UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D. C. 20549

FORM 10-K

x **Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**

for the fiscal year ended December 31, 2018

OR

o **Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**

for the transition period from to

NORTECH SYSTEMS INCORPORATED

(Exact name of registrant as specified in its charter)

Commission file number **0-13257**

State of Incorporation: **Minnesota**

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

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

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

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common Stock, par value $.01 per share	NASDAQ Capital Market

Securities registered pursuant to Section 12(g) of the Act: **None**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes o No x

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Act. Yes o No x

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

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted 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 such files). Yes x No o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. o

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

Large accelerated filer o	Accelerated filer o
Non-accelerated filer x	Smaller reporting company x
	Emerging growth company o

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. o

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

The aggregate market value of voting stock held by non-affiliates of the registrant, based on the closing price of $3.42 per share, was $3,520,018 on June 30, 2018.

Shares of common stock outstanding at March 26, 2019: 2,684,672.

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DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant s Proxy Statement for the 2019 Annual Shareholders Meeting have been incorporated by reference into Part III of this Form 10-K. The Proxy Statement is expected to be filed with the Securities and Exchange Commission (the SEC) within 120 days after December 31, 2018, the end of our fiscal year.

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NORTECH SYSTEMS INCORPORATED

ANNUAL REPORT ON FORM 10-K

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NORTECH SYSTEMS INCORPORATED

FORM 10-K

For the Year Ended December 31, 2018

PART I

Item 1. Business

General

Nortech Systems, Inc., (the Company , we , our) organized in December 1990, is an Electronic Manufacturing Services (EMS) company headquartered in Maple Grove, Minnesota, a suburb of Minneapolis, Minnesota. We maintain facilities and operations in Minnesota in the United States; Monterrey, Mexico; and Suzhou, China. We offer a full range of value-added engineering, technical and manufacturing services and support including project management, designing, testing, prototyping, manufacturing, supply chain management and post-market services. Our manufacturing and engineering services include complete medical devices, printed circuit board assemblies, wire and cable assemblies, and complex higher level electromechanical assemblies. The majority of our revenue is derived from products built to the customer s design specifications.

Our breadth of manufacturing, technical expertise and experience make us attractive to our broad customer base. Our customers are original equipment manufacturers (OEMs) in the Aerospace and Defense, Medical and Industrial markets. The diversity in the markets we serve is an advantage in dealing with the effects of fluctuations from the economy and competition. In the design phase, we provide technical support, subject matter expertise in design for manufacturing and testing capabilities that allow our customer programs to get to production faster while meeting both their quality and cost requirements. Our customers rely on our experience and capabilities in manufacturing and supply chain to manage and reduce cost over the life cycle of their products. This requires a strong relationship with our customers based on a trusting partnership as we perform as an extension of their operations.

All of our facilities are certified to one or more of the industry standards, including International Standards Organization (ISO) 9001, ISO 13485, and Aerospace Systems (AS) 9100, with most having additional certifications based on the needs of the customers they serve. In addition to industry standard certifications we actively manage quality metrics throughout product life-cycle at all levels of the organization to provide real-time, pro-active support to our customers and their projects. Process validation is performed through the strict phases of installation qualification, operation qualification and performance qualification.

Business Segment

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

Business Strategy

The EMS industry has evolved into a dynamic, high-tech, regulated global electronics contract services industry. We continue to expand our capabilities and footprint to better meet these changing market requirements. Along with offering technical expertise in our quality processes, engineering design applications and testing, we are also increasing our focus on supplier-managed inventory services and the cost drivers throughout the global supply chain. We continue to transform our business model from one that is less transactional and price/commodity driven to a solution based model focused on value added

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services. We continue to pursue acquisitions, mergers, and/or joint ventures of companies in the EMS industry to expand our service offering, advance our competitive edge, grow our customer base and increase revenues. Our strategic objectives and our history have been based on both organic and acquired growth.

Our quality systems and processes are based on ISO standards with all facilities certified to ISO 9001 and/or AS9100 standards. We also have ISO 13485 certification which recognizes our quality management systems applicable to contract design, manufacture and repair of assemblies for the medical industry. Our Milaca operation is a U.S. Food and Drug Administration (FDA) registered facility. These certifications and registrations provide our customers assurance of our capabilities and proven processes.

We are committed to quality, cost effectiveness and responsiveness to customer requirements. To achieve these objectives we have invested in Restriction of Hazardous Substances (lead free) processing, equipment, plant capacity studies, people, enterprise resource planning systems, lean manufacturing and supply chain management techniques at our facilities. We are committed to continuous improvement and have invested in training our people to identify and act on improvement opportunities. We maintain a diversified customer base and expand into other capabilities and services when there is a fit with our core competencies and strategic vision.

Marketing

We concentrate our marketing efforts in the Aerospace and Defense, Medical and Industrial markets. Our marketing strategy emphasizes our breadth, expertise and experience in each of our markets. Our expertise helps our customers save time and money and also reduces their risks. The breadth of our manufacturing, supply chain, engineering services and complete turnkey solutions assist our customers in getting their products to market quickly while managing the total cost solution. Our strength is managing low to moderate volume components and assemblies with high mix customer demand. This requires us to have close customer relationships and operational flexibility to manage the variation of product demands.

Our customer emphasis continues to be on companies that require an electronic manufacturing partner with a high degree of manufacturing and quality sophistication, including statistical process control, statistical quality control, ISO standards, Military Specifications, AS9100 and FDA facility registration. We continue efforts to penetrate our existing customer base and expand market opportunities with participation in industry forums and selected trade shows. We target customers who value proven manufacturing performance, design, project management and application engineering expertise and who value the flexibility to manage the supply chain of a high mix of products and services. We market our services through a mix of traditional marketing outreach, a specialized business development team and independent manufacturers representatives. For more information on our marketing and service offerings see our web site at nortechsys.com. The information on our company s website is not part of this filing.

Sources and Availability of Materials

We currently purchase the majority of our electronic components globally and directly from electronic component manufacturers and large electronic distributors. On occasion, some of our components may be placed on a stringent allocation basis; however, we are not currently experiencing any major material purchasing or availability problems.

Major Customers

Our largest customer has two divisions that together accounted for approximately 23.2% and 24.9% of net sales for the years ended December 31, 2018 and 2017, respectively. One division accounted for approximately 20.8% and 23.5% of net sales for the years ended December 31, 2018 and 2017, respectively. The second division accounted for approximately 2.4% and 1.4% of net sales for the years ended December 31, 2018 and 2017, respectively.

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Patents and Licenses

Our success depends on our technical expertise, trade secrets, supply chain and manufacturing skills. However, during the normal course of business we have obtained or developed proprietary product requiring licensing, patent, copyright or trademark protection. During 2017, we acquired intellectual property (IP) related to a mobile medical device platform that has the capability to transmit and record data which has not been significant to our revenue or operations.

Competition

The contract manufacturing EMS industry s competitive makeup includes small closely held contract manufacturing companies, large global full-service contract manufacturers, company-owned in-house manufacturing facilities and foreign contract manufacturers. We do not believe that the small closely held operations pose a significant competitive threat in the markets and customers we serve, as they generally do not have the complete manufacturing and engineering services or capabilities required by our target customers. We do believe the larger global full service and foreign manufacturers are more focused on higher volume customer engagements and we do not see them as our primary competition. We continue to see opportunities with OEM companies that have their own in-house electronic manufacturing capabilities as they evaluate their internal costs and investments against outsourcing to contract manufacturers like us. We do see trends of the low volume, high mix customer demand going to a regional supply base. This is a good fit with our operations in US, Mexico and Asia. We continue to study and investigate other regions and global alternatives to meet our competitive challenges and customer requirements.

Research and Development

We perform research and development for customers on an as requested, project and program basis for development of conceptual engineering and design activities as well as products moving into production. While we did not expend significant dollars in 2018 or 2017 on company-sponsored product research and development, we continue to explore opportunities for developing proprietary manufacturing methods or products.

Environmental Law Compliance

We believe that our manufacturing facilities are currently operating under compliance with local, state, and federal environmental laws. We plan to continue acquiring environmental-oriented equipment and incurring the expenditures we deem necessary for compliance with applicable laws. Expenditures relating to compliance for operating facilities incurred in the past have not significantly affected our capital expenditures, earnings or competitive position.

Government Regulation

As a medical device manufacturer, we have additional compliance requirements. We are required to register with the FDA and are subject to periodic inspection by the FDA for compliance with the FDA s Quality System Regulation (QSR) requirements, which require manufacturers of medical devices to adhere to certain regulations, including testing, quality control and documentation procedures. Compliance with applicable regulatory requirements is subject to continual review and is rigorously monitored through periodic inspections and product field monitoring by the FDA. To support the quality requirements of our Aerospace and Defense market customers, our Blue Earth facility is International Traffic in Arms Regulations (ITAR) registered.

Employees

We have 728 full-time and 91 part-time/temporary employees as of December 31, 2018. Manufacturing personnel, including direct, indirect support and sales functions, comprise 778 employees, while general administrative employees total 41.

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Foreign Operations and Export Sales from Our Domestic Operations

We have leased manufacturing facilities in Monterrey, Mexico and Suzhou, China with approximately $821,000 and $630,000 in long-term assets at December 31, 2018, respectively. Export sales from our domestic operations represented 4.8% and 4.5% of net sales the years ended December 31, 2018 and 2017, respectively.

Available Information

Our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and any amendments to those reports are available free of charge, as soon as reasonably practicable, after we electronically file such material with, or furnish it to, the United States Securities and Exchange Commission (SEC). These reports are available on our website at http://www.nortechsys.com and on the SEC s website at http://www.sec.gov. Information included on our website is not deemed to be incorporated into this Annual Report on Form 10-K.

Item 1A. Risk Factors

In evaluating our Company, careful consideration should be given to the following risk factors, in addition to the other information included in this Annual Report on Form 10-K. Each of these risk factors could adversely affect our business, operating results and/or financial condition, as well as adversely affect the value of an investment in our common stock. In addition to the following disclosures, please refer to the other information contained in this report, including our consolidated financial statements and the related notes.

The economic conditions around the world could adversely affect demand for our products and services and the financial health of our customers.

Demand for our products and services depends upon worldwide economic conditions, including but not limited to overall economic growth rates, construction, consumer spending, financing availability, employment rates, interest rates, inflation, consumer confidence, defense spending levels, and the profits, capital spending, and liquidity of industrial companies.

An economic downturn or financial market turmoil may depress demand for our equipment in all major geographies and markets. If our original equipment manufacturers are unable to purchase our products because of unavailable credit or unfavorable credit terms, depressed end-user demand, or are simply unwilling to purchase our products, our net sales and earnings will be adversely affected. Also, we are subject to the risk that our customers will have financial difficulties, which could harm their ability to satisfy their obligation to pay accounts receivable. Further, an economic downturn may affect our ability to satisfy the financial covenants in the terms of our financing arrangements.

Operating in foreign countries exposes our operations to risks that could adversely affect our operating results.

We operate manufacturing facilities in Mexico and China. Our operations in those countries are subject to risks that could adversely impact our financial results, such as economic or political volatility, foreign legal and regulatory requirements, international trade factors (export controls, trade sanctions, duties, tariff barriers and other restrictions), protection of our proprietary technology in certain countries, potentially burdensome taxes, crime, employee turnover, staffing, managing personnel in diverse culture, labor instability, transportation delays, and foreign currency fluctuations.

We operate in the highly competitive EMS industry and we depend on continuing outsourcing by OEMs.

We compete against many EMS companies. The larger global competitors have more resources and greater economies of scale and have more geographically diversified international operations. We also compete with OEM operations that are continually evaluating manufacturing products internally against the advantages of outsourcing or delaying their decision to outsource. We may also be at a competitive disadvantage with respect to price when compared to manufacturers with excess capacity, lower cost structures and availability of lower cost labor.

Competitive factors in our targeted markets are believed to be quality, the ability to meet delivery schedules, customer service, value-added engineering, technology solutions, geographic location and price. We also expect that our competitors will continue to improve the performance of their current products or services, to reduce their current products or service sales prices and improve services that maybe offered. Any of these could cause a decline in sales, loss of market share, or lower profit margin.

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The availability of excess manufacturing capacity of our competitors also creates competitive pressure on price and winning new business. We must continue to provide a quality product, be responsive and flexible to customers requirements, and deliver to customers expectations. Our lack of execution could have an adverse effect on our results of operations and financial condition.

We offer a full range of value-added engineering, technical and manufacturing services and support including project management, designing, testing, prototyping, manufacturing, supply chain management and post-market services.

We are dependent on suppliers for electronic components and may experience shortages, extended lead times, cost premiums and shipment delays that would adversely affect our customers and us.

We purchase raw materials, commodities and components for use in our production. Increased costs of these materials could have an adverse effect on our production costs if we are unable to pass along price increases or reduce the other cost of goods produced through cost improvement initiatives. Fuel and energy cost increases, as well as unforeseen tariffs, could also adversely affect our freight and operating costs. Due to customer specifications and requirements, we are dependent on suppliers to provide critical electronic components and materials for our operations that could result in shortages of some of the electronic components needed for their production. Component shortages may result in expedited freight, overtime premiums and increased component costs. In addition to the financial impact on operations from lost revenue and increased cost, there could potentially be harm to our customer relationships.

We depend heavily on our people and may from time to time have difficulty attracting and retaining skilled employees.

Our operations depend upon the continued contributions of our key management, marketing, technical, financial, accounting, product development engineers, sales people and operational personnel. We also believe that our continued success will depend upon our ability to attract, retain and develop highly skilled managerial and technical resources within the highly competitive EMS industry. Not being able to attract or retain these employees could have a material adverse effect on revenues and earnings.

Our engineering revenue depends on our ability to deliver quality value-added engineering services required by our customers in the future.

The markets for our engineering services are characterized by rapidly changing technology and evolving process development. The continued success of our business will depend upon our ability to hire and retain qualified engineering personnel and maintain and enhance our technological leadership. Although we believe that we currently have the ability to provide the value-added engineering services that is required by our customers, there is no certainty that we will develop the capabilities required by our customers in the future. The emergence of new technology, industry standards or customer requirements may render the engineering services we currently provide obsolete or uncompetitive. The acquisition and implementation of new engineering knowledge and technical skills may require significant expense that could adversely affect our operating results, as could our failure to anticipate and adapt to our customers changing technological requirements.

We may not meet regulatory quality standards applicable to our manufacturing and quality processes which could have an adverse effect on our business.

We are registered with the FDA and are subject to periodic inspection by the FDA for compliance with the FDA s QSR requirements, which require manufacturers of medical devices to adhere to certain regulations, including testing, quality control and documentation procedures. We are also ITAR registered which is required for our manufacturing of defense related products. Compliance with applicable regulatory requirements is subject to continual review and is rigorously monitored through periodic inspections and product field monitoring. If any inspection reveals noncompliance with these regulations, it could adversely affect our operations.

A large percentage of our sales have been made to a small number of customers, and the loss of a major customer, if not replaced, would adversely affect us.

Our largest customer has two divisions that account for 23.2% and 24.9% of net sales for the years ended December 31, 2018 and 2017, respectively. The loss of a substantial portion of net sales to our largest customers could have a material adverse effect on us.

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Our customers cancel orders, change order quantity, timing and specifications that if not managed would have an adverse effect on inventory carrying costs.

We face, through the normal course of business, customer cancellations and rescheduled orders and are not always successful in recovering the costs of such cancellations or rescheduling. In addition, excess and obsolete inventory losses as a result of customer order changes, cancellations, product changes and contract termination could have an adverse effect on our operations. We estimate and reserve for any known or potential impact from these possibilities.

Our exposure to financially troubled customers or suppliers may adversely affect our financial results.

We provide manufacturing services to companies and industries that have in the past, and may in the future, experience financial difficulty. If our customers experience financial difficulty, we could have difficulty recovering amounts owed to us from these customers, or demand for our products from these customers could decline. Additionally, if our suppliers experience financial difficulty we could have difficulty sourcing supply necessary to fulfill production requirements and meet scheduled shipments. If one or more of our customers were to become insolvent or otherwise were unable to pay for the services provided by us on a timely basis, or at all, our operating results and financial condition could be adversely affected. Such adverse effects could include one or more of the following: an increase in our provision for doubtful accounts, a charge for inventory write-offs, a reduction in revenue, and an increase in our working capital requirements due to higher inventory levels and increases in days our accounts receivables are outstanding.

Some shareholders may be able to take actions that do not reflect the will or best interests of other shareholders.

Our officers and directors control a majority share of our outstanding common stock and could individually or together exert a significant degree of influence over our affairs.

The manufacture and sale of our products carries potential risk for product liability claims.

We represent and warrant the goods and services we deliver are free from defects in material and workmanship for one year from ship date. We make no other guarantees or warranties, expressed or implied, of any nature whatsoever as to the goods including without limitation, warranties to merchantability, fit for a particular purpose, non-infringement of patent or the like unless agreed upon in writing. If a product liability claim results in our being liable and the amount is in excess of our insurance coverage or there is no insurance coverage for the claim then it could have an adverse effect on our business and financial position.

Complying with securities laws, tax laws, accounting policies and regulations, and subsequent changes, may be costly for us and adversely affect our financial statements.

New or changing laws, regulations, policy and standards relating to corporate governance and public disclosure, including SEC and Nasdaq regulations, tax legislation and the implementation of significant changes in the United States Generally Accepted Accounting Principles (GAAP), present challenges due to complexities, assumptions and judgements required to implement. We apply judgments based on our understanding, interpretation and analysis of the relevant facts, circumstances, historical experience and valuations, as appropriate. As a result, actual amounts could differ from those estimated at the time the financial statements are issued. In addition, implementation may change the financial accounting or reporting standards that govern the preparation of our financial statements or authoritative entities could reverse their previous interpretations or positions on how various financial accounting or reporting standards should be applied. These changes may be difficult to predict and implement and could materially or otherwise impact how we prepare and report our estimates, uncertainties, financial statements, operating results and financial condition. Our efforts to comply with evolving laws, regulations, accounting policies and standards have resulted in, and are likely to continue to result in, increased general and administrative expenses and management time and attention from revenue-generating activities to compliance activities and may have an adverse affect on our financial statements, including cash flows.

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Anti-Corruption and Trade Laws - We may incur costs and suffer damages if our employees, agents, or suppliers violate anti-bribery, anti-corruption or trade laws and regulations.

Laws and regulations related to bribery, corruption and trade, and enforcement thereof, are increasing in frequency, complexity and severity on a global basis. The continued geographic expansion of our business into China increases our exposure to, and cost of complying with, these laws and regulations. If our internal controls and compliance program do not adequately prevent or deter our employees, agents, suppliers and other third parties with whom we do business from violating anti-corruption laws, we may incur defense costs, fines, penalties, reputational damage and business disruptions.

Changes in currency translation rates could adversely impact our revenue and earnings.

Changes in exchange rates will impact our reported sales and earnings. A majority of our manufacturing and cost structure is based in the United States. In addition, decreased value of local currency may adversely affect demand for our products and may adversely affect the profitability of our products in U.S. dollars in foreign markets where payments are made in the local currency.

Non-compliance with environmental laws may result in restrictions and could adversely affect operations.

Our operations are regulated under a number of federal, state, and foreign environmental and safety laws and regulations that govern the discharge of hazardous materials into the air and water, as well as the handling, storage, and disposal of such materials. These laws and regulations include the Clean Air Act; the Clean Water Act; the Resource Conservation and Recovery Act; and the Comprehensive Environmental Response, Compensation, and Liability Act; as well as analogous state and foreign laws. Compliance with these environmental laws is a major consideration for us due to our manufacturing processes and materials. It is possible we may be subject to potential financial liability for costs associated with the investigation and remediation at our sites; this may have an adverse effect on operations. We have not incurred significant costs related to compliance with environmental laws and regulations and we believe that our operations comply with all applicable environmental laws.

Environmental laws could also become more stringent over time, imposing greater compliance costs and increasing risks and penalties associated with violation. We operate in environmentally sensitive locations and are subject to potentially conflicting and changing regulatory agendas of political, business, and environmental groups. Changes or restrictions on discharge limits; emissions levels; or material storage, handling, or disposal might require a high level of unplanned capital investment or relocation. It is possible that environmental compliance costs and penalties from new or existing regulations may harm our business, financial condition, and results of operations.

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We may be subject to risks associated with our prior acquisitions, and the risks could adversely affect our operating results.

The success of our prior acquisitions depend on our ability to integrate the new operations with the existing operations. The Company cannot ensure that the expected benefits of any acquisition will be realized. Additionally, unforeseen issues could arise which adversely affect the anticipated returns or which are otherwise not recoverable as an adjustment to the purchase price. Other acquisition risks include delays in realizing benefits from the acquired companies or products; difficulties due to lack of or limited prior experience in any new product or geographic markets we enter; unforeseen losses of customers of, or suppliers to, acquired businesses; difficulties in retaining key employees of the acquired businesses; or challenges arising from increased geographic diversity and complexity of our operations and our information technology systems. The price we pay for a business may exceed the value we realize and we cannot assure you that we will achieve the expected synergies and benefits of any prior acquisition. Acquisitions have resulted in the recognition of goodwill and other intangible assets which are subject to potential impairments in the future that could harm our financial results.

If we fail to comply with the covenants contained in our credit agreement we may be unable to secure additional financing and repayment obligations on our outstanding indebtedness may be accelerated.

Our credit agreement contains financial and operating covenants with which we must comply. As of December 31, 2018, we were in compliance with these covenants. However, our continued compliance with these covenants is dependent on our financial results, which are subject to fluctuation as described elsewhere in these risk factors. If we fail to comply with the covenants in the future or if our lender does not agree to waive any future non-compliance, we may be unable to borrow funds and any outstanding indebtedness could become immediately due and payable, which could materially harm our business.

We are dependent on our information technology systems for order, inventory and production management, financial reporting, communications and other functions. If our information systems fail or experience major interruptions due to physical damage or loss of power on our business and our financial results could be adversely affected.

We rely on our information technology systems to effectively manage our operational and financial functions. Our computer systems, Internet web sites, telecommunications, and data networks are vulnerable to damage or interruption from power loss, natural disasters and other sources of physical damage or disruption to the equipment which maintains, stores and hosts our information technology systems. We have taken steps to protect and create redundancies for the equipment that facilitates the use of our management information systems, but these steps may not be adequate to ensure that our operations are not disrupted by events within and outside of our control.

If our information technology systems fail or experience major interruptions, or the information technology systems of third parties that we rely upon fail or experience major interruptions, due to cyber-attacks or other activities designed to disrupt global information systems, our business and our financial results could be adversely affected.

We rely on information technology systems to effectively manage our operational and financial functions and our day-to-day functions. We increasingly rely on information technology systems to process, transmit, and store electronic information. In addition, a significant portion of internal communications, as well as communication with customers and suppliers, depends on information technology. We are exposed to the risk of cyber incidents in the normal course of business. Cyber incidents

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may be deliberate attacks for the theft of intellectual property or other sensitive information or may be the result of unintentional events. Like most companies, our information technology systems may be vulnerable to interruption due to a variety of events beyond our control, including, but not limited to, terrorist attacks, telecommunications failures, computer viruses, hackers, foreign governments, and other security issues. We have technology security initiatives and data recovery plans in place to mitigate our risk to these vulnerabilities, but these measures may not be adequate, or implemented properly, or executed timely to ensure that our operations are not disrupted. Potential consequences of a material cyber incident include damage to our reputation, litigation, and increased cyber security protection and remediation costs. Such consequences could adversely affect our results of operations.

We may experience difficulties implementing our new global enterprise resource planning system.

We are engaged in an implementation of a new global enterprise resource planning system (ERP). The ERP is designed to efficiently maintain our books and records and provide information important to the operation of our business to our management team. The ERP implementation has and will continue to require significant investment of human and financial resources. In implementing the ERP, we may experience significant delays, increased costs and other difficulties. Any significant disruption or deficiency in the design and implementation of the ERP could adversely affect our ability to process orders, ship product, send invoices and track payments, fulfill contractual obligations or otherwise operate our business. While we have invested significant resources in planning, project management and training, additional and significant implementation issues may arise. In addition, our efforts to adjust and centralize various business processes and functions within our organization in connection with our ERP implementation may disrupt our operations and negatively impact our business, results of operations and financial condition.

Our business may be impacted by natural disasters or future climate change.

Natural disasters, such as tornadoes and earthquakes, and possible future changes in climate could negatively impact our business and supply chain. Our properties may be exposed to rare catastrophic weather events, such as severe storms and/or floods. If the frequency of extreme weather events increases due to climate change, our exposure to these events could increase. In countries that we rely on for operations and materials, such as Mexico and China, potential natural disasters or future climate changes could disrupt our manufacturing operations, reduce demand for our customers products and increase supply chain costs.

Item 1B. Unresolved Staff Comments

As a smaller reporting company, we are not required to provide the information required by this Item.

Item 2. Properties

Administration

Our corporate headquarters consists of an approximately 19,000 square feet building located in Maple Grove, Minnesota, a northwestern suburb of Minneapolis, Minnesota, and its lease expires January 2025.

Manufacturing facilities

Our manufacturing facilities are in good operating condition and we believe our overall production capacity is sufficient to handle our foreseeable manufacturing needs and customer requirements. The following are our manufacturing facilities as of December 31, 2018:

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Location	Own/Lease	Lease End Date	Manufacturing Space Square Feet	Office Space Square Feet	Total Square Feet
Bemidji, MN	Own		56,000	13,000	69,000
Blue Earth, MN	Own		92,000	48,000	140,000
Merrifield, MN	Own		34,000	12,000	46,000
Milaca, MN	Lease	June 30, 2020	15,000	5,000	20,000
Mankato, MN	Own		43,000	15,000	58,000
Monterrey, Mexico	Lease	January 31, 2019	45,000	1,000	46,000
Monterrey, Mexico	Lease	January 24, 2029	76,000	1,000	77,000
Suzhou, China	Lease	December 31, 2021	27,000	3,000	30,000

On February 21, 2018, we entered into a ten-year lease agreement for a 77,000 square foot manufacturing facility in Nuevo Leon, Mexico which we took occupancy during the fourth quarter of 2018. This facility replaced the Monterrey, Mexico facility lease which expired January 31, 2019.

Item 3. Legal Proceedings

From time to time, we are involved in ordinary, routine or regulatory legal proceedings incidental to the business. When a loss is deemed probable and reasonably estimable an amount is recorded in our consolidated financial statements.

Item 4. Mine Safety Disclosures

Not applicable.

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PART II

Item 5. Market for Registrant s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

As of March 26, 2019, there were 656 shareholders of record. Our stock is listed on the NASDAQ Capital Market under the symbol NSYS . We intend to invest our profits into the growth of our operations and, therefore, do not plan to pay out dividends to shareholders in the foreseeable future. We did not declare or pay a cash dividend in 2018 or 2017. Future dividend policy and payments, if any, will depend upon earnings and our financial condition, our need for funds, limitations on payments of dividends present in our current or future debt agreements, and other factors.

Stock price comparisons (NASDAQ):

During the Three Months Ended	Low	High
March 31, 2018	$ 2.87	$ 4.85
June 30, 2018	$ 2.77	$ 3.67
September 30, 2018	$ 3.21	$ 8.08
December 31, 2018	$ 3.51	$ 5.50
March 31, 2017	$ 3.35	$ 4.60
June 30, 2017	$ 3.13	$ 3.89
September 30, 2017	$ 3.16	$ 3.75
December 31, 2017	$ 3.36	$ 6.24

Issuer Purchase of Equity Securities

As of December 31, 2017, we had a $250,000 share repurchase program which was authorized by our Board of Directors in August 2017 and expired in July 2018 with no authorized repurchases remaining under this program. Under this repurchase program, we repurchased 55,199 shares totaling $194,420 during the year ended December 31, 2018. In August 2018, the Board of Directors approved an additional $250,000 share repurchase program. Under this repurchase program, we repurchased 21,002 shares totaling $81,329 during the year ended December 31, 2018.

The table below sets forth information regarding repurchases we made of our common stock under the $250,000 share repurchase program authorized in August 2018 during the periods indicated.

Period	Total Number of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Plan	Maximum Dollar Value of Shares that May Yet Be Purchased Under the Plan

Balance at December 31, 2017		$			$	
Stock repurchases	21,002		3.87	21,002		166,571
Balance at December 31, 2018	21,002	$	3.87	21,002	$	166,571

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Equity Compensation Plan Information

Certain information with respect to our equity compensation plans are contained in Part III, Item 12 of this Annual Report on Form 10-K.

Item 6. Selected Financial Data

As a smaller reporting company, we are not required to provide the information required by this Item.

Item 7. Management s Discussion and Analysis of Financial Condition and Results of Operations

Overview

We are a Minnesota, United States based full-service global EMS contract manufacturer offering a full range of value-added engineering, technical and manufacturing services and support including project management, design, testing, prototyping, manufacturing, supply chain management and post-market services. Our products are complex wire and cable assemblies, printed circuit board assemblies, higher-level assemblies, medical devices and other box builds for a wide range of industries. We serve three major markets within the EMS industry: Aerospace and Defense, Medical, and the Industrial market which includes industrial capital equipment, transportation, vision, agriculture, oil and gas. As of December 31, 2018, we have the following facilities in Minnesota; Bemidji, Blue Earth, Eden Prairie, Mankato, Merrifield, Milaca and Maple Grove. We also have facilities in Monterrey, Mexico and Suzhou, China. On January 31, 2017, we closed our manufacturing operations in Augusta, Wisconsin (see Note 9, of Notes to Consolidated Financial Statements).

Our revenue is derived from complex designed products built to the customers specifications. The products we manufacture are engineered and designed products that require sophisticated manufacturing support. Quality, on time delivery, and reliability are of upmost importance. Our goal is to expand and diversify our customer base by focusing on sales and marketing efforts that fit our value-added service, early engagement design, and development strategy. We continue to focus on lean manufacturing initiatives, quality and on-time delivery improvements to increase asset utilization, reduce lead times and provide competitive pricing.

Our strategic investments have positioned us to capitalize on growth opportunities in the medical markets and improve our competitiveness by expanding our global footprint. Our industrial and defense markets are focused on improving our asset utilization and profitability while transforming to a value added, solution-sell business model that supports early engagement, design for manufacturability and rapid prototyping.

Critical Accounting Policies and Estimates

Our significant accounting policies and estimates are summarized in Notes to Consolidated Financial Statements . Some of the accounting policies require us to exercise significant judgment in selecting the appropriate assumptions for calculating financial estimates. Such judgments are subject to an inherent degree of uncertainty. These judgments are based on historical experience, known trends in the industry, terms of existing contracts and other information from outside sources, as appropriate. Actual results may differ from these estimates under different assumptions and conditions.

Certain of the most critical estimates that require significant judgment are as follows:

Revenue Recognition

Our revenue is comprised of product, engineering services and repair services. All revenue is recognized when the Company satisfies its performance obligation(s) under the contract by transferring the promised product or service to our customer either when (or as) our customer obtains control of the product or service, with the majority of our revenue being recognized over time including goods produced under contract

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manufacturing agreements and services revenue. A performance obligation is a promise in a contract to transfer a distinct product or service to a customer. A contract s transaction price is allocated to each distinct performance obligation. The majority of our contracts have a single performance obligation. Revenue is recorded net of returns, allowances and customer discounts. Our net sales for services were less than 10% of our total sales for all periods presented, and accordingly, are included in net sales in the Condensed Consolidated Statements of Operations and Comprehensive Income. Sales, value add, and other taxes collected from customers and remitted to governmental authorities are accounted for on a net (excluded from revenues) basis. Shipping and handling costs charged to our customers are included in net sales, while the corresponding shipping expenses are included in cost of goods sold.

Effective January 1, 2018, we adopted the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2014-09, Revenue from Contracts with Customers (Topic 606) (ASU 2014-09), which supersedes the revenue recognition requirements in ASC 605, Revenue Recognition. ASU 2014-09 is based on the principle that revenue is recognized to depict the transfer of goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. It also requires additional disclosure about the nature, amount, timing, and uncertainty of revenue, cash flows arising from customer contracts, including significant judgments and changes in judgments, and assets recognized from costs incurred to obtain or fulfill a contract. The Company adopted the provisions of ASU 2014-09 using the modified retrospective approach with application to contracts that were not completed as of January 1, 2018. The adoption of ASU 2014-09 had a significant impact to the Company s results of operations, cash flows and financial position, and as a result we now recognize the majority of our revenue over time rather than upon shipment resulting in an adjustment to retained earnings of $1,381,000 on January 1, 2018. The Company has presented the disclosures required by this new standard, refer to Note 3.

Goodwill and Other Intangible Assets

In accordance with ASC 350, *Goodwill and Other Intangible Assets*, goodwill is not amortized but is required to be reviewed for impairment at least annually or when events or circumstances indicate that carrying value may exceed fair value. We test impairment annually as of October 1st. In testing goodwill for impairment we perform a quantitative impairment test, including computing the fair value of the reporting unit and comparing that value to its carrying value. If the fair value is less than its carrying value, then the goodwill is determined to be impaired. In the event that goodwill is impaired, an impairment charge to earnings would become necessary. Based upon our annual goodwill impairment test we concluded that goodwill was impaired due to a significant reduction of results from operations during the fourth quarter of 2017. As described in Note 1 to the consolidated financial statements included in Part II, Item 8 of this Annual Report on Form 10-K, in 2017 we adopted Accounting Standards Update No, 2017-04, *Simplifying the Test for Goodwill Impairment*, and performed a single step in performing our impairment analysis, which is to determine the estimated fair value of our reporting unit and compare it to the carrying value of the reporting unit, including goodwill. To the extent the carrying amount of goodwill exceeds the implied goodwill, the difference is the amount of the goodwill impairment. Our annual impairment test as of October 1, 2017, resulted in $0.9 million of impairment charges related to our goodwill. The impairment charge was based on a combined approach using both the income approach which is based on discounted cash flows and the market approach which is based on the guideline public company method. Discounted cash flow models include assumptions related to our product revenue, gross margins, operating margins and other assumptions. There was no impairment of goodwill recorded in 2018.

We recognize the assets acquired and liabilities assumed in business combinations on the basis of their fair values at the date of acquisition. We assess the fair value of assets, including intangible assets, using a variety of methods and each asset is measured at fair value from the perspective of a market participant. The method used to estimate the fair values of intangible assets incorporates significant assumptions regarding the estimates a market participant would make in order to evaluate an asset, including a market

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participant s use of the asset and the appropriate discount rates for a market participant. Any excess purchase price over the fair value of the net tangible and intangible assets acquired is allocated to goodwill.

On July 1, 2015, we completed the acquisition of substantially all of the assets of Devicix, LLC upon the terms and conditions contained in an Asset Purchase Agreement entered into on June 17, 2015. The Devicix acquisition resulted in $3.2 million of goodwill, which is deductible for tax purposes. We recorded an impairment charge of $908,000 on the goodwill related to the Devicix, LLC purchase as of December 31, 2017.

Long-Lived Assets Impairment

We evaluate long-lived assets, primarily property and equipment, whenever current events or changes in circumstances indicate that the carrying amount of an asset or asset group may not be recoverable. Recoverability for assets to be held and used is based on our projection of the undiscounted future operating cash flows of the underlying assets. To the extent such projections indicate that future undiscounted cash flows are not sufficient to recover the carrying amounts of related assets, a charge might be required to reduce the carrying amount to equal estimated fair value. We determined there was a triggering event during the fourth quarter of 2017 and determined the undiscounted cash flows exceeded the carrying amounts of long-lived assets. We did not have a triggering event in 2018.

Allowance for Doubtful Accounts

When evaluating the adequacy of the allowance for doubtful accounts, we analyze accounts receivable, historical write-offs of bad debts, customer concentrations, customer credit-worthiness, current economic trends and changes in customer payment terms. We maintain an allowance for doubtful accounts at an amount estimated to be sufficient to provide adequate protection against losses resulting from collecting less than full payment on outstanding accounts receivable. An amount of judgment is required when assessing the ability to realize accounts receivable, including assessing the probability of collection and the current credit-worthiness of each customer. If the financial condition of our customers was to deteriorate, resulting in an impairment of their ability to make payments, an additional provision for uncollectible accounts may be required. We believe the reserve is adequate for any exposure to loss in the December 31, 2018 accounts receivable. At December 31, 2018, our allowance for doubtful accounts was $0.2 million.

Inventory Reserves

Inventory reserves are maintained for the estimated value of the inventory that may have a lower value than stated or quantities in excess of future production needs. We have an evaluation process to assess the value of the inventory that is slow moving, excess or obsolete on a quarterly basis. We evaluate our inventory based on current usage and the latest forecasts of product demand and production requirements from our customers. We believe the total reserve at December 31, 2018 of $1.1 million is adequate.

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Operating Results

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

	2018	2017
Net Sales	100.0%	100.0%
Cost of Goods Sold	88.3	89.2
Gross Profit	11.7	10.8
Selling Expenses	3.2	4.2
General and Administrative Expenses	7.4	7.2
Impairment of Goodwill	0.0	0.8
Gain on Sale of Property and Equipment	0.0	(0.3)
Income (Loss) from Operations	1.1	(1.1)
Other Expense	(0.7)	(0.7)
Income (Loss) Before Income Taxes	0.4	(1.8)
Income Tax Expense	0.3	0.4
Net Income (Loss)	0.1%	(2.2)%

Net Sales

Our net sales in 2018 were $113.4 million, compared to $112.3 million in 2017, an increase of 0.9%. Our 2018 amounts include $4.8 million of additional sales related to the change in the revenue recognition policy. Net sales results were varied by markets. The medical market decreased by $1.8 million or 3.5% with medical component products accounting for 30% of the decrease and medical devices the remaining 70%. The industrial market increased by $0.2 million or 0.4% in 2018 as compared to 2017. Net sales from the aerospace and defense markets increased by $2.7 million or 17.2% in 2018 as compared to 2017.

Net sales by our major EMS industry markets for the years ended December 31, 2018 and 2017 were as follows:

(in millions)		**2018**		**2017**	**% Change**
Aerospace and Defense	$	18.3	$	15.7	16.6
Medical		45.1		51.4	(12.3)
Industrial		50.0		45.2	10.6
Total Net Sales	$	113.4	$	112.3	1.0

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Net sales by our major EMS industry markets for the year ended December 31, 2018, to the pro-forma amounts for the same period had the previous guidance been in effect (in millions):

	As Reported 2018	Pro forma as if the previous accounting guidance was in effect	% Change
Aerospace and Defense	$ 18.3	$ 17.6	2.8
Medical	45.1	47.5	-5.1
Industrial	50.0	43.4	15.2
Total Net Sales	$ 113.4	$ 108.5	4.5

Net sales by timing of transfer of goods and services for year ended December 31, 2018 is as follows (in millions):

	Product/ Service Transferred Over Time	Product Transferred at Point in Time	Noncash Consideration	Total Net Sales by Market
Aerospace and Defense	$ 17.3	$ 0.2	$ 0.8	$ 18.3
Medical	39.0	4.2	1.9	45.1
Industrial	47.0	0.8	2.2	50.0
Total net sales	$ 103.3	$ 5.2	$ 4.9	$ 113.4

Backlog

Our 90-day backlog at December 31, 2018 was $27.4 million, compared to $19.4 million at the end of 2017. Our medical customers 90-day backlog increased 126.7% compared to the prior year end. The medical increase was augmented by an increase in backlog to our defense customers of 20.6%, and partially offset by a decrease in backlog for our industrial customers of 13.2%.

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

	Backlog as of the Year Ended December 31,		
(in millions)	**2018**	**2017**	**% Change**
Aerospace and Defense	$ 6.0	$ 5.0	20.6
Medical	14.3	6.3	126.7
Industrial	7.1	8.2	(13.2)
Total Backlog	$ 27.4	$ 19.4	40.8

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

Gross Profit

Our gross profit as a percentage of net sales was 11.7% and 10.8% for the years ended December 31, 2018 and 2017, respectively. The increase in gross profit for the year was driven by customer and product

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mix, operational efficiencies and cost improvements as we adjusted to current revenue levels. We recognized revenue of $4.9 million related to the noncash consideration recorded at zero margin as a result of implementing revenue recognition, partially offsetting this increase.

Selling

Selling expenses were $3.6 million, or 3.2% of net sales, for the year ended December 31, 2018 and $4.7 million, or 4.2% of net sales, for the year ended December 31, 2017. The decrease in selling expenses for 2018 is due to reductions in volume dependent expenses.

General and Administrative

General and administrative expenses were $8.4 million, or 7.4% of net sales, for the year ended December 31, 2018 and $8.1 million, or 7.2% of net sales, for the year ended 2017. The year over year comparison is consistent due to our adjustment of spending based on customer demands.

Gain from Sale of Property and Equipment

Net gain from sale of property and equipment for the year ended December 31, 2017 was $0.4 million from the sale of the Augusta building and building improvements (see Note 9, of Notes to Consolidated Financial Statements). There was no gain from sale of property and equipment recorded in 2018.

Income (Loss) from Operations

Our income from operations for the 2018 fiscal year was $1.2 million, an increase of $2.5 million over our loss from operations for the 2017 fiscal year of $1.3 million, resulting from our improvement in gross profit as a percent of sales and the impairment charge taken in 2017.

Loss on Extinguishment of Debt

Loss on the extinguishment of debt for the year ended December 31, 2017 was $0.2 million, primarily related to legal and terminations fees (see Note 4, of Notes to Consolidated Financial Statements). There was no loss on extinguishment of debt recorded in 2018.

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Interest Expense

Interest expense for the year ended December 31, 2018 was $0.8 million, compared with $0.6 million for the year ended December 31, 2017 due largely to higher interest rates.

Income Taxes

Income tax expense for the year ended December 31, 2018 was $0.3 million. Income tax expense for the year ended December 31, 2017 was $0.4 million. The effective tax rate for fiscal 2018 and 2017 was 66.3% and (18.1%), respectively. Our 2018 tax rate was driven by the tax on global intangible low-taxed income provisions that was enacted in 2018 and onward. Our 2017 tax rate was impacted by federal tax reform, which saw a significant change in valuation allowance. The Company was in a loss position and could not avail itself of a domestic production activities deduction credit.

The statutory reconciliation for the years ended December 31, 2018 and 2017 is as follows:

(in thousands)	2018	2017
Statutory federal tax provision (benefit)	$ 107	$ (704)
State income tax benefit	(36)	(117)
Effect of foreign operations	52	(88)
Uncertain tax positions	(19)	
Income tax credits		(112)
Valuation allowance	(199)	1,011
Permanent differences	15	8
Global Intangile Low-Taxed Income Effect	296	
Return to Provision - Credits and NOL	176	
Deferred adjustments	(62)	
Loss of Section 199 due to carryback claim		46
Effects of tax reform		280
Other	(4)	51
Income tax expense	$ 326	$ 375

Net Income (Loss)

Our net income in 2018 was $0.2 million or $0.06 per diluted common share. Net loss in 2017 was $2.4 million or $0.89 per diluted common share.

Liquidity and Capital Resources

We believe that our existing financing arrangements and anticipated cash flows from operations will be sufficient to satisfy our working capital needs, capital expenditures and debt repayments for at least the next 12 months.

Credit Facility

We have a credit agreement with Bank of America which was entered into on June 15, 2017 (as amended effective December 29, 2017, the Bank of America Credit Agreement), and provides for a line of credit arrangement of $16 million that expires on June 15, 2022. The credit arrangement also has a $5 million real estate term note outstanding with a maturity date of June 15, 2022. The Bank of America Credit Agreement replaced our previous credit agreement with Wells Fargo Bank (the Wells Fargo Credit Agreement),

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which terminated on June 20, 2017, resulting in a loss on the extinguishment of debt of $175,000 primarily related to legal and terminations fees.

Under the Bank of America Credit Agreement, both the line of credit and real estate term notes are subject to variations in the LIBOR rate. Our Bank of America Credit Agreement bears interest at the combined weighted-average interest rate of 4.80% as of December 31, 2018, compared with 3.74% as of December 31, 2017. We had borrowings on our Bank of America Credit Agreement of $ $9.3 million outstanding, compared with $8.5 million outstanding as of December 31, 2017. There are no acceleration clauses under the Bank of America Credit Agreement that would accelerate the maturity of our outstanding line of credit borrowings.

The line of credit and real estate term notes with Bank of America contain certain covenants which, among other things, require us to adhere to regular reporting requirements, abide by annual shareholder dividend limitations, maintain certain financial performance, and limit the amount of annual capital expenditures. The availability under our line is subject to borrowing base requirements, and advances are at the discretion of the lender. The line of credit is secured by substantially all of our assets.

The Bank of America Credit Agreement provides for, among other things, a Fixed Charge Coverage Ratio of not less than (i) 1.0 to 1.0 for each period of four fiscal quarters, commencing with the period of four fiscal quarters ending December 31, 2018. In addition, the Bank of America Credit Agreement requires that we comply with certain minimum levels of cumulative EBITDA for measurement periods during fiscal 2018, including cumulative EBITDA of $1,970,000 for the twelve months ended December 31, 2018.

The availability under the line is subject to borrowing base requirements, and advances are at the discretion of the lender. At December 31, 2017, we had unused availability under our line of credit of $4.2 million, supported by our borrowing base. The line is secured by substantially all of our assets.

The Wells Fargo Bank Credit Agreement, which terminated on June 20, 2017, provided for a line of credit arrangement of $15.0 million, of which $7.3 million was outstanding at December 31, 2016. This credit arrangement also had a $3.5 million of real estate term notes with a maturity in 2027, an equipment loan for $2.7 million and a term loan facility of up to $1.0 million for capital expenditures. As of December 31, 2016, there was $0.7 million outstanding against the $1.0 million capital term note.

As part of the July 1, 2015, Devicix acquisition, we entered into two unsecured subordinated promissory notes payable to the seller in the principal amounts of $1.0 million and $1.3 million. The $1.0 million promissory note has a four-year term, bearing interest at 4.0% per annum, requiring monthly principal and interest payments of $22,579 and is subject to offsets if certain revenue levels are not met. The $1.3 million promissory note has a four-year term and bears interest at 4.0% per annum, requiring monthly principal and interest payments of $29,353 and is not subject to offset.

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Cash flows for the years ended December 31, 2018 and 2017 are summarized as follows:

(in thousands)	2018	2017
Cash flows provided by (used in):		
Operating activities	$ 2,444	$ 806
Investing activities	(1,390)	(258)
Financing activities	(889)	(38)
Effect of exchange rate changes on cash	3	1
Net change in cash	$ 168	$ 511

Cash provided by operating activities for the year ended December 31, 2018 was $2.4 million, comprised primarily of net earnings and the noncash add back of depreciation and amortization. Cash provided by operating activities for the year ended December 31, 2017 was $0.8 million comprised of the noncash add back of depreciation, amortization and impairment of goodwill, offset by changes in account receivable, contingent liability and gain on disposal of August facility (see Note 9, of Notes to Consolidated Financial Statements). The year-over-year increase in cash provided by operating activities is due to the improvement in net earnings partially offset by net decrease in working capital.

Net cash used in investing activities was $1.4 million and $0.3 million for the years ended December 31, 2018 and 2017, respectively. Cash used in investing activities in 2018 was primarily reinvestments in the business to purchase property and equipment. Cash used in investing activities in 2017, was primarily due to purchases of property and equipment offset by net proceeds from the sale of the August facility (see Note 9, of Notes to Consolidated Financial Statements).

Net cash used in financing activities in 2018 of $0.9 million consisted of payments on long-term debt and capital leases. Net cash used in financing activities in 2017 of less than $0.1 million consisted of borrowings on the line of credit of $1.2 million and proceeds from long-term debt of $5.1 million offset by payments of long-term debt of $5.9 million, debt issuance costs of $0.3 million, loss on extinguishment of debt of $0.2 million and share repurchases of $30,340.

Cash conversion cycle:

	Years Ended ended December 31,	
	2018	2017
Days in trade accounts receivable	65	60
Days in inventory	62	78
Days in accounts payable	(66)	(52)
Cash conversion cycle	61	86

We calculate days in accounts receivable as accounts receivable for the respective year-to-date period divided by annual sales for the respective year-to-date period by day. We calculate days in inventory and accounts payable as each balance sheet line item for the respective year-to-date period divided by annual cost of goods sold for the respective year-to-date period by day. We calculate cash conversion cycle as the sum of days in receivable and inventory less days in accounts payable. The decrease in our cash conversion cycle in 2018 is due largely to the impact of the adoption of ASU 2014-09 and timing of payments.

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Off-Balance Sheet Arrangements

We do not have any off-balance sheet arrangements, other than our outstanding operating leases for production and office equipment, office space, and buildings with contractual obligations totaling $7.4 million (see Note 8 of Notes to Consolidated Financial Statements).

Forward-Looking Statements

This Annual Report on Form 10-K, including Management s Discussion and Analysis of Financial Condition and Results of Operations in Item 7, contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. We may also make forward-looking statements in other reports filed with the SEC, in materials delivered to stockholders and in press releases. Such statements generally will be accompanied by words such as anticipate, believe, estimate, expect, forecast, intend, possible, potential, predict, other similar words that convey the uncertainty of future events or outcomes. Although we believe these forward-looking statements are reasonable, they are based upon a number of assumptions concerning future conditions, any or all of which may ultimately prove to be inaccurate. Forward-looking statements involve a number of risks and uncertainties. Important factors that could cause actual results to differ materially from the forward-looking statements include, without limitation:

- Volatility in the marketplace which may affect market supply, demand of our products or currency exchange rates;
- Increased competition from within the EMS industry or the decision of OEMs to cease or limit outsourcing;
- Changes in the reliability and efficiency of our operating facilities or those of third parties;
- Risks related to availability of labor;
- Increases in certain raw material costs such as copper and oil;
- Commodity and energy cost instability;
- Risks related to FDA noncompliance;
- The loss of a major customer;
- General economic, financial and business conditions that could affect our financial condition and results of operations;
- Increased or unanticipated costs related to compliance with securities and environmental regulation;
- Disruption of global or local information management systems due to natural disaster or cyber-security incident;

The factors identified above are believed to be important factors (but not necessarily all of the important factors) that could cause actual results to differ materially from those expressed in any forward-looking statement made by us. Discussion of these factors is also incorporated in Part I, Item 1A, Risk Factors, and should be considered an integral part of Part II, Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations. Unpredictable or unknown factors not discussed herein could also have material adverse effects on forward-looking statements. All forward-looking statements included in this Form 10-K are expressly qualified in their entirety by the forgoing cautionary statements. We undertake no obligations to update publicly any forward-looking statement (or its associated cautionary language) whether as a result of new information or future events.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk

Not applicable.

NORTECH SYSTEMS INCORPORATED AND SUBSIDIARIES

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FOR THE YEARS ENDED DECEMBER 31, 2018 AND 2017

Item 8. Financial Statements and Supplementary Data

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the shareholders and the board of directors of Nortech Systems Incorporated:

Opinion on the Consolidated Financial Statements

We have audited the accompanying consolidated balance sheets of Nortech Systems Incorporated and subsidiaries (the Company) as of December 31, 2018 and 2017, the related consolidated statements of operations and comprehensive income (loss), shareholders equity and cash flows, for the year then ended, and the related notes (collectively referred to as the consolidated financial statements). In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2018 and 2017, and the results of their operations and their cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

Basis for Opinion

These consolidated financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on the Company s consolidated financial statements based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) (PCAOB) and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. As part of our audits we are required to obtain an understanding of internal control over financial reporting but not for the purpose of expressing an opinion on the effectiveness of the Company s internal control over financial reporting. Accordingly, we express no such opinion.

Our audits included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures included examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audits provide a reasonable basis for our opinion.

/s/ Baker Tilly Virchow Krause, LLP

We have served as the Company s auditor since 2017.

Minneapolis, Minnesota

April 1, 2019

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NORTECH SYSTEMS INCORPORATED AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS AND

COMPREHENSIVE INCOME (LOSS)

FOR THE YEARS ENDED DECEMBER 31, 2018 AND 2017

(IN THOUSANDS, EXCEPT SHARE DATA)

Net Sales	$	113,370	$	112,335
Cost of Goods Sold		100,059		100,217
Gross Profit		13,311		12,118
Operating Expenses:				
Selling Expenses		3,629		4,747
General and Administrative Expenses		8,433		8,086
Impairment of Goodwill				908
Gain on Sale of Property and Equipment				(355)
Total Operating Expenses		12,062		13,386
Income (Loss) From Operations		1,249		(1,268)
Other Expense				
Loss on Extinguishment of Debt				(175)
Interest Expense		(757)		(628)
Income (Loss) Before Income Taxes		492		(2,071)
Income Tax Expense		326		375
Net Income (Loss)	$	166	$	(2,446)
Earnings (Loss) Per Common Share:				
Basic	$	0.06	$	(0.89)
Weighted Average Number of Common Shares Outstanding - Basic		2,692,382		2,745,602
Diluted	$	0.06	$	(0.89)
Weighted Average Number of Common Shares Outstanding - Dilutive		2,699,614		2,745,602
Other comprehensive income (loss)				
Foreign currency translation		(132)		(57)
Comprehensive income (loss), net of tax	$	34	$	(2,503)

See accompanying notes to consolidated financial statements

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NORTECH SYSTEMS INCORPORATED AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS AS OF DECEMBER 31, 2018 AND 2017

(IN THOUSANDS, EXCEPT SHARE DATA)

	2018	2017
ASSETS		
Current Assets		
Cash	$ 480	$ 473
Restricted Cash	467	306
Accounts Receivable, less allowances of $222 and $209	20,093	17,417
Inventories	17,004	18,527
Contract Assets	6,431	
Prepaid Assets and Other Current Assets	1,381	1,044
Total Current Assets	45,856	37,767
Property and Equipment, Net	10,178	10,176
Goodwill	2,375	2,375
Other Intangible Assets, Net	1,523	1,739
Other Non Current Assets	28	28
Total Assets	$ 59,960	$ 52,085
LIABILITIES AND SHAREHOLDERS EQUITY		
Current Liabilities		
Current Maturities of Long-Term Debt	$ 780	$ 1,003
Current Portion of Capital Lease Obligation	337	295
Accounts Payable	18,142	11,699
Accrued Payroll and Commissions	2,747	2,900
Other Accrued Liabilities	2,886	2,148
Total Current Liabilities	24,892	18,045
Long-Term Liabilities		
Long-term Line of Credit	9,264	8,503
Long-Term Debt, Net of Current Maturities	3,624	4,353
Long-Term Capital Lease Obligation, Net of Current Portion	951	1,222
Other Long-Term Liabilities	139	137
Total Long-Term Liabilities	13,978	14,215
Total Liabilities	38,870	32,260
Commitments and Contingencies		
Shareholders Equity		
Preferred Stock, $1 par value; 1,000,000 Shares Authorized; 250,000 Shares Issued and Outstanding	250	250
Common Stock - $0.01 par value; 9,000,000 Shares Authorized; 2,663,049 and 2,739,250 Shares Issued and Outstanding, respectively	27	27
Additional Paid-In Capital	15,610	15,760
Accumulated Other Comprehensive Loss	(233)	(101)
Retained Earnings	5,436	3,889
Total Shareholders Equity	21,090	19,825
Total Liabilities and Shareholders Equity	$ 59,960	$ 52,085

See accompanying notes to consolidated financial statements

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NORTECH SYSTEMS INCORPORATED AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

FOR THE YEARS ENDED DECEMBER 31, 2018 AND 2017

(IN THOUSANDS)

	2018	2017
CASH FLOWS FROM OPERATING ACTIVITIES		
Net Income (Loss)	$ 166	$ (2,446)
Adjustments to Reconcile Net Income (Loss) to Net Cash		
Provided by Operating Activities:		
Depreciation	1,877	2,186
Amortization	312	315
Compensation on Stock-Based Awards	126	43
Loss on Extinguishment of Debt		17
Compensation on Equity Appreciation Rights		(22)
Deferred Taxes	1	439
Change in Contingent Consideration		(486)
Change in Accounts Receivable Allowance	13	(674)
Change in Inventory Reserves	268	171
Impairment of Goodwill		908
Gain on Disposal of Property and Equipment		(355)
Changes in Current Operating Items		
Accounts Receivable	(2,746)	578
Inventories and Contract Assets	(3,875)	1,956
Prepaid Expenses	(302)	233
Income Taxes Receivable	(37)	(31)
Income Taxes Payable	(39)	39
Accounts Payable	6,028	(2,115)
Accrued Payroll and Commissions	(154)	(411)
Other Accrued Liabilities	806	461
Net Cash Provided by Operating Activities	2,444	806
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from Sale of Property and Equipment	14	669
Purchase of Intangible Asset	(4)	(114)
Purchases of Property and Equipment	(1,400)	(813)
Net Cash Used in Investing Activities	(1,390)	(258)
CASH FLOWS FROM FINANCING ACTIVITIES		
Net Change in Line of Credit	761	1,187
Proceeds from Long-Term Debt		5,123
Principal Payments on Long-Term Debt	(1,044)	(5,893)
Payments on Capital Lease Obligation	(330)	
Loss on Extinguishment of Debt		(158)
Debt Issuance Costs		(267)
Share Repurchases	(276)	(30)
Net Cash used in Financing Activities	(889)	(38)
Effect of Exchange Rate Changes on Cash	3	1
Net Change in Cash	168	511

Cash - Beginning of Year		779		268
Cash - End of Year	$	947	$	779
Reconciliation of cash and restricted cash reported within the consolidated balance sheets				
Cash	$	480	$	473
Restricted Cash		467		306
Total Cash and restricted cash reported in the consolidated statements of cash flows	$	947	$	779
Supplemental Disclosure of Cash Flow Information:				
Cash Paid for Interest	$	719	$	538
Cash Paid for Income Taxes		335		20
Supplemental Noncash Investing and Financing Activities:				
Property and Equipment Purchases in Accounts Payable		445		29
Equipment Acquired under Capital Lease		100		1,517

See accompanying notes to consolidated financial statements

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NORTECH SYSTEMS INCORPORATED AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF SHAREHOLDERS EQUITY

FOR THE YEARS ENDED DECEMBER 31, 2018 AND 2017

(IN THOUSANDS)

	Preferred	Common	Additional Paid-In	Accumulated Other Comprehensive	Retained Income	Total Shareholders
BALANCE DECEMBER 31, 2016	$ 250	$ 27	$ 15,747	$ (44)	$ 6,335	22,315
Net Loss					(2,446)	(2,446)
Foreign Currency Translation Adjustment				(57)		(57)
Compensation on Stock-based awards			43			43
Issuance of common stock						
Share repurchases			(30)			(30)
BALANCE DECEMBER 31, 2017	250	27	15,760	(101)	3,889	19,825
Net Income					166	166
Cumulative Adjustment					1,381	1,381
Foreign currency translation adjustment				(132)		(132)
Compensation on stock-based awards			126			126
Issuance of common stock						
Share repurchases			(276)			(276)
BALANCE DECEMBER 31, 2018	$ 250	$ 27	$ 15,610	$ (233)	$ 5,436	$ 21,090

See accompanying notes to consolidated financial statements

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NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The accompanying consolidated financial statements have been prepared in accordance with Generally Accepted Accounting Principles in the United States of America (GAAP) for financial information and pursuant to the rules and regulations of the Securities and Exchange Commission (SEC).

Nature of Business

Our manufacturing services include complete medical devices, printed circuit board assemblies, wire and cable assemblies, and complex higher level electromechanical assemblies for a wide range of medical, industrial and defense and aerospace industries. We provide a full turn-key contract manufacturing service to our customers. All products are built to the customer s design specifications. We also provide engineering services and repair services.

Our manufacturing facilities are located in Bemidji, Blue Earth, Merrifield, Milaca and Mankato, Minnesota as well as, Monterrey, Mexico and Suzhou, China. Products are sold to customers both domestically and internationally.

Principles of Consolidation

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

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of our consolidated financial statements. Estimates also affect the reported amounts of revenue and expense during the reporting period. Significant items subject to estimates and assumptions include the valuation allowance for inventories, allowance for doubtful accounts, accrued warranties, realizability of deferred tax assets, goodwill impairment and long-lived asset impairment testing. Actual results could differ from those estimates.

Restricted Cash

Cash and cash equivalents classified as restricted cash on our consolidated balance sheets are restricted as to withdrawal or use under the terms of certain contractual agreements. The December 31, 2018 balance included cash collateral required to be held against our corporate employee purchasing card program and lockbox deposits that are temporarily restricted due to timing at the period end. The lockbox deposits are applied against our line of credit the next business day. As of December 31, 2018, we had no outstanding letters of credit. Restricted cash as of December 31, 2018 and December 31, 2017 was $467 and $306, respectively.

Accounts Receivable and Allowance for Doubtful Accounts

We grant credit to customers in the normal course of business. Accounts receivable are unsecured and are presented net of an allowance for doubtful accounts. The allowance for doubtful accounts was $222 and

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$209 at December 31, 2018 and 2017, respectively. We determine our allowance by considering a number of factors, including the length of time accounts receivable are past due, our previous loss history, the customers current ability to pay their obligations to us, and the condition of the general economy and the industry as a whole. We write-off accounts receivable when they become uncollectible, and payments subsequently received on such receivables are credited to the allowance for doubtful accounts.

Inventories

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

Inventories are as follows:

(in thousands)		**2018**		**2017**
Raw materials	$	16,769	$	13,870
Work in process		1,015		3,112
Finished goods		332		2,389
Reserves		(1,112)		(844)
Total	$	17,004	$	18,527

Property and Equipment

Property and equipment are stated at cost less accumulated depreciation. Additions, improvements and major renewals are capitalized, while maintenance and minor repairs are expensed as incurred. When assets are retired or disposed of, the assets and related accumulated depreciation are removed from the accounts and the resulting gain or loss is reflected in operations. Leasehold improvements are depreciated over the shorter of their estimated useful lives or their remaining lease terms. All other property and equipment are depreciated by the straight-line method over their estimated useful lives, as follows:

Buildings	39 Years
Leasehold improvements	3-15 Years
Manufacturing equipment	3-7 Years

Office and other equipment	3-7 Years

Property and equipment at December 31, 2018 and 2017:

(in thousands)		2018		2017
Land	$	360	$	360
Building and Leasehold Improvements		9,184		8,827
Manufacturing Equipment		21,260		21,267
Office and Other Equipment		7,074		6,035
Accumulated Depreciation		(27,700)		(26,313)
Total Property and Equipment, net	$	10,178	$	10,176

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Other Intangible Assets

Finite life intangible assets at December 31, 2018 and 2017 are as follows:

		December 31, 2018		
(in thousands)	**Years**	**Gross Carrying Amount**	**Accumulated Amortization Amount**	**Net Book Value Amount**
Customer Relationships	9	1,302	506	796
Intellectual Property	3	100	61	39
Trade Names	20	814	143	671
Other	7	17		17
Totals		$ 2,233	$ 710	$ 1,523

		December 31, 2017		
	Years	**Gross Carrying Amount**	**Accumulated Amortization Amount**	**Net Book Value Amount**
Customer Relationships	9	1,302	361	941
Intellectual Property	3	100	28	72
Trade Names	20	814	102	712
Other	7	14		14
Totals		$ 2,230	$ 491	$ 1,739

Amortization of finite life intangible assets was $219 and $237 for the years ended December 31, 2018 and 2017, respectively.

Estimated future annual amortization expense (except projects in process) related to these assets is approximately as follows:

Year	**Amount**
2019	$ 219
2020	191
2021	185
2022	185
2023	185
Thereafter	541

	$	1,506

Goodwill and Other Intangible Assets

In accordance with ASC 350, *Goodwill and Other Intangible Assets*, goodwill is not amortized but is required to be reviewed for impairment at least annually or when events or circumstances indicate that carrying value may exceed fair value. We test impairment annually as of October 1st. In testing goodwill for impairment we perform a quantitative impairment test, including computing the fair value of the reporting unit and comparing that value to its carrying value. If the fair value is less than its carrying value, then the goodwill is determined to be impaired. In the event that goodwill is impaired, an impairment charge

NORTECH SYSTEMS INCORPORATED AND SUBSIDIARIES

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to earnings would become necessary. Based upon our annual goodwill impairment test we concluded that goodwill was impaired due to a significant reduction of results from operations during the fourth quarter of 2017. We adopted Accounting Standards Update No, 2017-04, *Simplifying the Test for Goodwill Impairment*, and performed a single step in performing our impairment analysis, which is to determine the estimated fair value of our reporting unit and compare it to the carrying value of the reporting unit, including goodwill. To the extent the carrying amount of goodwill exceeds the implied goodwill, the difference is the amount of the goodwill impairment. Our annual impairment test as of October 1, 2017, resulted in $908 of impairment charges related to our goodwill. The impairment charge was based on a combined approach using both the income approach which is based on discounted cash flows and the market approach which is based on the guideline public company method. Discounted cash flow models include assumptions related to our product revenue, gross margins, operating margins and other assumptions. There was no impairment of goodwill recorded in 2018.

We recognize the assets acquired and liabilities assumed in business combinations on the basis of their fair values at the date of acquisition. We assess the fair value of assets, including intangible assets, using a variety of methods and each asset is measured at fair value from the perspective of a market participant. The method used to estimate the fair values of intangible assets incorporates significant assumptions regarding the estimates a market participant would make in order to evaluate an asset, including a market participant s use of the asset and the appropriate discount rates for a market participant. Any excess purchase price over the fair value of the net tangible and intangible assets acquired is allocated to goodwill.

On July 1, 2015, we completed the acquisition of substantially all of the assets of Devicix, LLC upon the terms and conditions contained in an Asset Purchase Agreement entered into on June 17, 2015. The Devicix acquisition resulted in $3,200 of goodwill, which is deductible for tax purposes. We recorded an impairment charge of $908 on the goodwill related to the Devicix, LLC purchase as of December 31, 2017. There was no impairment of goodwill recorded in 2018.

Long-Lived Asset Impairment

We evaluate long-lived assets, primarily property and equipment, as well as the related depreciation periods, whenever current events or changes in circumstances indicate that the carrying amount of an asset or asset group may not be recoverable. Recoverability for assets to be held and used is based on our projection of the undiscounted future operating cash flows of the underlying assets or asset group. To the extent such projections indicate that future undiscounted cash flows are not sufficient to recover the carrying amounts of related assets, a charge might be required to reduce the carrying amount to equal estimated fair value. Assets held for sale are reported at the lower of the carrying amount or fair value less costs to dispose. We determined there was a triggering event during the fourth quarter of 2017 and determined the undiscounted cash flows exceeded the carrying amounts of long-lived assets. We determined there were no triggering events in 2018.

Preferred Stock

Preferred stock issued is non-cumulative and nonconvertible. The holders of the preferred stock are entitled to a non-cumulative dividend of 12% when and if declared. In liquidation, holders of preferred stock have preference to the extent of $1.00 per share plus dividends accrued but unpaid. No preferred stock dividends were declared or paid during the years ended December 31, 2018 and 2017.

Revenue Recognition

Our revenue is comprised of product, engineering services and repair services. All revenue is recognized when the Company satisfies its performance obligation(s) under the contract by transferring the promised product or service to our customer either when (or as) our customer obtains control of the product or service, with the majority of our revenue being recognized over time including goods produced under contract

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manufacturing agreements and services revenue. A performance obligation is a promise in a contract to transfer a distinct product or service to a customer. A contract s transaction price is allocated to each distinct performance obligation. The majority of our contracts have a single performance obligation. Revenue is recorded net of returns, allowances and customer discounts. Our net sales for services were less than 10% of our total sales for all periods presented, and accordingly, are included in net sales in the Consolidated Statements of Operations and Comprehensive Income (Loss). Sales, value add, and other taxes collected from customers and remitted to governmental authorities are accounted for on a net (excluded from revenues) basis. Shipping and handling costs charged to our customers are included in net sales, while the corresponding shipping expenses are included in cost of goods sold.

Effective January 1, 2018, we adopted the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2014-09, Revenue from Contracts with Customers (Topic 606) (ASU 2014-09), which supersedes the revenue recognition requirements in ASC 605, Revenue Recognition. ASU 2014-09 is based on the principle that revenue is recognized to depict the transfer of goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. It also requires additional disclosure about the nature, amount, timing, and uncertainty of revenue, cash flows arising from customer contracts, including significant judgments and changes in judgments, and assets recognized from costs incurred to obtain or fulfill a contract. The Company adopted the provisions of ASU 2014-09 using the modified retrospective approach with application to contracts that were not completed as of January 1, 2018. The adoption of ASU 2014-09 had a significant impact to the Company s results of operations, cash flow and financial position, and as a result we now recognize the majority of our revenue over time rather than upon shipment resulting in an adjustment to retained earnings of $1,381 on January 1, 2018. The Company has presented the disclosures required by this new standard, refer to Note 3.

Product Warranties

We provide limited warranty for the replacement or repair of defective product within a specified time period after the sale at no cost to our customers. We make no other guarantees or warranties, expressed or implied, of any nature whatsoever as to the goods including, without limitation, warranties to merchantability, fit for a particular purpose or non-infringement of patent or the like unless agreed upon in writing. We estimate the costs that may be incurred under our limited warranty and provide a reserve based on actual historical warranty claims coupled with an analysis of unfulfilled claims at the balance sheet date. Our warranty claim costs are not material given the nature of our products and services.

Advertising

Advertising costs are charged to operations as incurred. The total amount charged to expense was $132 and $68 for the years ended December 31, 2018 and 2017, respectively.

Income Taxes

We account for income taxes under the asset and liability method. Deferred income tax assets and liabilities are recognized annually for differences between the financial statement and tax basis of assets and liabilities that will result in taxable or deductible amounts in the future based on enacted tax laws and rates applicable to the periods in which the differences are expected to affect taxable income. Valuation allowances are established when necessary to reduce deferred tax assets to the amount expected to be realized. The company recognizes interest and penalties accrued on any unrecognized tax benefits as a component on income tax expense.

We recognize the tax benefit from an uncertain tax position only if it is more likely than not that the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the

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position. The tax benefits recognized in the consolidated financial statements from such positions are measured based on the largest benefit that has a greater than fifty percent likelihood of being realized upon ultimate resolution. Management must also assess whether uncertain tax positions as filed could result in the recognition of a liability for possible interest and penalties if any. Our estimates are based on the information available to us at the time we prepare the income tax provisions. Our income tax returns are subject to audit by federal, state, and local governments, generally three years after the returns are filed. These returns could be subject to material adjustments or differing interpretations of the tax laws.

Incentive Compensation

We use a Black-Scholes option-pricing model to determine the grant date fair value of our incentive awards and recognize the expense on a straight-line basis over the vesting period less awards expected to be forfeited using estimated forfeiture rates. See Note 7 for additional information.

Net Income (Loss) Per Common Share

Basic net income (loss) per common share is computed by dividing net income (loss) by the weighted-average number of common shares outstanding. Dilutive net income (loss) per common share assumes the exercise and issuance of all potential common stock equivalents in computing the weighted-average number of common shares outstanding, unless their effect is antidilutive.

A reconciliation of basic and diluted share amounts for the years ended December 31, 2018 and 2017 is as follows:

	2018	**2017**
Basic weighted average common shares outstanding	2,692,382	2,745,602
Weighted average common stock equivalents from assumed exercise of stock options	7,232	
Diluted weighted average common shares outstanding	2,699,614	2,745,602

Fair Value of Financial Instruments

The carrying amounts of all financial instruments approximate their fair values. The carrying amounts for cash and cash equivalents, accounts receivable, accounts payable, and accrued liabilities approximate fair value because of the short maturity of these instruments. Based on the borrowing rates currently available to us for bank loans with similar terms and average maturities, the carrying value of our long-term debt and line of credit approximates its fair value.

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Valuation techniques used to measure fair value maximize the use of observable inputs and minimize the use of unobservable inputs.

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The fair value framework requires the categorization of assets and liabilities into one of three levels based on the assumptions (inputs) used in valuing the asset or liability. Level 1 provides the most reliable measure of fair value, while Level 3 generally requires significant management judgment. The three levels are defined as follows:

Level 1: Quoted prices (unadjusted) in active markets for identical assets or liabilities.

Level 2: Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly.

Level 3: Unobservable inputs for the asset or liability, reflecting the reporting entity s own assumptions about the assumptions that market participants would use in pricing

Our assessment of the significance of a particular input to the fair value measurements requires judgment, and may affect the valuation of the assets and liabilities being measured and their placement within the fair value hierarchy. We endeavor to use the best available information in measuring fair value. Assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement.

Acquisition-Related Contingent Consideration

The Company acquired Devicix on July 1, 2015. The aggregate consideration paid to Devicix shareholders includes up to $2,500 of contingent consideration to be paid based on the achievement of certain performance-based milestones. The fair value of the contingent consideration was measured using an expected present value approach to estimate an expected value. This fair value measurement is based on significant inputs not observable in the market and thus represents a Level 3 measurement within the fair value hierarchy. The fair value of this Level 3 measured liability was $34 and $70 at December 31, 2018 and 2017, respectively.

Goodwill

The changes in the carrying amount of goodwill for the years presented are as follows:

Carrying amount at December 31, 2016	$	3,283
Impairment of goodwill		(908)
Carrying amount at December 31, 2017		2,375
Impairment of goodwill		
Carrying amount at December 31,2018	$	2,375

In determining the nonrecurring fair value measurements of impairment of goodwill we utilized a blend of the market value and discounted cash flow approach. We determined there was no impairment of goodwill during the year ended December 31, 2018. During the year ended December 31, 2017, we determined fair values for the identified assets and recorded an impairment charge of goodwill, set forth in the table below:

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	Fair value as of mesurement date	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)	Impairment Charge
December 31, 2017					
Goodwill	$ 2,375			$ 2,375	$ 908

Enterprise-Wide Disclosures

Our results of operations for the years ended December 31, 2018 and 2017 represent a single operating and reporting segment referred to as Contract Manufacturing within the EMS industry. We strategically direct production between our various manufacturing facilities based on a number of considerations to best meet our customers requirements. We share resources for sales, marketing, engineering, supply chain, information services, human resources, payroll and all corporate accounting functions. Consolidated financial information is available that is evaluated regularly by the chief operating decision maker in assessing performance and allocating resources.

Export sales from our domestic operations represent approximately 4.8% and 4.5% of consolidated net sales for the years ended December 31, 2018 and 2017, respectively.

Net sales by our major EMS industry markets for the years ended December 31, 2018 and 2017 are as follows:

(in thousands)	2018	2017
Aerospace and Defense	$ 18,314	$ 15,683
Medical	45,082	51,449
Industrial	49,974	45,203
Total Net Sales	$ 113,370	$ 112,335

Noncurrent assets, excluding deferred taxes, by country are as follows:

(in thousands)	United States	Mexico	China	Total
December 31, 2018				
Property and equipment, net	$ 8,687	$ 821	$ 670	$ 10,178

Other assets	3,898	8		3,906
December 31, 2017				
Property and equipment, net	$ 8,713	$ 1,003	$ 460	$ 10,176
Other assets	4,114	8		4,122

Foreign Currency Transactions

The functional currency for our Mexico subsidiary is the US dollar. Foreign exchange transaction gains and losses attributable to exchange rate movements related to transactions made in the local currency and on

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intercompany receivables and payables not deemed to be of a long-term investment nature are recorded in other income (expense). The functional currency for our China subsidiary is the Renminbi (RMB). Assets and liabilities of the China operation are translated from RMB into U.S. dollars at period-end rates, while income and expense are translated at the weighted-average exchange rates for the period. The related translation adjustments are reflected as a foreign currency translation adjustment in accumulated other comprehensive income (loss) within shareholders equity. The total foreign currency translation adjustment decreased shareholders equity by $132, from an accumulated foreign currency translation loss of $101 as of December 31, 2017 to an accumulated foreign currency translation loss of $233 as of December 31, 2018.

Transaction gains and losses that arise from exchange rate fluctuations on transactions denominated in a currency other than the functional currency are included in the consolidated statements of income. Net foreign currency transaction losses included in the determination of net earnings was $170 and $192 for the years ended December 31, 2018 and 2017, respectively.

Recently Issued and Adopted Accounting Pronouncements

In February 2016, the FASB issued ASU No. 2016-02, Leases (Topic 842), which supersedes the existing guidance for lease accounting, Leases (Topic 840). ASU No. 2016-02 requires lessees to recognize a lease liability and a right-of-use asset for all leases that extend beyond one year. The amendments in this ASU will be effective for us for interim and annual periods beginning after December 15, 2018. The original guidance required application on a modified retrospective basis with the earliest period presented in the financial statements. In August 2018, the FASB issued ASU 2018-11, Targeted Improvements to ASC 842, which includes an option to not restate comparative periods in transition and instead to elect to use the effective date of ASC 842, Leases , as the date of initial application of transition. Based on the effective date, this guidance will apply and the Company will adopt this ASU beginning on January 1, 2019, and the Company plans to elect the transition option provided under ASU 2018-11. We have completed the qualitative analysis from the lessee perspective. As part of our process, we elected to utilize certain practical expedients that were provided for transition relief. Accordingly, we are not reassessing expired or existing contracts, lease classifications or related initial direct costs as part of our assessment process. Additionally, we elected the practical expedient to treat lease and non-lease components of fixed payments due to the lessor as one, and therefore no separate allocation is required on the initial implementation date of January 1, 2019, and thereafter. We anticipate the adoption of this standard will result in an increase in our right of use assets and lease liabilities in the range of $5,500 to $6,500 recorded on our consolidated balance sheets on January 1, 2019; however, these estimates are subject to change as the Company finalizes its implementation. In 2019, the Company will also implement additional internal controls to comply with the requirements of the standard. The Company does not believe the adoption of this guidance will have a material impact on its consolidated results of operations or cash flows.

In March 2018, we adopted FASB ASU 2018-05, *Income Taxes (Topic 740): Amendments to SEC Paragraphs Pursuant to SEC Staff Accounting Bulletin No. 118*, which updates the income tax accounting in U.S. GAAP to reflect the Securities and Exchange Commission (SEC) interpretive guidance released on December 22, 2017, when the Tax Cuts and Jobs Act (the Tax Act) was signed into law. Additional information regarding the adoption of this standard is contained in Note 5, *Income Taxes* .

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NOTE 2. CONCENTRATION OF CREDIT RISK AND MAJOR CUSTOMERS

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

Our largest customer has two divisions that together accounted for 10% or more of our net sales during the year ended December 31, 2018 and 2017. One division accounted for approximately 20.8% and 23.5% of net sales for the years ended December 31, 2018 and 2017, respectively. The second division accounted for approximately 2.4% and 1.4% of net sales for the years ended December 31, 2018 and 2017, respectively. Together they accounted for approximately for 23.2% and 24.9% of net sales for the years ended December 31, 2018 and 2017, respectively. Accounts receivable from the customer at December 31, 2018 and 2017 represented 16.3% and 16.4% of our total accounts receivable, respectively.

NOTE 3. REVENUE

Revenue recognition

Our revenue is comprised of product, engineering services and repair services. All revenue is recognized when the Company satisfies its performance obligation(s) under the contract by transferring the promised product or service to our customer either when (or as) our customer obtains control of the product or service, with the majority of our revenue being recognized over time including goods produced under contract manufacturing agreements and services revenue. A performance obligation is a promise in a contract to transfer a distinct product or service to a customer. A contract s transaction price is allocated to each distinct performance obligation. The majority of our contracts have a single performance obligation, as the promise to transfer products or services is not separately identifiable from other promises in the contract and, therefore, not distinct.

Revenue is measured as the amount of consideration we expect to receive in exchange for transferring products or providing services. As such, revenue is recorded net of returns, allowances and customer discounts. Sales, value add, and other taxes collected from customers and remitted to governmental authorities are accounted for on a net (excluded from revenues) basis. Shipping and handling costs are included in cost of goods sold.

The majority of our revenue is derived from the transfer of goods produced under contract manufacturing agreements which have no alternative use and we have an enforceable right to payment for our performance completed to date. Our performance obligations within our contract manufacturing agreements are generally satisfied over time as the goods are produced based on customer specifications and we have an enforceable right to payment for the goods produced. If these requirements are not met, the revenue is recognized at a point in time, generally upon shipment. Revenue under contract manufacturing agreements that was recognized over time accounted for approximately 91% of our revenue for the twelve months ended December 31, 2018. Revenues under these agreements are generally recognized over time using an input measure based upon the proportion of actual costs incurred.

Accounting for contract manufacturing agreements involves the use of various techniques to estimate total revenue and costs. We estimate profit on these agreements as the difference between total estimated revenue and expected costs to complete the performance obligation within the terms of the agreement and recognize the respective profit as the goods are produced. The estimates to determine the profit earned on

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the performance obligation are based on anticipated selling prices and historical cost of goods sold and represent our best judgement at the time. Changes in judgements on these above estimates could impact the timing and amount of revenue recognized with a resulting impact on the timing and amount of associated profit.

On occasion our customers provide materials to be used in the manufacturing process and the fair value of the materials is included in revenue as noncash consideration at the point in time when the manufacturing process commences along with the same corresponding amount recorded as cost of goods sold. The inclusion of noncash consideration has no impact on overall profitability.

Contract Assets

Contract assets, recorded as such in the consolidated balance sheet, consist of unbilled amounts related to revenue recognized over time. Significant changes in the contract assets balance during the year ended December 31, 2018 was as follows:

Year Ended December 31, 2018		
Outstanding at January 1, 2018	$	6,459
Increase (decrease) attributed to:		
Transferred to receivables from contract assets recognized		(5,932)
Product transferred over time		5,904
Outstanding at December 31, 2018	$	6,431

We expect substantially all of the remaining performance obligations for the contract assets recorded as of December 31, 2018, to be transferred to receivables within 90 days, with any remaining amounts to be transferred within 180 days. We bill our customers upon shipment with payment terms of up to 120 days.

The following tables summarize our net sales by market for the year ended December 31, 2018:

	Year Ending December 31, 2018			
(in thousands)	**Product/ Service Transferred Over Time**	**Product Transferred at Point in Time**	**Noncash Consideration**	**Total Net Sales by Market**
Aerospace and Defense	$ 17,263	$ 232	$ 819	$ 18,314

Medical		39,071		4,157		1,854		45,082
Industrial		46,950		821		2,203		49,974
Total net sales	$	103,284	$	5,210	$	4,876	$	113,370

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Impact of New Revenue Guidance on Financial Statement Line Items

The following table compares the reported consolidated statement of operations and comprehensive loss, balance sheet and cash flows, as of and for the year ended December 31, 2018, to the pro-forma amounts had the previous guidance been in effect:

	Year Ending December 31, 2018			
Consolidated Statement of Operations		**As Reported**		**Pro forma as if the previous accounting guidance was in effect**
Net Sales	$	113,370	$	108,522
Cost of Goods Sold		100,059		95,249
Gross Profit		13,311		13,273
Income from Operations		1,249		1,211
Income Before Income Taxes		492		454
Income Tax Expense		326		326
Net Income	$	166	$	128
Net Income Per Common Share - Diluted	$	0.06	$	0.05

	As of December 31, 2018			
Consolidated Balance Sheet		**As Reported**		**Pro forma as if the previous accounting guidance was in effect**
Assets				
Inventories	$	17,004	$	22,015
Contract Assets	$	6,431	$	
Shareholders Equity				
Retained Earnings	$	21,090	$	19,671

	Year Ending December 31, 2018
Consolidated Statement of Cash Flows	**As Reported**

				Pro forma as if the previous accounting guidance was in effect
Net Income	$	166	$	128
Adjustments to Reconcile Net Loss to Net Cash Provided by Operating Activities				
Change in Current Operating Items				
Inventories		(3,875)		(3,809)
Contract Asset		28		
Net Cash Provided by Operating Activities	$	2,444	$	2,444

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NOTE 4. FINANCING ARRANGEMENTS

We have a credit agreement with Bank of America which was entered into on June 15, 2017 and provides for a line of credit arrangement of $16,000 that expires on June 15, 2022. The credit arrangement also has a $5,000 real estate term note outstanding with a maturity date of June 15, 2022. The Bank of America credit agreement replaces our previous credit agreement with Wells Fargo Bank which terminated on June 20, 2017 and resulted in a loss on the extinguishment of debt of $175 primarily related to legal and terminations fees.

Under the Bank of America credit agreement, both the line of credit and real estate term notes are subject to variations in the LIBOR rate. Our line of credit bears interest at a weighted-average interest rate of 4.8% as of December 31, 2018. We had borrowings on our line of credit of $9,264 and $8,503 outstanding as of December 31, 2018 and December 31, 2017, respectively. There are no subjective acceleration clauses under the credit agreement that would accelerate the maturity of our outstanding borrowings.

The line of credit and real estate term notes with Bank of America contain certain covenants which, among other things, require us to adhere to regular reporting requirements, abide by annual shareholder dividend limitations, maintain certain financial performance, and limit the amount of annual capital expenditures. The availability under our line is subject to borrowing base requirements, and advances are at the discretion of the lender. The line of credit is secured by substantially all of our assets.

The Bank of America credit agreement as amended provides for, among other things, a fixed charge coverage ratio of not less than (i) 1.0 to 1.0 for each period of four fiscal quarters, commencing with the period of four fiscal quarters ending December 31, 2018. In addition, the agreement requires that the Company comply with certain minimum levels of cumulative EBITDA for measurement periods during fiscal 2018, including cumulative EBITDA of $1,970 for the twelve months ending December 31, 2018.

The availability under the line is subject to borrowing base requirements, and advances are at the discretion of the lender. At December 31, 2018 and 2017, we had unused availability under our line of credit of $6,137 and $4,231, respectively, supported by our borrowing base. The line is secured by substantially all of our assets.

As part of the July 1, 2015 Devicix acquisition we entered into two unsecured subordinated promissory notes payable to the seller in the principal amounts of $1,000 and $1,300. The $1,000 promissory note has a four-year term, bearing interest at 4% per annum, requiring monthly principal and interest payments of $23 and is subject to offsets if certain revenue levels are not met. The $1,300 promissory note has a four-year term and bears interest at 4% per annum, requiring monthly principal and interest payments of $29 and is not subject to offset.

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Long-term debt balances at December 31, 2018 and 2017 consisted of the following (in thousands):

(in thousands)	**December 31, 2018**	**December 31, 2017**
Term note payable - Bank of America		
Real estate term note bearing interest at one-month LIBOR + 2.25% (4.8% and 4.5% as of December 31, 2018 and 2017, respectively) maturing June 15, 2022 with monthly payments of approximately $41,000 plus interest secured by substantially all assets.	$ 4,253	$ 4,751
Devicix Acquistion Note 1 payable to DeLange Holdings bears interest rate of 4.0% per annum, maturing July 1, 2019.	156	394
Devicix Acquistion Note 2 payable to DeLange Holdings bears interest rate of 4.0% per annum, maturing July 1, 2019.	203	512
	4,612	5,657
Discount on Devicix Notes Payable	(23)	(63)
Debt issuance Costs	(185)	(238)
Total long-term debt	4,404	5,356
Current maturities of long-term debt	(780)	(1,003)
Long-term debt - net of current maturities	$ 3,624	$ 4,353

Future maturity requirements for long-term debt outstanding as of December 31, 2018, are as follows:

Years Ending December 31,	**Amount**
2019	$ 857
2020	498
2021	498
2022	2,759
	$ 4,612

During the third quarter of fiscal year 2017, the Company entered into a five-year lease of equipment used in the normal course of business with a principal borrowing amount of $1,096. The lease qualified as a capital lease and is accounted for accordingly, based on an effective interest rate of 4.97%. As of December 31, 2017, the property held under the capital lease was $1,103.

The Company entered into a second lease in September 2017, with a four year, six-month term used in the normal course of business with a principal borrowing amount of $502. The lease qualified as a capital lease and is accounted for accordingly, based on an effective interest rate of 6.22%. As of December 31, 2017, the property held under the capital lease was $421. As of December 31, 2018, the Company had no depreciation expense related to the leased assets as it was not in operational use and related implementation costs were not complete.

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The Company has lease financing facilities for property and equipment. The obligations are collateralized by the property underlying lease. Total cost of the leased equipment was $1,624 at December 31, 2018 and $1,524 at December 31, 2017.

Current maturities of capital leases were $337 at December 31, 2018 and $295 at December 31, 2017.

Interest expense related to the leased assets was $91 and $9 for the years ended December 31, 2018 and 2017, respectively. Depreciation expense related to the leased assets was $201 and $0 for the years ended December 31, 2018 and 2017, respectively.

Approximate future minimum lease payments under non-cancelable capital leases subsequent to December 31, 2018 are as follows:

Years Ending December 31,		**Amount**
2019	$	398
2020		398
2021		398
2022		211
2023		2
Total noncancelable future lease commitments	$	1,407
Less: interest		(119)
Present value of obligations under capital leases	$	1,288

NOTE 5. INCOME TAXES

On December 22, 2017, the Tax Cuts and Jobs Act (U.S. Tax Reform) was enacted. The legislation significantly changed U.S. tax law by lowering the federal corporate tax rate from 34.0% to 21.0%, effective January 1, 2018, modifying the foreign earnings deferral provisions, and imposing a one-time toll charge on deemed repatriated earnings of foreign subsidiaries as of December 31, 2017. Effective for 2018 and forward, there is a tax on global intangible low-taxed income provisions (GILTI). As of December 31, 2017, two provisions that affected the consolidated financial statements were the corporate tax rate reduction and the one-time toll charge. As the corporate tax rate reduction was enacted in 2017 and effective January 1, 2018, we appropriately accounted for the tax rate change in the valuation of our deferred taxes. As a result of GILTI, we recorded a tax expense of $296 in 2018.

Global Intangible Low Taxed Income (GILTI): The Tax Act creates a new requirement that certain income (i.e. GILTI) earned by controlled foreign corporations (CFCs) must be included currently in the gross income of the CFCs U.S. Shareholder. GILTI is the excess of the shareholder s net CFC tested income over the net deemed tangible income return, which is currently defined as the excess of 1) 10 percent of the aggregate of the U.S. shareholder s pro rata share of the qualified business asset investment of each CFC with respect to which it is a U.S. shareholder over 2) the amount of certain interest expense taken into

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account in the determination of net CFC-tested income. Under U.S. GAAP, we are allowed to make an accounting policy choice of either 1) treating taxes due on future U.S. inclusions in taxable income related to GILTI as a current-period expense when incurred (the period cost method) or 2) factoring such amounts into a company s measurement of its deferred taxes (the deferred method). We have selected the period cost method. As a result, we have not provided deferred taxes related to the temporary differences that upon reversal will affect the amount of income subject to GILTI in the period.

The SEC issued Staff Accounting Bulletin No. 118 (SAB 118), which provides us with up to one year to finalize accounting for the impacts of U.S. Tax Reform. In 2017, we estimated the provisional tax impacts related to the toll charge, deferred income taxes, including the impacts of the change in corporate tax rate, and out indefinite reinvestment assertion. As of the fourth quarter of 2018, we have completed our accounting for the tax effects of U.S. Tax Reform and determined we would not be subject to the one-time transition tax. The total impact was calculated to be $223.

The income tax expense for the years ended December 31, 2018 and 2017 consists of the following:

(in thousands)	**2018**	**2017**
Current taxes - Federal	$ (38)	$ (124)
Current taxes - State	10	10
Current taxes - Foreign	334	49
Deferred taxes - Federal		176
Deferred taxes - State		239
Deferred taxes - Foreign	20	25
Income tax expense	$ 326	$ 375

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The statutory rate reconciliation for the years ended December 31, 2018 and 2017 is as follows:

(in thousands)	**2018**	**2017**
Statutory federal tax provision (benefit)	$ 107	$ (704)
State income tax benefit	(36)	(117)
Effect of foreign operations	52	(88)
Uncertain tax positions	(19)	
Income tax credits		(112)
Valuation allowance	(199)	1,011
Permanent differences	15	8
Global Intangile Low-Taxed Income Effect	296	
Return to Provision - Credits and NOL	176	
Deferred adjustments	(62)	
Loss of Section 199 due to carryback claim		46
Effects of tax reform		280
Other	(4)	51
Income tax expense	$ 326	$ 375

Income (loss) from operations before income taxes was derived from the following sources:

(in thousands)	**2018**	**2017**
Domestic	$ (1,090)	$ (2,831)
Foreign	1,582	760
Total	$ 492	$ (2,071)

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Deferred tax assets (liabilities) at December 31, 2018 and 2017, consist of the following:

(in thousands)	**2018**	**2017**
Deferred Tax		
Allowance for uncollectable accounts	$ 53	$ 49
Inventories reserve	267	198
Accrued vacation	145	194
Amortization		191
Stock-based compensation and equity appreciation rights	54	23
Net operating loss carryforwards	175	359
Tax credit carryforwards	449	613
Other	76	24
	1,219	1,651
Valuation allowance	(614)	(1,146)
Deferred tax assets	605	505
Prepaid expenses	(40)	(165)
Section 481(a) adjustment	(249)	
Property and equipment	(316)	(319)
Deferred tax liabilities	(605)	(484)
Net deferred tax assets	$	$ 21

We currently have significant deferred tax assets as a result of temporary differences between taxable income on our tax returns and U.S. GAAP income, research and development tax credit carry forwards and federal and state net operating loss carry forwards. A deferred tax asset generally represents future tax benefits to be received when temporary differences previously reported in our financial statements become deductible for income tax purposes, or when net operating loss carry forwards are applied against future taxable income, or when tax credit carry forwards are utilized on our tax returns. We assess the realizability of our deferred tax assets and the need for a valuation allowance based on the guidance provided in current financial accounting standards.

Significant judgment is required in determining the realizability of our deferred tax assets. The assessment of whether valuation allowances are required considers, among other matters, the nature, frequency and severity of any current and cumulative losses, forecasts of future profitability, the duration of statutory carry forward periods, our experience with loss carry forwards not expiring unused and tax planning alternatives.

We have concluded that a valuation allowance is needed for all of our United States based deferred tax assets due to the cumulative net losses we have sustained in the past three years and our near term financial outlook. In analyzing the need for a valuation allowance, we considered our history of operating results for income tax purposes over the past three years in each of the tax jurisdictions where we operate, statutory carry forward periods and tax planning alternatives. Finally, we considered both our near and long-term financial outlook and timing regarding when we might return to profitability. After considering all available evidence both positive and negative, we concluded that the valuation allowance is needed for all of our U.S. based deferred tax assets, no valuation allowance was placed on the foreign assets.

At December 31, 2018, we had federal general business tax credit carryforwards of $284 that will begin to expire in 2028 and a federal net operating loss (NOL) carry forward of $23 that will begin to expire in 2037, if unused. For U.S. state tax purposes we have Minnesota R&D credit carryforwards of $198 and

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various state net operating loss carryforwards of $400 for Iowa, $4 for Montana, $1,168 for Minnesota, $662 for Wisconsin. The state credits and NOLs expire at various years starting in 2024.

The tax effects from an uncertain tax positions can be recognized in our consolidated financial statements, only if the position is more likely than not to be sustained on audit, based on the technical merits of the position. We recognize the financial statement benefit of a tax position only after determining that the relevant tax authority would more likely than not sustain the position following an audit. For tax positions meeting the more likely than not threshold, the amount recognized in the financial statements is the largest benefit that has a greater than 50 percent likelihood of being realized upon ultimate settlement with the relevant tax authority. The following table sets forth changes in our total gross unrecognized tax benefit liabilities, excluding accrued interest, for the years ended December 31, 2018 and 2017 (in thousands):

Balance as of December 31, 2016	$	52
Tax positions related to 2017:		
Additions based on tax positions related to the current year		22
Statute of limitations		(22)
Balance as of December 31, 2017	$	52
Tax positions related to current year:		
Additions based on tax positions related to the current year		
Statute of limitations		(19)
Balance as of December 31, 2018	$	33

The $33 of unrecognized tax benefits as of December 31, 2018 includes amounts which, if ultimately recognized, will reduce our annual effective tax rate. In prior years, it was included in other long-term liabilities on the accompanying consolidated balance sheets. In 2018, the amount has been netted against the applicable deferred tax asset as any adjustment would reduce the recorded asset.

Our policy is to accrue interest and any penalties related to potential underpayment of income taxes within the provision for income taxes. The liability for accrued interest as of December 31, 2018 and 2017 was not significant. Interest is computed on the difference between our uncertain tax benefit positions and the amount deducted or expected to be deducted in our tax returns.

We are subject to income taxes in the U.S. federal jurisdiction and various state jurisdictions. The Company files income tax returns in the U.S. federal jurisdiction and various state and foreign jurisdictions. As of December 31, 2018, with few exceptions, the Company or its subsidiaries are no longer subject to examination prior to tax year 2012.

NOTE 6. 401(K) RETIREMENT PLAN

We have a 401(k) profit sharing plan (the 401(k) Plan) for our employees. The 401(k) Plan is a defined contribution plan covering substantially all of our U.S. employees. Employees are eligible to participate in the Plan after completing three months of service and attaining the age of 18. Employees are allowed to contribute up to 60% of their wages to the 401(k) Plan. Historically we have matched 25% of the employees contributions up to 6% of covered compensation. We made contributions of approximately $286 and $287 during the years ended December 31, 2018 and 2017, respectively.

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NOTE 7. INCENTIVE PLANS

Stock Options

On May 3, 2005, the shareholders approved the 2005 Incentive Compensation Plan (the 2005 Plan) and eliminated the remaining 172,500 option shares available for grant under the prior 2003 Plan effective February 23, 2005. The total number of shares of common stock that may be granted under the 2005 Plan is 200,000. The 2005 Plan has not been renewed, and therefore no further grants may be made under the 2005 Plan. The 2005 Plan provides that option shares granted come from our authorized but unissued common stock. Under the 2005 Incentive Compensation Plan, there were no stock options granted during the years ended December 31, 2017 and 2016. In May 2017, the shareholders approved the 2017 Stock Incentive Plan which authorized the issuance of 350,000 shares. There were 134,000 and 150,000 options granted during the year ended December 31, 2018 and 2017, respectively. For both of the above plans, The price of the option shares granted under the plan will not be less than 100% of the fair market value of the common shares on the date of grant. Options are generally exercisable after one or more years and expire no later than 10 years from the date of grant.

We estimate the fair value of share-based awards on the date of grant using an option-pricing model. The value of the portion of the award that is ultimately expected to vest is recognized as expense in the consolidated statements of operations over the requisite service periods. Because share-based compensation expense is based on awards that are ultimately expected to vest, share-based compensation expense will be reduced to account for estimated forfeitures. We estimate forfeitures at the time of grant and revise the estimate, if necessary, in subsequent periods if actual forfeitures differ from those estimates.

We used the Black-Scholes option-pricing model to calculate the fair value of option-based awards. Our determination of fair value of option-based awards on the date of grant using the Black-Scholes model is affected by our stock price as well as assumptions regarding a number of subjective variables. These variables include, but are not limited to, our expected stock price, volatility over the term of the awards, risk-free interest rate, and the expected life of the options. The risk-free interest rate is based on a treasury instrument whose term is consistent with the expected life of our stock options. The expected volatility and holding period are based on our historical experience. For all grants, the amount of compensation expense recognized has been adjusted for an estimated forfeiture rate, which is based on historical data.

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A summary of option activity as of and for the year-ended December 31, 2018 is as follows:

	Shares	Weighted-Average Exercise Price Per Share	Weighted-Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value
Outstanding January 1, 2017	37,750	$ 4.75		
Granted	150,000	3.43		
Exercised				
Cancelled				
Outstanding December 31, 2017	187,750	$ 3.70	8.13	$ 74,070
Granted	134,000	3.36		
Exercised				
Cancelled	(97,000)	(3.84)		
Outstanding December 31, 2018	224,750	$ 3.44	8.60	$ 52,715
Exercisable on December 31, 2018	44,750	$ 3.65	6.59	$ 8,075

There were no options exercises during the years ended December 31, 2018 and 2017. Total compensation expense related to stock options for the years ended December 31, 2018 and 2017 was $126 and $43, respectively. As of December 31, 2018, there was $160 of unrecognized compensation which will vest over the next 4.05 years.

Equity Appreciation Rights Plan

In November 2010, the Board of Directors approved the adoption of the Nortech Systems Incorporated Equity Appreciation Rights Plan (the 2010 Plan). The total number of Equity Appreciation Right Units (Units) the Plan can issue shall not exceed an aggregate of 1,000,000 Units as amended and restated on March 11, 2015 and approved by the shareholders on May 6, 2015. The 2010 Plan provides that Units issued shall fully vest three years from the base date as defined in the agreement unless terminated earlier. Units give the holder a right to receive a cash payment equal to the appreciation in book value per share of common stock from the base date, as defined, to the redemption date. Unit redemption payments under this plan shall be paid in cash within 90 days after we determine the book value of the Units as of the calendar year immediately preceding the redemption date. The Units are adjusted to each reporting period based on the expected appreciation of the Units as defined in the Plan.

During the year ended December 31, 2016, we granted 31,666 Units with a base date of January 1, 2016 and a vesting date of January 1, 2019. During the year-ended December 31, 2017, we granted a total of 100,000 Units with a vesting date of December 31, 2019.

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Total compensation expense (income) related to the vested outstanding Units based on the estimated appreciation over their remaining terms was approximately $0 and ($22) for the years ended December 31, 2018 and 2017, respectively. The expense (income) for the years ended December 31, 2018 and 2017 was the result of a change in the estimate of the appreciation of book value per share of common stock.

A summary of the liability as of December 31 and changes during the years then ended, is as follows:

(in thousands)	**2018**	**2017**
Beginning Balance	$	$ 45
Reductions		(22)
Payments		(23)
Ending Balance	$	$

NOTE 8. COMMITMENTS AND CONTINGENCIES

Operating Leases

We have various operating leases for production and office equipment, office space, and buildings under non-cancelable lease agreements expiring on various dates through 2029.

Rent expense for the years ended December 31, 2018 and 2017 totaled approximately $1,376 and $1,271 respectively.

On February 21, 2018, we entered into a ten-year lease agreement for a 77,000 square foot manufacturing facility in Nuevo Leon, Mexico which we took occupancy during the fourth quarter of 2018. The Lease Agreement provides for monthly rent payments of approximately $43. This facility replaced the Monterrey, Mexico facility lease which expired January 31, 2019.

Approximate future minimum lease payments under non-cancelable leases are as follows:

Years Ending December 31,		Amount
2019	$	1,024
2020		858
2021		722
2022		726
2023		738
Thereafter		3,380
Total	$	7,448

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Litigation

We are subject to various legal proceedings and claims that arise in the ordinary course of business. In our opinion, the amount of any ultimate liability with respect to these actions will not materially affect our consolidated financial statements or results of operations.

Executive Life Insurance Plan

During 2002, we set up an Executive Bonus Life Insurance Plan (the Plan) for our key employees (participants). Pursuant to the Plan, we will pay a bonus to officer participants of 15% and a bonus to all other participants of 10% of the participants base annual salary, as well as an additional bonus to cover federal and state taxes incurred by the participants. The participants are required to purchase life insurance and retain ownership of the life insurance policy once it is purchased. The Plan provides a five-year graded vesting schedule in which the participants vest at a rate of 20% each year. Should a participant terminate employment prior to the fifth year of vesting, that participant may be required to reimburse us for any unvested amounts, under certain circumstances. Expenses under the Plan were $0 and $207 for the years ended December 31, 2018 and 2017, respectively. On December 13, 2017, the Plan was terminated.

Change of Control Agreements

Since 2002, we entered into Change of Control Agreements (the Agreement(s)) with certain key executives (the Executive(s)). The Agreements provide an inducement for each Executive to remain as an employee in the event of any proposed or anticipated change of control in the organization, including facilitating an orderly transition, and to provide economic security for the Executive after a change in control has occurred.

In the event of an involuntarily termination in connection with a change of control as defined in the agreements, each Executive would receive their base salary, annual bonus at time of termination, and continued participation in health, disability and life insurance plans for a period of three years for officers and two years for all other participants. Participants would also receive professional outplacement services up to $10, if applicable. Each Agreement remains in full force until the Executive terminates employment or we terminate the employment of the Executive.

Stock Repurchase Plan

The $250 share repurchase program, authorized by our Board of Directors in August 2017, expired in July 2018 with no authorized repurchases remaining under this program. Under this repurchase program, we repurchased 55,199 shares totaling $201 during the year ended December 31, 2018. In August 2018, the Board of Directors approved an additional $250 share repurchase program. Under this repurchase program, we repurchased 21,002 shares totaling $81 during the year ended December 31, 2018.

As of December 31, 2017, we had a $250 share repurchase program which was authorized by our Board of Directors in August 2017. Under this repurchase program, we repurchased 8,581 shares in open market transactions totaling $30, during the year ended December 31, 2017. As of December 31, 2017, we had a $220 authorized balance remaining under this share repurchase program. The par value of repurchased shares is deducted from common stock and the excess repurchase price over par value is deducted from additional paid-in capital.

NORTECH SYSTEMS INCORPORATED AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

AS OF AND FOR THE YEARS ENDED DECEMBER 31, 2018 AND 2017

(IN THOUSANDS, EXCEPT SHARE AND PER SHARE DATA)

Executive Separation Agreement

The Company entered into a Separation Agreement with Matt Mahmood, our former Chief Operating Officer, effective October 5, 2018. In connection with the Separation Agreement, the Company recognized approximately $235 in expense during the year ended December 31, 2018 related to separation payments. As of December 31, 2018, approximately $177 is included in accrued payroll and commissions on the consolidated balance sheet which is expected to be paid in full during 2019.

NOTE 9. PLANT CLOSURE

On January 31, 2017, the Company closed its manufacturing operations in Augusta, Wisconsin. The Company operated a facility in Augusta since 1992, serving mainly an industrial customer base and defense overflow production that aligned with their custom cable capabilities. The Company consolidated its Augusta operations with its other facilities, continuing to serve customers without interruption. This consolidation increased the Company s overall asset utilization and cost leveraging. On March 31, 2017, the Company closed on the sale of the Augusta building and building improvements for $715. The Augusta building and building improvements had a net book value of $314, recognizing a gain on the sale, net of related expenses, of $354, and applied the net proceeds of $668 towards the outstanding real estate term note.

NOTE 10. RELATED PARTY TRANSACTIONS

During 2016, the Company entered into a consulting arrangement with a company co-owned by Matt Mahmood, who became the Chief Operating Officer of the Company on May 20, 2017 and who resigned from the Company on October 5, 2018. For the years ended December 31, 2018 and 2017, expenses were incurred in the amounts of $50, and $97, respectively.

On February 22, 2018, the Company entered into a Consulting Agreement with Crosscourt Group, LLC, a limited liability company owned and managed by William Murray, formerly an independent director of the Company. Mr. Murray resigned from this position in May 2018. The term of the Consulting Agreement was three months and ended in the second quarter of 2018. For the year ended December 31, 2018, expenses were incurred in the amounts of $68.

NOTE 11. SUBSEQUENT EVENTS

Effective January 1, 2019, the Company entered into an employment agreement with Jay D. Miller as the Company s Interim President. Effective February 27, 2019, the Company entered into an employment agreement with Jay D. Miller as the Company s President and Chief Executive officer. In connection with the employment agreements, the Company granted 7,500 stock options that vested on January 1, 2019, 125,000 stock options that vest annually over five years, 100,000 equity appreciation rights units and 25,000 shares of the Company s common stock.

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

None.

Item 9A. Controls and Procedures

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

Management s Annual Report on Internal Control Over Financial Reporting

Management of the Company is responsible for establishing and maintaining adequate internal control over financial reporting. Our internal control system was designed to provide reasonable assurance to management and the board of directors regarding the effectiveness of our internal control processes over the preparation and fair presentation of published financial statements.

All internal control systems, no matter how well designed, have inherent limitations. Therefore, even those systems determined effective can provide only reasonable assurance with respect to financial statement preparation and presentation.

We have assessed the effectiveness of our internal controls over financial reporting as of December 31, 2018. In making this assessment, we used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission in Internal Control Integrated Framework of 2013. Based on our assessment, we concluded that, as of December 31, 2018, our internal control over financial reporting was effective.

Changes in Internal Controls

There was no change in the Company s internal control over financial reporting that occurred during our most recent quarter that has materially affected, or is reasonably likely to materially affect, the Company s internal control over financial reporting.

Item 9B. Other Information

None.

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PART III

Item 10. Directors, Executive Officers and Corporate Governance

Information regarding the directors and executive officers of the Registrant will be included in the Registrant s 2018 proxy statement to be filed with the Securities and Exchange Commission within 120 days after December 31, 2018, the end of our fiscal year, and said portions of the proxy statement are incorporated herein by reference.

The company has adopted a code of conduct applicable to all officers, directors, and employees. A copy of this code of conduct will be provided to any person, without charge, upon request from Nortech c/o Chief Financial Officer 7550 Meridian Circle N # 150, Maple Grove, MN 55369.

Item 11. Executive Compensation

Information regarding executive compensation of the Registrant will be included in the Registrant s 2018 proxy statement to be filed with the Securities and Exchange Commission within 120 days after December 31, 2018, the end of our fiscal year, and said portions of the proxy statement are incorporated herein by reference.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

Information regarding security ownership of certain beneficial owners and management of the Registrant will be included in the Registrant s 2018 proxy statement to be filed with the Securities and Exchange Commission within 120 days after December 31, 2018, the end of our fiscal year, and said portions of the proxy statement are incorporated herein by reference.

Information regarding executive compensation plans (including individual compensation arrangements) as of the end of the last fiscal year, on two categories of equity compensation plans (that is, plans that have been approved by security holders and plans that have not been approved by security holders) will be included in the Registrant s 2018 proxy statement to be filed with the Securities and Exchange Commission within 120 days after December 31, 2018, the end of our fiscal year, and said portions of the proxy statement are incorporated herein by reference.

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The following table provides information about our equity compensation plans (including individual compensation arrangements) as of December 31, 2018.

Plan category	Number of securities to be issued upon the exercise of outstanding options, warrants and rights (1)	Weighted-average exercise price of outstanding options, warrants and rights	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in the first column)(2)
Equity compensation plans approved by security holders	187,750	$ 3.70	200,000
Equity compensation plans not approved by security holders			
Total	187,750	$ 3.70	

(1) Represents common shares issuable upon the exercise of 37,750 outstanding options granted under the 2005 Incentive Compensation Plan (the 2005 Plan) and 150,000 outstanding options granted under the 2017 Incentive Compensation Plan (the 2017 Plan).

(2) Represents common shares remaining available for issuance under the 2005 Plan of zero and common shares remaining available for issuance under the 2017 Plan of 200,000.

Item 13. Certain Relationships and Related Transactions, and Director Independence

The information required by this Item will be included in the Registrant s 2018 proxy statement to be filed with the Securities and Exchange Commission within 120 days after December 31, 2018, the end of our fiscal year, and said portions of the proxy statement are incorporated herein by reference.

Item 14. Principal Accountant Fees and Services

The information required by this Item will be included in the Registrant s 2018 proxy statement to be filed with the Securities and Exchange Commission within 120 days after December 31, 2018, the end of our fiscal year, and said portions of the proxy statement are incorporated herein by reference.

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PART IV

Item 15. Exhibits and Financial Statements Schedules

1. Consolidated Financial Statements - Consolidated Financial Statements and related Notes are included in Part II, Item 8, and are identified in the Index on Page 25.

2. Consolidated Financial Statement Schedule - The following financial statement schedule and the Auditors report thereon is included in this Annual Report on Form 10-K:

All schedules are omitted because it is not required information or the information is presented in the consolidated financial statements or related notes.

3. The following exhibits are incorporated herein by reference:

3.1 Articles of Incorporation (incorporated by reference to Amendment No. 1 to Form S-3 (filed on Form S-1) filed July 16, 1996 (File No. 333-00888)

3.2 Bylaws (amended and restated through March 13, 2019)*

10.1 2005 Incentive Compensation Plan (incorporated by reference to Exhibit A to Definitive Proxy Statement filed March 31, 2005)**

10.2 Third Amended and Restated Credit and Security Agreement between the Company and Wells Fargo Bank, National Association dated May 27, 2010 (incorporated by reference to Form 10-Q filed August 12, 2010)

10.3 Sixth Amendment dated March 16, 2014 to Third Amended and Restated Credit and Security Agreement between the Company and Wells Fargo Bank, National Association (incorporated by reference to Form 8-K filed May 21, 2014)

10.4 Form of Change of Control Agreement for Named Executive Officers (incorporated by reference to Form 10-K filed March 11, 2015)* **

10.5 Amendment dated November 5, 2014 to Employment Agreement with Michael Degen (incorporated by reference to Form 8-K filed November 7, 2014)**

10.6 Consulting Agreement with Michael Degen dated November 5, 2014 (incorporated by reference to Form 8-K filed November 7, 2014)**

10.7 Form of Employment Agreement with Richard Wasielewski dated March 15, 2014 (incorporated by reference to Form 10-K filed March 11, 2015)**

10.8 Restated Equity Appreciation Rights Plan dated March 11, 2015 (incorporated by reference to Appendix A to Definitive Proxy Statement filed March 24, 2015)**

10.9 Lease Agreement dated April 1, 2015 between the Company and LSOP 3 MN 3, LLC (incorporated by reference to Form 8-K filed April 9, 2015)

10.10 Seventh Amendment dated May 7, 2015 to Third Amended and Restated Credit and Security Agreement between the Company and Wells Fargo Bank, National Association (incorporated by reference to Form 8-K filed May 13, 2015)

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10.11 Asset Purchase Agreement dated June 17, 2015 between the Company and Devicix, LLC (incorporated by reference to Form 10-Q filed August 5, 2015)

10.12 Restated Amendment to Employment Agreement with Michael Degen dated November 5, 2014 (incorporated by reference to Form 10-Q filed November 5, 2015)**

10.13 Lease Agreement dated November 12, 2015 between the Company and Suzhou Industrial Park Biotech Development Co., Ltd. (incorporated by reference to Form 10-K filed March 21, 2016)

10.14 Eighth Amendment dated February 22, 2016 to Third Amended and Restated Credit and Security Agreement between the Company and Wells Fargo Bank, National Association (incorporated by reference to Form 8-K filed February 24, 2016)

10.15 Ninth Amendment dated September 29, 2016 to Third Amended and Restated Credit and Security Agreement between the Company and Wells Fargo Bank, National Association (incorporated by reference to Form 10-Q filed November 2, 2016)

10.16 Tenth Amendment dated January 12, 2017 to Third Amended and Restated Credit and Security Agreement between the Company and Wells Fargo Bank, National Association.*

10.17 2017 Stock Incentive Plan approved by shareholders May 3, 2017 (incorporated by reference from the Definitive Proxy Statement filed March 22, 2017)

10.18 Employment Agreement with Matthew Mahmood dated May 15, 2017 (incorporated by reference to Form 8-K filed May 19, 2017)

10.19 Amended and Restated Employment Agreement with Richard Wasielewski dated May 15, 2017 (incorporated by reference to Form 8-K filed May 19, 2017)

10.20 Loan and Security Agreement with Bank of America N.A. dated June 15, 2017 (incorporated by reference to Form 8-K filed June 21, 2017)

10.21 First Amendment dated December 29, 2017 to Loan and Security Agreement between the Company and Bank of America N.A. (incorporated by reference to Form 8-K filed January 8, 2018)

10.22 Employment Agreement with Constance Beck dated January 8, 2018 (incorporated by reference to Form 8-K filed January 12, 2018)

10.23 Lease Agreement dated February 21, 2018 by and between Manufacturing Assembly Solutions of Monterrey, Inc., a wholly owned Mexican subsidiary of the Company, and OPERADORA STIVA, S.A. DE C.V. (incorporated by reference to Form 8-K filed February 27, 2018)

10.24 Consulting Agreement with Crosscourt Group, LLC dated February 22, 2018 (incorporated by reference to Form 8-K filed February 27, 2018)

10.25 Separation and Release of claims dated October 10, 2018 between Nortech Systems Inc. and Mohammed Mahmood (incorporated by reference to Form 8-K filed October 10, 2018)

10.26 Amendment to Amended and Restated Employment Agreement between Nortech Systems Inc. and Richard Wasielewski dated December 19, 2018 (incorporated by reference to Form 8-K filed December 21, 2018)

10.27 Employment Agreement between Nortech Systems Inc. and Jay D. Miller to serve as Interim President dated effective January 1, 2019 (incorporated by reference to Form 8-K filed December 21, 2018)

10.28 Employment Agreement between Nortech Systems Inc. and Jay D. Miller to serve as President and CEO dated effective February 27, 2019 (incorporated by reference to Form 8-K filed February 20, 2019)

21 Subsidiaries of Nortech Systems Incorporated*

23 Consent of Baker Tilly Virchow Krause, LLP*

31.1 Certification of the Chief Executive Officer and President pursuant to Rule 13a-14(a) and Rule 15d-14(a), promulgated under the Securities Exchange Act of 1934, as amended.*

31.2 Certification of the Chief Financial Officer pursuant to Rule 13a-14(a) and Rule 15d-14(a), promulgated under the Securities Exchange Act of 1934, as amended.*

32.1 Certification of the Chief Executive Officer and President and Chief Financial Officer, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.*

101 Financial statements from the annual report on Form 10-K for the year ended December 31, 2018, formatted in XBRL: (i) Consolidated Balance Sheets, (ii) Consolidated Statements of Income, (iii) Consolidated Statements of Cash Flows, and (iv) the Notes to Consolidated Financial Statements.*

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* Filed electronically herewith.

** Management contract or compensatory plan or arrangement in which directors or executive officers are eligible to participate

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Nortech Systems Incorporated

Registrant

By: /s/ Jay D. Miller April 1, 2019
Jay D. Miller
President and Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

By: /s/ Jay D. Miller April 1, 2019
Jay D. Miller
President and Chief Executive Officer (principal executive officer) and Director

By: /s/ Constance M. Beck April 1, 2019
Constance M. Beck
Chief Financial Officer (principal financial and accounting officer)

By: /s/ David B. Kunin April 1, 2019
David B. Kunin, Chairman and Director

By: /s/ Kathleen P. Iverson April 1, 2019
Kathleen P. Iverson, Director

By: /s/ Michael J. Kennedy April 1, 2019
Michael J. Kennedy, Director

By: /s/ Ryan P. McManus April 1, 2019
Ryan P. McManus, Director

By: /s/ Steven J. Rosenstone April 1, 2019
Steven J. Rosenstone, Director