
Raw materials	20,882,797	22,194,867
	\$ 31,192,825	\$ 36,230,555

Table of Contents**Note C Earnings Per Share**

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

	Three Months Ended		Six Months Ended	
	October 31, 2009	October 31, 2008	October 31, 2009	October 31, 2008
Net income	\$ 517,298	\$ 1,505,316	\$ 114,823	\$ 2,084,640
Weighted-average shares				
Basic	3,822,556	3,822,556	3,822,556	3,822,556
Effect of dilutive stock options	28,839	52,087	16,540	56,974
Diluted	3,851,395	3,874,643	3,839,096	3,879,530
Basic earnings per share	\$ 0.14	\$ 0.39	\$ 0.03	\$ 0.55
Diluted earnings per share	\$ 0.13	\$ 0.39	\$ 0.02	\$ 0.54

Options to purchase 503,707 shares of common stock were outstanding at October 31, 2009 and 2008.

Note D Financing Transactions:

The Company has a revolving credit facility with Bank of America under which the Company may borrow up to the lesser of: (i) \$32 million; or (ii) an amount equal to the sum of 85% of the eligible receivable borrowing base and the lesser of \$16 million or 50% of the eligible inventory borrowing base. The revolving credit facility expires on September 30, 2010.

The Company was in compliance with the required financial covenants as of July 31, 2009. Historically, the Company has renegotiated its financial covenants for the current fiscal year during the first quarter of that fiscal year. The existing financial covenants remain in place until a new agreement has been reached. However as of October 31, 2009 a new agreement had not been reached. Effective October 31, 2009 the Company was in violation of a financial covenant. The financial covenant violation affected the revolving credit facility, term loan, mortgage and leases. Also, the term of the agreement has not been negotiated with Bank of America beyond September 30, 2010, which resulted in all of the outstanding debt being reclassified as short term debt. Bank of America has provided a Forbearance on the violation until January 8, 2010 to allow the Company to transition to Wells Fargo/HSBC Trade Bank.

In October 2009 the Company decided to conduct a strategic review of its financing arrangements to determine the best long-term alternatives. As part of the review process, the Company contacted five potential new banks and asked them to review the Company's financial position and to submit proposals on possible financing alternatives. The Company received viable proposals from four of the five as well as a proposal from Bank of America. Based on an evaluation of all the proposals, the Company has decided to reduce the overall size of its revolving credit facility to \$25 million and to pursue the proposal from Wells Fargo/HSBC Trade Bank. The reduction in the line will reduce the Company's overall credit facility cost as there is currently no need for the excess capacity due to a reduction in business activity. The Company is in the process of negotiating documents and undergoing the field audit with Wells Fargo/HSBC Trade Bank. The senior secured revolving credit facility would have a term of two years and a borrowing limit of \$25 million. On December 10, 2009 the Company received a Commitment Letter from Wells Fargo/HSBC Trade Bank. The Company

Table of Contents

anticipates it will finalize the transaction by December 31, 2009. The Company has discussed its decision with Bank of America and they have provided a forbearance on the financial covenant violation until January 8, 2010 to allow the Company to transition to Wells Fargo/HSBC Trade Bank. The Company will continue to operate under the same terms with Bank of America during the transition period. Bank of America has expressed its interest in continuing its relationship with the Company and if for any reason the Company is unable to complete the transaction with Wells Fargo/HSBC Trade Bank it will revisit the relationship with a view to continuing it under revised terms. The Company believes that going forward it will have financing from either Bank of America or another bank. The Company has a term loan with Bank of America with an outstanding balance at October 31, 2009 of \$1,500,000, with quarterly principal payments of \$250,000 due each quarter through the quarter ending June 30, 2011 and interest payable monthly throughout the term of the loan. The Company anticipates it will repay this debt using proceeds from the senior secured revolving credit facility from Wells Fargo/HSBC Trade Bank.

On November 19, 2003, the Company purchased the property that serves as the Company's corporate headquarters and its Midwestern manufacturing facility. The Company executed a note and mortgage with Bank of America in the amount of \$3,600,000. The note bears a fixed interest rate of 5.59% per year and is payable in sixty monthly installments. A final payment of approximately \$2,115,000 is due on or before April 30, 2013. The outstanding balances were \$2,591,313 and \$2,731,562 at October 31, 2009 and October 31, 2008, respectively. The Company anticipates it will initially repay this debt using the proceeds from the senior secured revolving credit facility from Wells Fargo/HSBC Trade Bank and the Company plans to enter into a mortgage agreement with Wells Fargo/HSBC Trade Bank in the third quarter of fiscal 2010 to re-finance the property.

The Company has various capital leases with Bank of America in the amount of \$1,417,093 at October 31, 2009. The Company anticipates it will enter into a loan with Wells Fargo/HSBC Trade Bank by December 31, 2009 to repay this debt.

As of October 31, 2009, \$14,897,291 was outstanding under the revolving credit facility with Bank of America. There was approximately \$8.7 million of unused availability under the revolving credit facility as of October 31, 2009. At October 31, 2009 the long term portion of debt related to the Bank of America revolving credit facility, mortgage and leases in the amount of \$15,397,291, \$2,451,063 and \$857,798, respectively, were reclassified to short term debt.

Note E Critical Accounting Policies:

Management Estimates and Uncertainties The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Significant estimates made in preparing the consolidated financial statements include depreciation and amortization periods, the allowance for doubtful accounts, reserves for inventory and valuation of long-lived assets. Actual results could materially differ from these estimates.

Revenue Recognition Revenues from sales of the Company's electronic manufacturing services business are recognized when the product is shipped to the customer. In general, it is the Company's policy to recognize revenue and related costs when the order has been shipped from our facilities, which is also the same point that title passes under the terms of the purchase order except for consignment inventory. Consignment inventory is shipped from the Company to an independent

Table of Contents

warehouse for storage or shipped directly to the customer and stored in a segregated part of the customer's own facility. Upon the customer's request for inventory, the consignment inventory is shipped to the customer if the inventory was stored off-site or transferred from the segregated part of the customer's facility for consumption, or use, by the customer. The Company recognizes revenue upon such transfer. The Company from time to time may ship an order from its facilities which is also the same point that title passes under the terms of the purchase order and invoice the customer at the end of the calendar month. This is done only in special circumstances to accommodate a specific customer. The Company does not earn a fee for storing the consignment inventory. The Company generally provides a 90 day warranty for workmanship only and does not have any installation, acceptance or sales incentives, although the Company has negotiated longer warranty terms in certain instances. The Company assembles and tests assemblies based on customers' specifications. Historically, the amount of returns for workmanship issues has been de minimis under the Company's standard or extended warranties.

Inventories Inventories are valued at the lower of cost or market. Cost is determined by the first-in, first-out method. The Company establishes inventory reserves for valuation, shrinkage, and excess and obsolete inventory. The Company records provisions for inventory shrinkage based on historical experience to account for unmeasured usage or loss. Actual results differing from these estimates could significantly affect the Company's inventories and cost of products sold. The Company records provisions for excess and obsolete inventories for the difference between the cost of inventory and its estimated realizable value based on assumptions about future product demand and market conditions. Actual product demand or market conditions could be different than that projected by management.

Impairment of Long-Lived Assets The Company reviews long-lived assets including amortizable intangible assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. An asset is considered impaired if its carrying amount exceeds the future undiscounted net cash flow the asset is expected to generate. If such asset is considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the asset exceeds its fair market value.

New Accounting Standards:

In September 2006, the Financial Accounting Standards Board (FASB) issued Accounting Standards Codification (ASC or the Codification) 820-10 (Fair Value Measurements and Disclosures (formerly SFAS 157, Fair Value Measurements), which defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles and expands disclosures about fair value measurements. In November 2007, the FASB agreed to a one-year deferral of the effective date of ASC 820-10 for all non-financial assets and liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis. There was no significant impact from adoption of ASC 820-10 for non-financial assets and liabilities on the Company's financial statements.

In December 2007, the FASB issued ASC 805-10 Business Combinations (formerly SFAS 141R, Business Combinations). This Statement retains the fundamental requirements in ASC 805-10 that the acquisition method of accounting (formerly referred to as purchase method) is to be used for all business combinations and that an acquirer is identified for each business combination. This Statement defines the acquirer as the entity that obtains control of one or more businesses in the business combination and establishes the acquisition date as of the date that the acquirer achieves control. This Statement requires an acquirer to recognize the assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree at the acquisition date, measured at their fair values. This Statement requires the acquirer to recognize acquisition-related costs and restructuring costs separately from the business combination as period expense. This Statement is effective for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. The Company will implement ASC 805-10 for any future business combinations.

Table of Contents

In December 2007, the FASB issued ASC 810-10 Consolidation (formerly SFAS 160, Noncontrolling Interest in Consolidated Financial Statements, an amendment of Accounting Research Bulletin No. 51), which establishes accounting reporting standards for ownership interests in subsidiaries held by parties other than the parent, the amount of consolidated net income attributable to the parent and to the noncontrolling interest, changes in a parent's ownership interest, and the valuation of retained noncontrolling equity investments when a subsidiary is deconsolidated. ASC 810-10 also establishes disclosure requirements that clearly identify and distinguish between the interests of the parent and the interests of the noncontrolling owners. ASC 810-10 is effective for fiscal years beginning after December 15, 2008. There was no significant impact from adoption of ASC 810-10 on the Company's consolidated results of operations and financial condition.

In May 2009, the FASB issued ASC 855-10 Subsequent Events (formerly SFAS 165, Subsequent Events), which establishes standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. ASC 855-10 is effective for interim and annual periods ending after June 15, 2009. The Company adopted the provisions of ASC 855-10 in the first quarter of fiscal 2010, in accordance with the effective date.

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

In addition to historical financial information, this discussion of the business of SigmaTron International, Inc., its wholly-owned subsidiaries Standard Components de Mexico S.A., and AbleMex S.A. de C.V., SigmaTron International Trading Co. and its wholly-owned foreign enterprise Wujiang SigmaTron Electronics Co., Ltd. (SigmaTron China) and its procurement branch SigmaTron Taiwan (collectively the Company) and other Items in this Quarterly Report on Form 10-Q contain forward-looking statements concerning the Company's business or results of operations. Words such as continue, anticipate, will, expect, believe, plan, and similar expressions identify forward-looking statements. These forward-looking statements are based on the current expectations of the Company. Because these forward-looking statements involve risks and uncertainties, the Company's plans, actions and actual results could differ materially. Such statements should be evaluated in the context of the risks and uncertainties inherent in the Company's business including the Company's continued dependence on certain significant customers; the continued market acceptance of products and services offered by the Company and its customers; pricing pressures from our customers, suppliers and the market; the activities of competitors, some of which may have greater financial or other resources than the Company; the variability of our operating results; the results of long-lived assets impairment testing; the variability of our customers' requirements; the availability and cost of necessary components and materials; the ability of the Company and our customers to keep current with technological changes within our industries; regulatory compliance; the continued availability and sufficiency of our credit arrangements; changes in U.S., Mexican, Chinese or Taiwanese regulations affecting the Company's business; the current turmoil in the global economy and financial markets; the stability of the U.S., Mexican, Chinese and Taiwanese economic systems, labor and political conditions; currency exchange fluctuations; and the ability of the Company to manage its growth. These and other factors which may affect the Company's future business and results of operations are identified throughout the Company's Annual Report on Form 10-K and as risk factors and may be detailed from time to time in the Company's filings with the Securities and Exchange Commission. These statements speak as of the date of such filings, and the Company undertakes no obligation to update such statements in light of future events or otherwise unless otherwise required by law.

Table of Contents

Overview:

The Company operates in one business segment as an independent provider of electronic manufacturing services (EMS), which includes printed circuit board assemblies and completely assembled (box-build) electronic products. In connection with the production of assembled products, the Company also provides services to its customers, including (1) automatic and manual assembly and testing of products; (2) material sourcing and procurement; (3) design, manufacturing and test engineering support; (4) warehousing and shipment services; and (5) assistance in obtaining product approval from governmental and other regulatory bodies. The Company provides these manufacturing services through an international network of facilities located in the United States, Mexico, China and Taiwan.

The Company relies on numerous third-party suppliers for components used in the Company's production process. Certain of these components are available only from single sources or a limited number of suppliers. In addition, a customer's specifications may require the Company to obtain components from a single source or a small number of suppliers. The loss of any such suppliers could have a material impact on the Company's results of operations, and the Company may be required to operate at a cost disadvantage compared to competitors who have greater direct buying power from suppliers. The Company does not enter into purchase agreements with major or single-source suppliers. The Company believes that ad-hoc negotiations with its suppliers provides flexibility, given that the Company's orders are based on the needs of its customers, which constantly change.

Sales can be a misleading indicator of the Company's financial performance. Sales levels can vary considerably among customers and products depending on the type of services (consignment and turnkey) rendered by the Company and the demand by customers. Consignment orders require the Company to perform manufacturing services on components and other materials supplied by a customer, and the Company charges only for its labor, overhead and manufacturing costs, plus a profit. In the case of turnkey orders, the Company provides, in addition to manufacturing services, the components and other materials used in assembly. Turnkey contracts, in general, have a higher dollar volume of sales for each given assembly, owing to inclusion of the cost of components and other materials in net sales and cost of goods sold. Variations in the number of turnkey orders compared to consignment orders can lead to significant fluctuations in the Company's revenue levels. However, the Company does not believe that such variations are a meaningful indicator of the Company's gross margins. Consignment orders accounted for less than 5% of the Company's revenues for the six months ended October 31, 2009 and 2008.

In the past, the timing and rescheduling of orders have caused the Company to experience significant quarterly fluctuations in its revenues and earnings, and the Company expects such fluctuations to continue. The uncertainty associated with the worldwide economy in general, and the United States' economy specifically, makes forecasting difficult. Generally speaking, the markets of all of the Company's customers are expected to remain volatile. The Company believes sales have bottomed out and are starting to recover. Demand remains volatile and unpredictable.

Table of Contents**Results of Operations:****Net Sales**

Net sales decreased for the three month period ended October 31, 2009 to \$30,564,267 from \$41,132,728 for the three month period ended October 31, 2008. Net sales decreased for the six months ended October 31, 2009 to \$56,894,321 from \$79,610,846 for the same period in the prior fiscal year. Sales volume decreased for the three and six month periods ended October 31, 2009 as compared to the same period in the prior year in the fitness, consumer electronics, appliance, telecommunications, semiconductor equipment and life sciences marketplaces. The decrease in sales for these marketplaces was partially offset by an increase in sales in the gaming marketplace. The decrease in revenue for the three and six month periods ended October 31, 2009 is a result of our customers' decreased demand for product based on their forecasts, which we believe is attributable to the global economic slowdown.

Gross Profit

Gross profit decreased during the three month period ended October 31, 2009 to \$3,283,296 or 10.7% of net sales, compared to \$5,911,379 or 14.4% of net sales for the same period in the prior fiscal year. Gross profit decreased for the six month period ended October 31, 2009 to \$5,543,149 or 9.7% of net sales, compared to \$10,560,577 or 13.3% of net sales for the same period in the prior fiscal year. The decrease in gross margin in total dollars and as a percent of sales for the three and six month periods ended October 31, 2009 compared to the prior periods is due to decreased revenue levels and decreased plant capacity utilization.

The Company has reduced its worldwide headcount, through attrition and lay-offs. Further, the Company implemented salary reductions for all non-union U.S. employees beginning February 2009. The Company lowered its cost structure during fiscal year 2009 based on customers' demands for product. The soft demand resulted in layoffs at the Hayward, California and Tijuana, Mexico locations and work week hour reductions at its Hayward, California, Acuna, Mexico and Elk Grove Village, Illinois facilities. In the second half of the quarter ended October 31, 2009 the Company experienced an increase in demand for product and resumed operating near-full work weeks at its Hayward, California, Acuna, Mexico and Elk Grove Village, Illinois operations. There can be no assurance that sales levels and gross margins will not decrease in future quarters. Pricing pressures continue at all locations.

Selling and Administrative Expenses

Selling and administrative expenses decreased to \$2,368,409 or 7.8% of net sales for the three month period ended October 31, 2009 compared to \$3,469,956 or 8.4% of net sales in the same period last year. Selling and administration expenses decreased to \$4,945,250 or 8.7% of net sales for the six month period ended October 31, 2009 compared to \$6,662,459 or 8.4% of net sales in the same period in the prior fiscal year. The decrease in total dollars for the three and six month periods ended October 31, 2009, was approximately \$824,000 and \$1,200,000, respectively, and is primarily due to a decrease in bonus expense, accounting, IT, and office salaries, accounting fees and amortization expense. The decrease in total dollars for the six months ended October 31, 2009 was partially offset by an increase in legal fees and insurance expense of \$20,000 compared to the same period in the prior fiscal year.

Interest Expense

Interest expense for bank debt and capital lease obligations for the three month period ended October 31, 2009 was \$191,307 compared to \$485,864 for the same period in the prior year. Interest expense for the six month period ended October 31, 2009 was \$435,403 compared to \$1,007,475 for the same

Table of Contents

period in the prior year. These changes were attributable to the Company's decreased borrowings under its revolving credit facility, term loan and capital leases, and lower interest rates. Interest expense for future quarters in fiscal year 2010 may increase if interest rates or borrowings increase during fiscal year 2010.

Taxes

The income tax expense from operations was \$303,723 for the three month period ended October 31, 2009 compared to \$565,073 for the same period in the prior fiscal year. Income tax expense from operations was \$67,417 for the six month period ended October 31, 2009 compared to \$963,652 for the same period in the prior fiscal period. The effective tax rate for the six month period ended October 31, 2009 was 37% compared to 31.6% for the same period in the prior fiscal year.

Net Income

Net income from operations decreased to \$517,298 for the three month period ended October 31, 2009 compared to \$1,505,316 for the same period in the prior year. Net income from operations decreased to \$114,823 for the six months ended October 31, 2009 compared to \$2,084,640 in the same period last year. Basic and diluted earnings per share for the second fiscal quarter of 2010 were \$0.14 and \$0.13, respectively, compared to basic and diluted earnings per share of \$0.39 for the same period in the prior year. Basic and diluted earnings per share for the six months ended October 31, 2009 were \$0.03 and \$0.02, respectively, compared to basic and diluted earnings per share of \$0.55 and \$0.54, respectively, for the same period in the prior year.

Liquidity and Capital Resources:

Operating Activities.

Cash flow provided by operating activities was \$6,620,024 for the six months ended October 31, 2009, compared to \$656,168 for the same period in the prior year. During the first six months of fiscal year 2010, cash flow provided by operating activities was a result of net income, the non-cash effect of depreciation and amortization, a decrease in inventory and an increase in accounts payable. Net cash provided by operations was partially offset by an increase in accounts receivable. The change in accounts payable and accounts receivable is due to timing of payments in the ordinary course of business. The decrease in inventory was the result of our customers' decreased demand for product based on their forecasts, which we believe is attributable to the global economic slowdown.

Cash flow provided by operating activities was \$65