

MERRIMAC INDUSTRIES INC  
Form 10-Q  
November 09, 2009

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 3, 2009

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File No. 0-11201

Merrimac Industries, Inc.  
(Exact Name of Registrant as Specified in Its Charter)

DELAWARE  
(State or Other Jurisdiction of  
Incorporation or Organization)

22-1642321  
(I.R.S. Employer  
Identification No.)

41 FAIRFIELD PLACE  
WEST CALDWELL, NEW JERSEY 07006  
(Address of Principal Executive Offices) (Zip Code)

(973) 575-1300  
(Registrant's Telephone Number)

Former name, former address and former fiscal year, if changed since last report: N/A

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 a "smaller reporting

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company" in Rule 12b-2 of the Exchange Act. (Check one):

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

As of November 4, 2009, there were 2,992,456 shares of Common Stock, par value \$.01 per share, outstanding.

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## PART I. FINANCIAL INFORMATION

## ITEM 1. FINANCIAL STATEMENTS

MERRIMAC INDUSTRIES, INC.  
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS  
(UNAUDITED)

	Quarters Ended		Nine Months Ended	
	October 3, 2009	September 27, 2008 (Restated)	October 3, 2009	September 27, 2008 (Restated)
Net sales	\$ 8,271,178	\$ 8,327,790	\$ 23,966,766	\$ 21,575,742
Costs and expenses:				
Cost of sales	4,276,310	5,323,091	13,222,933	13,958,812
Selling, general and administrative	2,450,671	2,398,255	7,122,290	6,993,520
Research and development	101,665	105,114	318,187	852,513
Gain on sale of asset	-	-	(40,579)	-
	6,828,646	7,826,460	20,622,831	21,804,845
Operating income (loss)	1,442,532	501,330	3,343,935	(229,103)
Interest and other expense, net	(68,210)	(17,336)	(202,252)	(126,516)
Income (loss) from continuing operations net of income taxes	1,374,322	483,994	3,141,683	(355,619)
Provision for income taxes	443,279	10,000	686,014	10,000
Income (loss) from continuing operations	931,043	473,994	2,455,669	(365,619)
Income (loss) from discontinued operations, after income taxes	-	(10,956)	50,505	(65,992)
Net income (loss)	\$ 931,043	\$ 463,038	\$ 2,506,174	\$ (431,611)
Income (loss) per common share from continuing operations – basic	\$ 0.31	\$ 0.16	\$ 0.83	\$ (0.13)
Income (loss) per common share from discontinued operations – basic	\$ -	\$ -	\$ 0.01	\$ (0.02)
Net income (loss) per common share – basic	\$ 0.31	\$ 0.16	\$ 0.84	\$ (0.15)
Income (loss) per common share from continuing operations – diluted	\$ 0.31	\$ 0.16	\$ 0.82	\$ (0.13)
Income (loss) per common share from discontinued operations – diluted	\$ -	\$ -	\$ 0.02	\$ (0.02)
Net income (loss) per common share – diluted	\$ 0.31	\$ 0.16	\$ 0.84	\$ (0.15)
Weighted average number of shares outstanding-basic	2,986,022	2,948,037	2,966,501	2,940,112
Weighted average number of shares outstanding-diluted	3,013,986	2,965,537	3,000,131	2,940,112

See accompanying notes.

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MERRIMAC INDUSTRIES, INC.  
CONDENSED CONSOLIDATED BALANCE SHEETS

	October 3, 2009 (UNAUDITED)	January 3, 2009 (NOTE 1)
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 3,219,940	\$ 1,191,768
Accounts receivable, net of allowance for doubtful accounts of \$30,000	7,559,992	5,765,575
Inventories, net	5,604,220	4,899,706
Other current assets	840,012	542,320
Costs and estimated earnings in excess of billings on uncompleted contracts	3,249,726	1,880,338
Total current assets	20,473,890	14,279,707
Property, plant and equipment	38,179,022	37,765,928
Less accumulated depreciation and amortization	30,433,635	28,556,441
Property, plant and equipment, net	7,745,387	9,209,487
Other assets	437,398	543,217
Total assets	\$ 28,656,675	\$ 24,032,411
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Current portion of long-term debt	\$ 291,667	\$ 291,667
Accounts payable	700,737	794,351
Accrued liabilities	1,704,998	1,432,124
Customer deposits	2,137,761	654,133
Income taxes payable	213,565	17,448
Total current liabilities	5,048,728	3,189,723
Long-term debt, net of current portion	2,306,945	2,611,111
Deferred liabilities	50,621	64,254
Total liabilities	7,406,294	5,865,088
Commitments and contingencies		
Stockholders' equity:		
Preferred stock, par value \$.01 per share:		
Authorized: 1,000,000 shares		
No shares issued		
Common stock, par value \$.01 per share:		
20,000,000 shares authorized; 3,355,361 and 3,315,229 shares issued; and 2,992,456 and 2,952,324 shares outstanding, respectively		
	33,554	33,153
Additional paid-in capital	20,956,407	20,379,924
Retained earnings	3,382,584	876,410
	24,372,545	21,289,487
Less treasury stock, at cost – 362,905 shares at October 3, 2009 and January 3, 2009	(3,122,164)	(3,122,164)
Total stockholders' equity	21,250,381	18,167,323

Total liabilities and stockholders' equity	\$ 28,656,675	\$ 24,032,411
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See accompanying notes.

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MERRIMAC INDUSTRIES, INC.  
 CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY  
 NINE MONTHS ENDED OCTOBER 3, 2009  
 (UNAUDITED)

	Common Stock		Additional	Retained	Treasury Stock		Totals
	Shares	Amount	Paid-in Capital	Earnings	Shares	Amount	
Balance, January 3, 2009	3,315,229	\$ 33,153	\$ 20,379,924	\$ 876,410	362,905	\$ (3,122,164)	\$ 18,167,323
Net income				2,506,174			2,506,174
Share-based compensation			344,856				344,856
Exercise of stock options	31,632	316	231,712				232,028
Vesting of restricted stock	8,500	85	(85)				-
Balance, October 3, 2009	3,355,361	\$ 33,554	\$ 20,956,407	\$ 3,382,584	362,905	\$ (3,122,164)	\$ 21,250,381

See accompanying notes.



MERRIMAC INDUSTRIES, INC.  
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS  
(UNAUDITED)

	Nine Months Ended	
	October 3, 2009	September 27, 2008
Cash flows from operating activities:		Restated
Net income (loss)	\$ 2,506,174	\$ (431,611)
Income (loss) from discontinued operations	50,505	(65,992)
Income (loss) from continuing operations	2,455,669	(365,619)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Depreciation and amortization	1,933,210	1,907,668
Gain on sale of assets	(40,579)	-
Amortization of deferred financing costs	85,402	24,120
Share-based compensation	344,856	375,837
Changes in operating assets and liabilities:		
Accounts receivable	(1,794,417)	(1,592,848)
Inventories	(704,514)	(15,207)
Costs and estimated earnings in excess of billings on uncompleted contracts	(1,369,388)	(1,185,909)
Other current assets	(297,692)	48,944
Other assets	20,417	69,311
Accounts payable	(93,614)	(38,436)
Accrued liabilities	272,874	(126,234)
Customer deposits	1,483,628	157,065
Income taxes payable	196,117	10,000
Deferred liabilities	(13,633)	2,215
Net cash provided by (used in) operating activities of continuing operations	2,478,336	(729,093)
Income (loss) from discontinued operations	50,505	(65,992)
Net cash provided by (used in) operating activities	2,528,841	(795,085)
Cash flows from investing activities:		
Purchases of property, plant and equipment	(485,733)	(671,780)
Cash proceeds from sale of asset	57,202	664,282
Net cash used in investing activities	(428,531)	(7,498)
Cash flows from financing activities:		
Borrowings under revolving credit facility	-	1,000,000
Repayment of long-term debt	(304,166)	(616,667)
Restricted cash returned	-	250,000
Proceeds from the exercise of stock options	232,028	28,331
Proceeds from Stock Purchase Plan sales	-	59,435
Net cash (used in) provided by financing activities	(72,138)	721,099
Net increase (decrease) in cash and cash equivalents	2,028,172	(81,484)
Cash and cash equivalents at beginning of period	1,191,768	2,004,471

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Cash and cash equivalents at end of period	\$ 3,219,940	\$ 1,922,987
Supplemental disclosures of cash flow information:		
Cash paid during the period for:		
Interest on credit facilities	\$ 222,651	\$ 173,762
Income taxes	\$ 490,000	\$ —

See accompanying notes.

MERRIMAC INDUSTRIES, INC.  
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. BASIS OF PRESENTATION

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with the instructions to Form 10-Q and therefore do not include all information and footnote disclosures otherwise required by accounting principles generally accepted in the United States of America for a full fiscal year. The financial statements do, however, reflect all adjustments of a normal recurring nature, which are in the opinion of management, necessary for a fair presentation of the financial position of Merrimac Industries, Inc. (“Merrimac” or the “Company”) as of October 3, 2009 and its results of operations and cash flows for the periods presented. Results of operations of interim periods are not necessarily indicative of results for a full year.

The consolidated balance sheet at January 3, 2009 has been derived from the audited financial statements at that date but does not include all the information required by accounting principles generally accepted in the United States of America for complete financial statements. For further information, refer to the consolidated financial statements and footnotes thereto included in the Company’s Annual Report on Form 10-K filed with the Securities and Exchange Commission on April 20, 2009 for the year ended January 3, 2009. See the summary of Significant Accounting Policies in the Company’s 2008 Annual Report on Form 10-K for a discussion of the accounting policies utilized by the Company.

Merrimac’s financial statements are presented in accordance with accounting standards set by the Financial Accounting Standards Board, commonly referred to as the “FASB.” The FASB sets generally accepted accounting principles (“GAAP”) that the Company follows to ensure that reports of the Company’s financial condition, results of operations, and cash flows are presented on a consistent basis. References to GAAP issued by the FASB in these footnotes are to the FASB Accounting Standards Codification, sometimes referred to as the Codification or ASC (“ASC”).

We evaluated subsequent events through November 9, 2009, the date of financial statement issuance.

2. RESTATEMENT OF CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

In April 2009, the Company’s management determined that there were misstatements in the Company’s previously reported fiscal year 2008 quarterly financial statements. These misstatements were due to a combination of factors and primarily affected work in process inventories and cost of goods sold as well as having a minor impact on accrued liabilities and selling, general and administrative expenses. The main factors causing the misstatements were control deficiencies following the Company-wide conversion to an enterprise resource planning (ERP) software system and as a result of changes in personnel in the Company’s financial operations department. The unaudited condensed impact of the errors found affected all three previously reported quarters of fiscal year 2008 and the restatement of the quarterly consolidated financial statements were presented in the Company’s fiscal year 2008 Form 10-K. The condensed consolidated statement of operations for the quarter and nine months ended September 27, 2008 and condensed consolidated statements of cash flows for the nine months ended September 27, 2008 presented herein are the restated condensed consolidated financial statements and throughout this Form 10-Q, where applicable, the restated condensed consolidated financial statements for the quarter ended and nine months ended September 27, 2008 are presented.

3. DISCONTINUED OPERATIONS

Company management determined, and the Board of Directors approved on August 9, 2007, that the Company should divest its FMI operations. The divestiture enables Merrimac to concentrate its resources on RF Microwave and

Multi-Mix® Microtechnology product lines to generate sustainable, profitable growth. Beginning with the third quarter of 2007, the Company reflected FMI as a discontinued operation and the Company reclassified prior consolidated financial statements to reflect the results of operations, financial position and cash flows of FMI as discontinued operations.

On December 28, 2007, the Company sold substantially all of the assets of its wholly-owned subsidiary, FMI, to Firan Technology Group Corporation (“FTG”), a manufacturer of high technology/high reliability printed circuit boards that has operations in Toronto, Ontario, Canada and Chatsworth, California. The transaction was effected pursuant to an asset purchase agreement entered into between Merrimac, FMI and FTG. The total consideration payable by FTG was \$1,482,000 (Canadian \$1,450,000) plus the assumption of certain liabilities of approximately \$368,000 (Canadian \$360,000). FTG paid \$818,000 (Canadian \$800,000) of the purchase price at closing and the balance was paid on February 21, 2008 following the conclusion of a transitional period.

MERRIMAC INDUSTRIES, INC.  
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

The operating results of FMI, which were formerly represented as Merrimac's microwave micro-circuitry segment for the quarters and nine months ended October 3, 2009 and September 27, 2008 are summarized as follows:

	Quarter Ended		Nine Months Ended	
	October 3, 2009	September 27, 2008	October 3, 2009	September 27, 2008
Net sales	\$ -	\$ -	\$ -	\$ -
Income (loss) from discontinued operations before provision for income taxes	\$ -	\$ (10,956)	\$ 50,505	\$ (65,992)
Provision for income taxes	-	-	-	-
Income (loss) from discontinued operations	\$ -	\$ (10,956)	\$ 50,505	\$ (65,992)

#### 4. CONTRACT REVENUE RECOGNITION

The Company derives its revenues from sales of the following: customized products, which include amounts billable for non-recurring engineering services and in some instances the production and delivery of prototypes, and the subsequent production and delivery of units under short-term, firm-fixed price contracts; the design, documentation, production and delivery of a series of complex components under long-term firm-fixed price contracts; and the delivery of off-the-shelf standard products.

The Company accounts for all contracts, except those for the sale of off-the-shelf standard products, in accordance with the Revenue Recognition Topic of the ASC ("Revenue Recognition Topic"). Sales of off-the-shelf standard products and related costs of sales are recorded when title transfers to our customer, which is generally on the date of shipment, provided persuasive evidence of an arrangement exists, the sales price is fixed or determinable and collection of the related receivable is probable.

The Company recognizes all amounts billable under short-term contracts, including those involving non-recurring engineering ("NRE") services for customization of products, in net sales and all related costs in cost of sales under the completed-contract method when the customized units are delivered. The Company periodically enters into contracts with customers for the development and delivery of a prototype prior to the shipment of units. Under those circumstances, the Company recognizes all amounts billable for NRE services in net sales and all related costs in cost of sales when the prototype is delivered and recognizes all of the remaining amounts billable and the related costs when the units are delivered.

Periodically, the Company has complex, long-term contracts for the engineering design, development and production of space electronics products for which revenue is recognized under the percentage-of-completion method. Sales and related contract costs for design and documentation services under this type of contract are recognized based on the cost-to-cost method. Sales and related contract costs for products delivered under these contracts are recognized on the units-of-delivery method. The Company has one contract which is primarily related to the design and development (and to a lesser extent, the production of space electronics) for which revenue under the entire contract is recognized under the percentage-of-completion method using the cost-to-cost method. For such contract, the Company has recognized costs and estimated earnings in excess of billings of approximately \$3,250,000 at October 3, 2009.

Pursuant to the Revenue Recognition Topic, anticipated losses on all contracts are charged to operations in the period when the losses become known.

#### 5. ACCOUNTING PERIOD

The Company's fiscal year is the 52-53 week period ending on the Saturday closest to December 31. The Company has quarterly dates that correspond with the Saturday closest to the last day of each calendar quarter and each quarter consists of 13 weeks in a 52-week year. Periodically, the additional week to make a 53-week year is added to the fourth quarter, making such quarter consist of 14 weeks (fiscal year 2014 will be the next 53 week year).

#### 6. RECENT ACCOUNTING PRONOUNCEMENTS

In October 2008, the FASB issued guidance that clarifies the methods of measurement of a financial asset in a market that is not active and provides an example to illustrate key considerations in determining the fair value of a financial asset when the market for that financial asset is not active. The guidance is effective for prior periods for which financial statements have not been issued. The guidance is summarized in the Fair Value Measurements and Disclosures Topic of the ASC. Management currently believes that the guidance will have no material impact on the Company's consolidated financial statements.

In April 2009, the FASB issued accounting guidance for estimating the fair value of a financial asset when the volume and level of activity for the asset or liability have significantly decreased and reemphasized that regardless of market conditions, the fair value measurement is an exit price concept as defined in the FASB's guidance issued in October, 2008 and noted above. This guidance further amended earlier pronouncements on this topic to require interim disclosures of the valuation techniques and related inputs used to measure fair value and any changes to those valuation techniques and inputs. This pronouncement also provided additional guidance on defining the major categories of equity and debt securities measured at fair value in meeting the disclosure requirements for these types of assets. This guidance is to be applied prospectively beginning in the second quarter of fiscal year 2009. This guidance is summarized in the Fair Value Measurements and Disclosures Topic of the ASC. The adoption of this guidance by the Company did not have a material impact on the Company's financial statements.

MERRIMAC INDUSTRIES, INC.  
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

In April 2008, the FASB issued guidance regarding the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset. The intent of this guidance is to improve the consistency between the useful life of a recognized asset and the period of expected cash flows used to measure the fair value of the asset under generally accepted accounting principles in the United States of America. The guidance is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years. This guidance is summarized in the Intangibles – Goodwill and Other Topic of the ASC. The adoption of this guidance by the Company did not have a material impact on the Company's financial statements.

In December 2007, the FASB issued a pronouncement that established principles and requirements for how an acquiring company recognized and measured in its financial statements the identifiable assets acquired, the liabilities assumed, any noncontrolling interest in the acquired company and the goodwill acquired. The pronouncement also established disclosure requirements to enable the evaluation of the nature and financial effects of the business combination. The pronouncement is effective for fiscal periods beginning after December 15, 2008. The pronouncement is summarized in the Business Combinations Topic of the ASC. The adoption of this pronouncement by the Company did not have a material impact on the Company's consolidated financial statements.

In April 2009, the FASB issued guidance to address application issues raised by preparers, auditors, and members of the legal profession on initial recognition and measurements, subsequent measurement and accounting, and disclosure of assets and liabilities arising from contingencies in a business combination. The guidance shall be effective for assets or liabilities arising from contingencies in 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. This guidance is summarized in the Business Combinations Topic of the ASC. The adoption of this guidance by the Company did not have a material impact on the Company's consolidated financial statements.

In December 2007, the FASB issued a pronouncement establishing accounting and reporting standards of 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. The pronouncement also establishes disclosure requirements that clearly identify and distinguish between the interests of the parent and the interest of the noncontrolling owners. The pronouncement is effective for fiscal periods beginning after December 15, 2008. The pronouncement is summarized in the Consolidation Topic of the ASC. The adoption of this pronouncement by the Company did not have a material impact on the Company's consolidated financial statements.

In March 2008, the FASB issued a pronouncement changing the disclosure requirements for derivative instruments and hedging activities. Entities are required to provide enhanced disclosures about (a) how and why an entity uses derivative instruments, (b) how derivative instruments and related hedged items are accounted for under the pronouncement and its related interpretations, and (c) how derivative instruments and related hedge items affect an entity's financial position, financial performance, and cash flows. The pronouncement is effective for fiscal years beginning after November 15, 2008. The pronouncement is summarized in the Derivative and Hedging Topic of the ASC. The adoption of this pronouncement by the Company did not have a material impact on the Company's consolidated financial statements.

In November 2008, the FASB ratified guidance put forth by the Emerging Issues Task Force that relates to all investments accounted for under the equity method of accounting. The guidance states that an entity shall measure its equity investment initially at cost. Contingent consideration should only be included in the initial measurement of the equity method investment if it is required to be recognized by specific authoritative guidance other than that specified



under the Business Combinations Topic of the ASC. However, if any equity method investment agreement involves a contingent consideration arrangement in which the fair value of the investor's share of the investee's net assets exceeds the investor's initial cost, a liability should be recognized. An equity method investor is required to recognize other-than-temporary impairments of an equity method investment and shall account for a share issuance by the investee as if the investor had sold a proportionate share of its investment. Any gain or loss to the investor resulting from an investee's share issuance shall be recognized in earnings. The guidance shall be effective in fiscal years beginning on or after December 15, 2008, and interim periods within those fiscal years and shall be applied prospectively. The guidance is summarized in the Investments – Equity Method and Joint Ventures Topic of the ASC. The adoption of this guidance by the Company did not have a material impact on the Company's consolidated financial statements.

In May 2009, the FASB issued a pronouncement establishing general standards for 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. The pronouncement, among other things, sets forth the period after the balance sheet date during which management should evaluate events or transactions that may occur for potential recognition or disclosure in the financial statements, the circumstances under which an entity should recognize events or transactions occurring after the balance sheet date in its financial statements and the disclosures an entity should make about events or transactions that occurred after the balance sheet date. The pronouncement was effective for the Company beginning July 4, 2009. The pronouncement is summarized in the Subsequent Events Topic of the ASC. The adoption of this pronouncement by the Company did not have a material impact on the Company's interim or annual financial statements or the disclosures in those financial statements.

MERRIMAC INDUSTRIES, INC.  
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

In June 2009, the FASB issued a pronouncement that establishes the FASB ASC as the single sole source of authoritative generally accepted accounting principles recognized by the FASB to be applied by non-governmental entities. The Codification does not change current GAAP, but is intended to simplify user access to all authoritative GAAP by providing all the authoritative literature related to a particular topic in one place. Rules and interpretive releases of the Securities and Exchange Commission (“SEC”) under authority of federal securities laws are also sources of authoritative GAAP for SEC registrants. The pronouncement is effective for financial statements issued for interim and annual periods ending after September 15, 2009. The Company has updated references to GAAP in its consolidated financial statements issued for the period ended October 3, 2009. The adoption of this pronouncement did not impact the Company’s consolidated results of operations or financial position.

In June 2009, the FASB issued guidance relating to the determination of which entities, if any, have a controlling financial interest in a variable interest entity (“VIE”) from a quantitative based risk and rewards calculation. The original calculation method was replaced with a qualitative approach that focuses on identifying which entities have the power to direct the activities that most significantly impact the VIE’s economic performance and the obligation to absorb losses of the VIE or the right to receive benefits from the VIE. The update also requires ongoing assessments as to whether an entity is the primary beneficiary of a VIE, modifies the presentation of consolidated VIE assets and liabilities, and requires additional disclosures about a company’s involvement in VIE’s. This guidance is effective for financial statements issued for interim and annual periods ending after November 15, 2009. The guidance is summarized in the Consolidation Topic of the ASC. Management is currently evaluating the effect that adoption of this guidance will have, if any, on the Company’s consolidated results of operations and financial position.

In September 2009, the FASB issued guidance relating to measurement of the fair value of certain investments, including those with fair values that are not readily determinable, on the basis of the net asset value per share of the investment (or its equivalent) if such net asset value is calculated in a manner consistent with the measurement principles in Financial Services Topic of the ASC as of the entity’s measurement date (measurement of all or substantially all of the underlying investments of the investee in accordance with the Fair Value Measurements and Disclosures guidance). The guidance also requires enhanced disclosures about the nature and risks of investments within its scope that are measured at fair value on a recurring or nonrecurring basis. This guidance is effective for the Company beginning October 4, 2009. The guidance is summarized in the Fair Value Measurements and Disclosures Topic of the ASC. Management is currently evaluating the effect that adoption of this guidance will have, if any, on the Company’s consolidated results of operations and financial position.

In October 2009, the FASB issued guidance removing the objective-and-reliable-evidence-of-fair-value criterion from the separation criteria used to determine whether an arrangement involving multiple deliverables contains more than one unit of accounting, replaces references to “fair value” with “selling price” to distinguish from the fair value measurements required under the Fair Value Measurements and Disclosures guidance, provides a hierarchy that entities must use to estimate the selling price, eliminates the use of the residual method for allocation, and expands the ongoing disclosure requirements. This update is effective for financial statements beginning on or after June 15, 2010 and can be applied prospectively or retrospectively. The guidance is summarized in the Revenue Recognition Topic of the ASC. Management is currently evaluating the effect that adoption of this guidance will have, if any, on the Company’s consolidated results of operations and financial position.

## 7. SHARE-BASED COMPENSATION

On January 1, 2006, the start of the first quarter of fiscal 2006, the Company adopted the provisions of the Equity Topic and Compensation-Stock Compensation Topic of the ASC as they relate to share-based compensation (“Equity and Compensation Topic”) which requires that the costs resulting from all share-based payment transactions be

recognized in the financial statements at their fair values. The Company adopted the Equity and Compensation Topics using the modified prospective application method under which the provisions of the Equity and Compensation Topics apply to new awards and to awards modified, repurchased, or cancelled after the adoption date. Additionally, compensation cost for the portion of the awards for which the requisite service has not been rendered that are outstanding as of the adoption date is recognized in the consolidated statement of operations over the remaining service period after the adoption date based on the award's original estimate of fair value.

Because of the Company's net operating loss carryforwards, no tax benefits resulting from the exercise of stock options have been recorded, thus there was no effect on cash flows from operating or financing activities.

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The components of share-based compensation expense in the statements of operations are as follows:

	Quarters Ended		Nine Months Ended	
	October 3, 2009	September 27, 2008	October 3, 2009	September 27, 2008
Stock options	\$ 107,000	\$ 95,000	\$ 294,000	\$ 293,000
Restricted stock	17,000	17,000	51,000	64,000
Employee stock purchase plan	-	6,000	-	19,000
Total share-based compensation	\$ 124,000	\$ 118,000	\$ 345,000	\$ 376,000

For the quarters and nine months ended October 3, 2009 and September 27, 2008, share-based compensation expense was allocated as follows:

	Quarters Ended		Nine Months Ended	
	October 3, 2009	September 27, 2008	October 3, 2009	September 27, 2008
Cost of sales	\$ 48,000	\$ 45,000	\$ 129,000	\$ 135,000
Selling, general and administrative	76,000	73,000	216,000	241,000
Total share-based compensation	\$ 124,000	\$ 118,000	\$ 345,000	\$ 376,000

The fair value of the options granted was estimated on the date of grant using the Black-Scholes option valuation model.

The following weighted average assumptions for options granted in the quarter and nine months ended October 3, 2009 and September 27, 2008 were utilized:

	2009	2008
Expected option life (years)	6.0	6.0
Expected volatility	63.71%	37.56%
Risk-free interest rate	2.53%	3.14%
Expected dividend yield	0.00%	0.00%

The Black-Scholes option valuation model was developed for use in estimating the fair value of traded options, which have no vesting restrictions and are fully transferable. In addition, option valuation models require the input of highly subjective assumptions including the expected stock price volatility.

#### Share-Based Compensation Plans:

At October 3, 2009, the Company maintains share-based compensation arrangements under the following plans: (i) 1997 Long Term Incentive Plan; (ii) 2001 Stock Option Plan; (iii) 2006 Stock Option Plan; (iv) 2006 Key Employee Incentive Plan; and (v) 2006 Non-Employee Directors' Stock Plan (see Note 7 of Form 10-K).

The 2006 Stock Option Plan authorizes the grant of an aggregate of 500,000 shares of common stock to employees, directors and consultants of the Company. Under the 2006 Stock Option Plan, the Company may grant to eligible individuals incentive stock options, as defined in Section 422 of the Internal Revenue Code of 1986 (the "Code"), and/or

non-qualified stock options. The purpose of the 2006 Stock Option Plan is to attract, retain and motivate employees, compensate consultants, and to enable employees, consultants and directors, including non-employee directors, to participate in the long-term growth of the Company by providing for or increasing the proprietary interests of such persons in the Company, thereby assisting the Company to achieve its long-range goals.

At October 3, 2009, there were 448,350 options granted under the 2006 Stock Option Plan; 132 were exercised and 448,218 options were outstanding of which 196,282 were exercisable. Options are granted at the closing price of the Company's shares on the American Stock Exchange on the date immediately prior to grant, pursuant to the 2006 Stock Option Plan. Options available for grant under the 2006 Stock Option Plan were 51,650 at October 3, 2009.

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At October 3, 2009, there were 67,200 options outstanding under the 1997 Long Term Incentive Plan and the 2001 Stock Option Plan, of which all were exercisable. No options are available for future grant under the 1997 Long Term Incentive Plan or the 2001 Stock Option Plan. Under the 1993 Stock Option Plan, there were no options outstanding or available for future grant.

A summary of all stock option activity and information related to all options outstanding for the nine months ended October 3, 2009 follows:

	Weighted- Average Exercise Price	Number of Shares	Average Contractual Term (Years)	Aggregate Intrinsic Value
Outstanding at January 3, 2009	\$ 9.12	435,400		
Granted	7.83	177,850		
Exercised	7.34	(31,632)		\$ 96,000
Expired	8.01	(49,400)		
Forfeited	9.60	(16,800)		
Outstanding at October 3, 2009	\$ 8.87	515,418	7.8	\$ 72,000
Exercisable at October 3, 2009	\$ 9.62	263,482	6.3	\$ 28,000

As of October 3, 2009, the total future compensation cost related to nonvested stock options not yet recognized in the statement of operations was \$1,010,000. Of that total, \$155,000, \$394,000, \$283,000 and \$178,000, are expected to be recognized in 2009, 2010, 2011 and 2012, respectively. As of October 3, 2009, there is no future compensation cost related to the employee stock purchase plan. There were 93,190 and 116,213 options vested during the nine months ended October 3, 2009 and September 27, 2008, respectively.

The 2006 Non-Employee Directors' Stock Plan is a plan that authorizes the grant of an aggregate of 100,000 shares of Common Stock to the non-employee directors of the Company. The plan authorizes each non-employee director to receive 1,500 shares of restricted stock beginning in 2006, and 1,500 shares or such other amount as the Board of Directors may, from time to time, decide for each year in the future following the Company's Annual Meeting of Stockholders.

The Company issued a grant of 9,000 shares of restricted stock, 1,500 shares each, to its six non-employee directors, on June 24, 2009 and June 26, 2008. The per-share price of the grant was \$7.82 and \$5.15, respectively (the closing price of the Company's shares on The American Stock Exchange on the date immediately prior to the grant, pursuant to the terms of the plan). One third of such restricted stock vests on each anniversary of the grant date over a three-year period. Share-based compensation expense for the quarter and nine months ended October 3, 2009, related to the grants of restricted stock, was approximately \$17,000 and \$51,000, respectively, which was based on a straight-line amortization. Share based compensation expense for the quarter and nine months ended September 27, 2008, related to the grants of restricted stock, was approximately \$17,000 and \$64,000, respectively, which was based on a straight-line amortization. Restricted shares of common stock available for grant under the 2006 Non-Employee Directors' Stock Plan were 62,500 at October 3, 2009.

A summary of unvested restricted stock activity and information related to all restricted stock outstanding follows:

Weighted-Average Grant-Day Fair Value	Shares
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Outstanding at January 3, 2009	\$	7.36	17,500
Granted		7.82	9,000
Vested		8.07	(8,500)
Outstanding at October 3, 2009	\$	7.26	18,000

As of October 3, 2009, the total future compensation cost related to the 2006 Non-Employee Directors' Stock Plan not yet recognized in the statement of operations was \$108,000. Of that total, \$17,000, \$51,000, \$30,000 and \$10,000 are expected to be recognized in 2009, 2010, 2011 and 2012, respectively.

The Company elected to adopt the detailed method provided in the Equity and Compensation Topics for calculating the beginning balance of the additional paid-in capital pool ("APIC pool") related to the tax effects of employee stock-based compensation, and to determine the subsequent impact on the APIC pool and consolidated statements of cash flows of the tax effects of employee stock-based compensation awards that are outstanding upon adoption of the provisions of the Equity and Compensation Topics.

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## 8. INVENTORIES

Inventories are stated at the lower of cost or market, using the average cost method. Cost includes materials, labor and manufacturing overhead related to the purchase and production of inventories.

Inventories consist of the following:

	October 3, 2009	January 3, 2009
Finished goods	\$ 585,178	\$ 700,174
Work in process	2,112,775	1,837,324
Raw materials and purchased parts	2,906,267	2,362,208
Totals	\$ 5,604,220	\$ 4,899,706

## 9. CURRENT AND LONG-TERM DEBT

The Company was obligated under the following debt instruments at October 3, 2009 and January 3, 2009:

	October 3, 2009	January 3, 2009
<b>Wells Fargo Bank N.A.:</b>		
Revolving line of credit, 1.00% above prime (prime having a 5% floor limit for loan purposes)	\$	\$
Equipment loan, due September 29, 2011, 1.00% above prime (prime having a 5% floor limit for loan purposes) 6.00% at October 3, 2009	279,167	458,333
Mortgage loan, due September 29, 2011, 1.50% above prime (prime having a 5% floor limit for loan purposes) or LIBOR plus 3.5%, 6.50% at October 3, 2009	2,319,445	2,444,445
	2,598,612	2,902,778
Less current portion	291,667	291,667
Long-term portion	\$ 2,306,945	\$ 2,611,111

On September 29, 2008, the Company entered into a credit facility with Wells Fargo Bank, N.A. ("WFB") (the "Wells Fargo Credit Facility") which replaced the credit facility with Capital One, N.A. On September 30, 2008, the Company repaid all outstanding amounts under the credit facility with Capital One, N.A. with the proceeds of the Wells Fargo Credit Facility. The Wells Fargo Credit Facility consists of a three-year \$5,000,000 collateralized revolving credit facility, a three-year \$500,000 equipment term loan and a three-year \$2,500,000 real estate term loan. The revolving line of credit is subject to an availability limit under a borrowing base calculation of 85% of eligible domestic accounts receivable with a sublimit of \$5,000,000 and 30% of eligible inventories with a sublimit of \$400,000. The revolving line of credit is also subject to a minimum borrowing base availability of \$500,000. As of October 3, 2009, the Company had a borrowing base of approximately \$3,730,000 and availability under the credit facility as of October 3, 2009 of approximately \$3,230,000. The revolving line of credit expires September 29, 2011. The revolving line of credit bears interest at the prime rate plus one percent, with the prime rate having a floor limit of 5% for loan purposes. The Company may request a LIBOR quote for an initial minimum of \$1,000,000 with subsequent requests at a minimum of \$500,000. No more than three such requests may be active at any point in time. LIBOR advances bear interest at the LIBOR rate plus 3.25% for a credit advance, or 3.50% for a term loan. The equipment loan is required to be repaid in equal monthly installments of \$13,900 based on a four-year amortization period. The



real estate loan is required to be paid in equal monthly installments of \$10,400 amortized over a 180 month time period, with any unpaid principal and interest due and payable on the termination date of September 29, 2011.

Interest expense for the nine months ended October 3, 2009 was approximately \$223,000.

In the second quarter of 2009, the Company sold equipment for approximately \$57,000 and all of the proceeds were used to pay down the Wells Fargo equipment loan.

The Wells Fargo Credit Facility is collateralized by substantially all of the Company's assets.

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The credit facility requires the Company to maintain certain financial covenants, including a minimum debt service coverage ratio of not less than 1.1 to 1.0 and minimum net income. For the quarter ended October 3, 2009 and for the quarters ended October 3, 2009 and beyond, net income is not to be less than 75% of the Company's projected net income or not more than 100% of the Company's projected net loss. Additionally, the credit facility prohibits incurring or contracting to incur capital expenditures exceeding \$600,000 in the year ending January 2, 2010 and \$600,000 in each subsequent year. The Company also must also not permit the amount due from its affiliate in Costa Rica, Multi-Mix Microtechnology S.R.L., to exceed \$5,000,000 through the quarter ending October 3, 2009 and each fiscal quarter thereafter. The credit agreement contains other standard covenants related to the Company's operations, including prohibitions on the creation of additional liens, the incurrence of additional debt, the payment of dividends, the sale of certain assets and other corporate transactions, without Wells Fargo's consent. The Company was in compliance with all of its financial covenants as of October 3, 2009.

At October 3, 2009 and January 3, 2009, the fair value of the Company's debt approximates carrying value. The fair value of the Company's long-term debt is estimated based on current interest rates.

#### 10. WARRANTIES

The Company's standard catalog items, as well as products sold under contracts, have warranty obligations. With the exception of a very limited number of contracts, all of the Company's products have a one-year warranty. For items sold with extended warranties, estimated warranty costs for each contract are determined based on the contract terms and technology-specific issues. The Company accrues estimated warranty costs at the time of sale and any additional amounts are recorded when such costs are probable and can be reasonably estimated. Warranty expense was approximately \$19,000 and \$12,000 for the quarters ended October 3, 2009 and September 27, 2008, respectively. Warranty expense was approximately \$26,000 and \$77,000 for the nine months ended October 3, 2009 and September 27, 2008, respectively. The warranty reserve was \$165,000 and \$200,000 at October 3, 2009 and January 3, 2009, respectively.

#### 11. INCOME TAXES

The Company recorded a tax provision of \$443,000 for the quarter ended October 3, 2009, based on income from continuing operations before taxes of \$1,374,000. In 2008, the Company recorded a tax provision of \$10,000 for the quarter ended September 27, 2008 based on income from continuing operations before taxes of \$484,000. The Company's effective tax rate for the quarters ended October 3, 2009 and September 27, 2008 was 32% and 2%, respectively. The provision for income taxes is based on Federal, state and foreign income taxes, and has been reduced due to the utilization of net operating loss carryovers.

The Company recorded a \$686,000 provision for income taxes for the nine months ended October 3, 2009 based on income from continuing operations before taxes of \$3,142,000. For the nine months ended September 27, 2008, the Company recorded a tax provision of \$10,000 based on the loss from continuing operations before taxes of \$356,000. The Company's effective tax rate for the nine months ended October 3, 2009 and September 27, 2008 is 22% and 0%, respectively. The provision for income taxes is based on federal, state and foreign income taxes, and has been reduced due to the utilization of net operating loss carryovers.

As of January 3, 2009, the Company had deferred tax assets of approximately \$1.1 million related to net operating loss carryforwards a portion of which has been used to reduce the Company's taxable income in the first nine months of 2009. The Company had net operating loss carryforwards of approximately \$3.2 million as of January 3, 2009 and based on the nine months income from continuing operations before income taxes the Company anticipates it will

fully utilize the net operating loss carryforwards in 2009. A valuation allowance is required when management assesses that it is more likely than not that all or a portion of a deferred tax asset will not be realized. The Company's 2002, 2003, 2006 and 2007 net losses have weighed heavily in the Company's overall assessments. As a result of the original assessment, the Company established a full valuation allowance for its remaining U.S. net deferred tax assets. This assessment continued unchanged from 2003 through the third quarter of 2009. The Company will continue to evaluate the realizability of its deferred tax assets and liabilities on a periodic basis, and will adjust such amounts in light of changing facts and circumstances.

Internal Revenue Service Code Section 382 places a limitation on the utilization of net operating loss carryforwards when an ownership change, as defined in the tax law, occurs. Generally, an ownership change occurs when there is a greater than 50 percent change in ownership. If such a change should occur, the actual utilization of net operating loss carryforwards, for tax purposes, would be limited annually to a percentage of the fair market value of the Company at the time of such change. The Company may become subject to these limitations in 2009 depending on the extent of the changes in its ownership.

On December 31, 2006, the Company adopted the provision of the Incomes Taxes Topic of the ASC ("Income Tax Topic"), which clarifies the accounting for uncertainty in tax positions. As of that date the Company had no uncertain tax positions and did not record any additional benefits or liabilities. At October 3, 2009 and January 3, 2009, the Company had no uncertain tax positions and did not record any additional benefits or liabilities. The Company will recognize any accrued interest or penalties related to unrecognized tax benefits within the provision for income taxes.

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12. BUSINESS SEGMENT DATA

The Company's continuing operations are conducted primarily through one business segment, electronic components and subsystems. This segment involves the design, manufacture and sale of electronic component devices offering extremely broad frequency coverage and high performance characteristics for communications, defense and aerospace applications. Of the identifiable assets, 89% are located in the United States and 11% are located in Costa Rica.

13. NET INCOME (LOSS) PER COMMON SHARE

Basic net income (loss) per common share is calculated by dividing net income (loss) by the weighted average number of common shares outstanding during the period.

The calculation of diluted net income (loss) per common share is similar to that of basic net income (loss) per common share, except that the denominator is increased to include the number of additional common shares that would have been outstanding if all potentially dilutive common shares, principally those issuable under stock options, were issued during the reporting period to the extent they are not anti-dilutive, using the treasury stock method.

Because of the net loss for the nine months ended September 27, 2008 approximately 430,000 shares underlying stock options were excluded from the calculation of diluted net loss per share, respectively, as the effect would be anti-dilutive. For the quarter and nine months ended October 3, 2009, 315,668 shares underlying options were excluded from the calculation of diluted net income per share because the options did not have any intrinsic value.

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The weighted average number of shares outstanding basic and diluted is as follows:

	Quarter Ended		Nine Months Ended	
	October 3, 2009	September 27, 2008	October 3, 2009	September 27, 2008
Net income (loss) for basic and diluted computations	\$ 931,043	\$ 463,038	\$ 2,506,174	\$ (431,611)
Weighted average number of shares outstanding - basic	2,986,022	2,948,037	2,966,501	2,940,112
Dilutive effect of options and restricted stock	27,964	17,500	33,630	-