

TRANSCAT INC  
Form 10-Q  
November 09, 2012

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended: September 29, 2012

or

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

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

Commission File Number: 000-03905

TRANSCAT, INC.

(Exact name of registrant as specified in its charter)

Ohio  
(State or other  
jurisdiction of  
incorporation or  
organization)

16-0874418  
(I.R.S. Employer  
Identification No.)

35 Vantage Point Drive, Rochester, New York 14624  
(Address of principal executive offices) (Zip Code)

(585) 352-7777  
(Registrant's telephone number, including area code)

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

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

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

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Large accelerated filer

Accelerated filer

Non-accelerated filer  (Do not check if a smaller reporting company)

Smaller reporting company

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

The number of shares of common stock, par value \$0.50 per share, of the registrant outstanding as of November 7, 2012 was 7,417,800.

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## PART I. FINANCIAL INFORMATION

## ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS

TRANSCAT, INC.  
CONSOLIDATED STATEMENTS OF OPERATIONS  
(In Thousands, Except Per Share Amounts)

|   | (Unaudited)<br>Second Quarter Ended |                       | (Unaudited)<br>Six Months Ended |                       |
|---|-------------------------------------|-----------------------|---------------------------------|-----------------------|
|   | September<br>29,<br>2012            | September 24,<br>2011 | September<br>29,<br>2012        | September 24,<br>2011 |
| Product Sales                             | \$ 16,948                           | \$ 16,969             | \$33,313                        | \$ 34,151             |
| Service Revenue                           | 9,840                               | 8,214                 | 18,572                          | 16,637                |
| Total Revenue                             | 26,788                              | 25,183                | 51,885                          | 50,788                |
| Cost of Products Sold                     | 13,225                              | 12,658                | 25,380                          | 25,572                |
| Cost of Services Sold                     | 7,485                               | 6,372                 | 14,220                          | 12,765                |
| Total Cost of Products and Services Sold  | 20,710                              | 19,030                | 39,600                          | 38,337                |
| Gross Profit                              | 6,078                               | 6,153                 | 12,285                          | 12,451                |
| Selling, Marketing and Warehouse Expenses | 2,959                               | 3,042                 | 6,400                           | 6,668                 |
| Administrative Expenses                   | 1,939                               | 1,870                 | 4,111                           | 3,972                 |
| Total Operating Expenses                  | 4,898                               | 4,912                 | 10,511                          | 10,640                |
| Operating Income                          | 1,180                               | 1,241                 | 1,774                           | 1,811                 |
| Interest and Other Expense, net           | 51                                  | 38                    | 98                              | 83                    |
| Income Before Income Taxes                | 1,129                               | 1,203                 | 1,676                           | 1,728                 |
| Provision for Income Taxes                | 384                                 | 457                   | 570                             | 657                   |
| Net Income                                | \$ 745                              | \$ 746                | \$ 1,106                        | \$ 1,071              |
| Basic Earnings Per Share                  | \$ 0.10                             | \$ 0.10               | \$ 0.15                         | \$ 0.15               |
| Average Shares Outstanding                | 7,411                               | 7,302                 | 7,390                           | 7,290                 |
| Diluted Earnings Per Share                | \$ 0.10                             | \$ 0.10               | \$ 0.15                         | \$ 0.14               |
| Average Shares Outstanding                | 7,567                               | 7,640                 | 7,574                           | 7,624                 |

See accompanying notes to consolidated financial statements.

TRANSCAT, INC.  
 CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME  
 (In Thousands)

|  | (Unaudited)<br>Second Quarter Ended |                       | (Unaudited)<br>Six Months Ended |                       |
|--|-------------------------------------|-----------------------|---------------------------------|-----------------------|
|  | September<br>29,<br>2012            | September 24,<br>2011 | September<br>29,<br>2012        | September 24,<br>2011 |
| Net Income                                   | \$ 745                              | \$ 746                | \$ 1,106                        | \$ 1,071              |
| <b>Other Comprehensive Income (Loss):</b>    |                                     |                       |                                 |                       |
| Currency Translation Adjustment              | 6                                   | (17 )                 | 1                               | (19 )                 |
| Unrecognized Prior Service Cost, net of tax  | 13                                  | 2                     | (69 )                           | 5                     |
| Unrecognized Gain on Other Asset, net of tax | 11                                  | -                     | 7                               | -                     |
|  | 30                                  | (15 )                 | (61 )                           | (14 )                 |
| Comprehensive Income                         | \$ 775                              | \$ 731                | \$ 1,045                        | \$ 1,057              |

See accompanying notes to consolidated financial statements.

TRANSCAT, INC.  
CONSOLIDATED BALANCE SHEETS  
(In Thousands, Except Share and Per Share Amounts)

|   | (Unaudited)<br>September 29,<br>2012 | March 31,<br>2012 |
|---|--------------------------------------|-------------------|
| <b>ASSETS</b>   |                                      |                   |
| Current Assets:   |                                      |                   |
| Cash  | \$ 194                               | \$ 32             |
| Accounts Receivable, less allowance for doubtful accounts of \$85 and \$99 as of September 29, 2012 and March 31, 2012, respectively  | 12,466                               | 13,800            |
| Other Receivables   | 1,421                                | 845               |
| Inventory, net  | 7,082                                | 6,396             |
| Prepaid Expenses and Other Current Assets   | 1,538                                | 1,064             |
| Deferred Tax Asset  | 874                                  | 1,041             |
| Total Current Assets  | 23,575                               | 23,178            |
| Property and Equipment, net   | 6,132                                | 5,306             |
| Goodwill  | 15,298                               | 13,390            |
| Intangible Assets, net  | 2,651                                | 2,449             |
| Deferred Tax Asset  | 297                                  | -                 |
| Other Assets  | 927                                  | 654               |
| Total Assets  | \$ 48,880                            | \$ 44,977         |
| <b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>   |                                      |                   |
| Current Liabilities:  |                                      |                   |
| Accounts Payable  | \$ 7,573                             | \$ 7,516          |
| Accrued Compensation and Other Liabilities  | 3,785                                | 5,171             |
| Income Taxes Payable  | 123                                  | 366               |
| Total Current Liabilities   | 11,481                               | 13,053            |
| Long-Term Debt  | 7,242                                | 3,365             |
| Deferred Tax Liability  | -                                    | 139               |
| Other Liabilities   | 1,462                                | 1,042             |
| Total Liabilities   | 20,185                               | 17,599            |
| Shareholders' Equity:   |                                      |                   |
| Common Stock, par value \$0.50 per share, 30,000,000 shares authorized; 7,413,961 and 7,840,994 shares issued as of September 29, 2012 and March 31, 2012, respectively; 7,413,961 and 7,341,007 shares outstanding as of September 29, 2012 and March 31, 2012, respectively | 3,707                                | 3,920             |
| Capital in Excess of Par Value  | 10,527                               | 10,810            |
| Accumulated Other Comprehensive Income  | 387                                  | 448               |
| Retained Earnings   | 14,074                               | 14,394            |
| Less: Treasury Stock, at cost, 498,782 shares as of March 31, 2012  | -                                    | (2,194 )          |
| Total Shareholders' Equity  | 28,695                               | 27,378            |
| Total Liabilities and Shareholders' Equity  | \$ 48,880                            | \$ 44,977         |

See accompanying notes to consolidated financial statements.



TRANSCAT, INC.  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
(In Thousands)

|  | (Unaudited)<br>Six Months Ended |                       |
|--|---------------------------------|-----------------------|
|  | September<br>29,<br>2012        | September 24,<br>2011 |
| Cash Flows from Operating Activities:  |                                 |                       |
| Net Income   | \$1,106                         | \$ 1,071              |
| Adjustments to Reconcile Net Income to Net Cash<br>Provided by Operating Activities: |                                 |                       |
| Deferred Income Taxes  | (222 )                          | (59 )                 |
| Depreciation and Amortization  | 1,221                           | 1,408                 |
| Provision for Accounts Receivable and Inventory Reserves                             | 95                              | 91                    |
| Stock-Based Compensation Expense   | 148                             | 340                   |
| Changes in Assets and Liabilities:   |                                 |                       |
| Accounts Receivable and Other Receivables  | 1,145                           | (1,112 )              |
| Inventory  | (672 )                          | 859                   |
| Prepaid Expenses and Other Assets  | (897 )                          | (603 )                |
| Accounts Payable   | 71                              | (1,205 )              |
| Accrued Compensation and Other Liabilities   | (1,098 )                        | 338                   |
| Income Taxes Payable   | (243 )                          | (236 )                |
| Net Cash Provided by Operating Activities  | 654                             | 892                   |
| Cash Flows from Investing Activities:  |                                 |                       |
| Purchases of Property and Equipment  | (1,346 )                        | (900 )                |
| Business Acquisition   | (3,129 )                        | (3,122 )              |
| Net Cash Used in Investing Activities  | (4,475 )                        | (4,022 )              |
| Cash Flows from Financing Activities:  |                                 |                       |
| Revolving Line of Credit, net  | 3,877                           | 2,920                 |
| Payments on Other Debt Obligations   | -                               | (10 )                 |
| Payments of Contingent Consideration   | (14 )                           | (58 )                 |
| Issuance of Common Stock   | 124                             | 269                   |
| Excess Tax Benefits Related to Stock-Based Compensation                              | -                               | 37                    |
| Net Cash Provided by Financing Activities  | 3,987                           | 3,158                 |
| Effect of Exchange Rate Changes on Cash  | (4 )                            | 7                     |
| Net Increase in Cash   | 162                             | 35                    |
| Cash at Beginning of Period  | 32                              | 32                    |
| Cash at End of Period  | \$194                           | \$ 67                 |
| Supplemental Disclosure of Cash Flow Activity:                                       |                                 |                       |
| Cash paid during the period for:   |                                 |                       |
| Interest   | \$66                            | \$ 46                 |
| Income Taxes, net  | \$1,032                         | \$ 920                |



Supplemental Disclosure of Non-Cash Investing and Financing Activities:

|  |     |    |     |
|--|-----|----|-----|
| Contingent Consideration Related to Business Acquisition | \$- | \$ | 100 |
|--|-----|----|-----|

See accompanying notes to consolidated financial statements.

TRANSCAT, INC.  
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY  
(In Thousands)  
(Unaudited)

|                                     | Common Stock                         |         | Capital                         | Accumulated<br>Other<br>Comprehensive<br>Income | Retained<br>Earnings | Treasury Stock<br>Outstanding<br>at Cost |           | Total    |
|-------------------------------------|--------------------------------------|---------|---------------------------------|---|----------------------|--|-----------|----------|
|                                     | Issued<br>\$0.50 Par Value<br>Shares | Amount  | In<br>Excess<br>of Par<br>Value |   |                      | Shares                                   | Amount    |          |
| Balance as of March 31,<br>2012     | 7,840                                | \$3,920 | \$10,810                        | \$ 448  | \$ 14,394            | 499                                      | \$(2,194) | \$27,378 |
| Issuance of Common Stock            | 21                                   | 10      | 114                             |   |                      |  |           | 124      |
| Retirement of Treasury<br>Stock     | (499 )                               | (249 )  | (519 )                          |   | (1,426 )             | (499 )                                   | 2,194     | -        |
| Stock-Based Compensation            | 52                                   | 26      | 122                             |   |                      |  |           | 148      |
| Other Comprehensive Loss            |                                      |         |                                 | (61 )   |                      |  |           | (61 )    |
| Net Income                          |                                      |         |                                 |   | 1,106                |  |           | 1,106    |
| Balance as of September 29,<br>2012 | 7,414                                | \$3,707 | \$10,527                        | \$ 387  | \$ 14,074            | -  | \$-       | \$28,695 |

See accompanying notes to consolidated financial statements.

TRANSCAT, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(In Thousands, Except Per Share Amounts)

(Unaudited)

NOTE 1 – GENERAL

Description of Business: Transcat, Inc. (“Transcat” or the “Company”) is a distributor of professional grade handheld test, measurement and control instruments and accredited provider of calibration, repair, inspection and other compliance services primarily for pharmaceutical and FDA-regulated, industrial manufacturing, energy and utilities, chemical manufacturing and other industries.

Basis of Presentation: Transcat’s unaudited Consolidated Financial Statements have been prepared in accordance with accounting principles generally accepted in the United States (“GAAP”) for interim financial information and in accordance with the instructions to Form 10-Q and Article 10 of Regulation S-X of the Securities and Exchange Commission (“SEC”). Accordingly, the Consolidated Financial Statements do not include all of the information and footnotes required by GAAP for complete financial statements. In the opinion of the Company’s management, all adjustments considered necessary for a fair presentation (consisting of normal recurring adjustments) have been included. The results for the interim periods are not necessarily indicative of what the results will be for the fiscal year. The accompanying Consolidated Financial Statements should be read in conjunction with the audited Consolidated Financial Statements as of and for the fiscal year ended March 31, 2012 (“fiscal year 2012”) contained in the Company’s 2012 Annual Report on Form 10-K filed with the SEC.

Fair Value of Financial Instruments: Transcat has determined the fair value of debt and other financial instruments using a valuation hierarchy. The hierarchy, which prioritizes the inputs used in measuring fair value, consists of three levels. Level 1 uses observable inputs such as quoted prices in active markets; Level 2 uses inputs other than quoted prices in active markets that are either directly or indirectly observable; and Level 3, which is defined as unobservable inputs in which little or no market data exists, requires the Company to develop its own assumptions. The carrying amount of debt on the Consolidated Balance Sheets approximates fair value due to variable interest rate pricing, and the carrying amounts for cash, accounts receivable and accounts payable approximate fair value due to their short-term nature. Investment assets, which fund the Company’s non-qualified deferred compensation plan are included as a component of other assets (non-current) on the Consolidated Balance Sheets, consist of mutual funds and are valued based on quoted market prices in active markets.

Stock-Based Compensation: The Company measures the cost of services received in exchange for all equity awards granted, including stock options and restricted stock, based on the fair market value of the award as of the grant date. The Company records compensation cost related to unvested stock awards by recognizing, on a straight-line basis, the unamortized grant date fair value over the remaining service period of each award. Excess tax benefits from the exercise of stock awards are presented in the Consolidated Statements of Cash Flows as a financing activity. Excess tax benefits are realized benefits from tax deductions for exercised awards in excess of the deferred tax asset attributable to stock-based compensation costs for such awards. The Company did not capitalize any stock-based compensation costs as part of an asset. The Company estimates forfeiture rates based on its historical experience. During the first six months of the fiscal year ending March 30, 2013 (“fiscal year 2013”) and the first six months of fiscal year 2012, the Company recorded non-cash stock-based compensation cost of \$0.1 million and \$0.3 million, respectively, in the Consolidated Statements of Operations.

Foreign Currency Translation and Transactions: The accounts of Transmation (Canada) Inc., a wholly-owned subsidiary, are maintained in the local currency and have been translated to U.S. dollars. Accordingly, the amounts representing assets and liabilities, except for equity, have been translated at the period-end rates of exchange and related revenue and expense accounts have been translated at an average rate of exchange during the period. Gains and losses arising from translation of Transmation (Canada) Inc.’s balance sheets into U.S. dollars are recorded directly

to the accumulated other comprehensive income component of shareholders' equity.

Transcat records foreign currency gains and losses on Canadian business transactions. The net foreign currency loss was less than \$0.1 million in the first six months of fiscal years 2013 and 2012. The Company utilizes foreign exchange forward contracts to reduce the risk that its earnings would be adversely affected by changes in currency exchange rates. The Company does not apply hedge accounting and therefore the change in the fair value of the contracts, which totaled less than \$0.1 million during the first six months of fiscal years 2013 and 2012, was recognized as a component of other expense in the Consolidated Statements of Operations. The change in the fair value of the contracts is offset by the change in fair value on the underlying accounts receivables denominated in Canadian dollars being hedged. On September 29, 2012, the Company had a foreign exchange contract, which matured in October 2012, outstanding in the notional amount of \$1.8 million. The Company does not use hedging arrangements for speculative purposes.

Earnings Per Share: Basic earnings per share of common stock are computed based on the weighted average number of shares of common stock outstanding during the period. Diluted earnings per share of common stock reflect the assumed conversion of stock options and unvested restricted stock units using the treasury stock method in periods in which they have a dilutive effect. In computing the per share effect of assumed conversion, funds which would have been received from the exercise of options and unvested restricted stock units and the related tax benefits are considered to have been used to purchase shares of common stock at the average market prices during the period. The resulting net additional shares of common stock are included in the calculation of average shares of common stock outstanding.

The average shares outstanding used to compute basic and diluted earnings per share are as follows:

|   | Second Quarter Ended |                    | Six Months Ended   |                    |
|---|----------------------|--------------------|--------------------|--------------------|
|   | September 29, 2012   | September 24, 2011 | September 29, 2012 | September 24, 2011 |
| Average Shares Outstanding – Basic          | 7,411                | 7,302              | 7,390              | 7,290              |
| Effect of Dilutive Common Stock Equivalents | 156                  | 338                | 184                | 334                |
| Average Shares Outstanding – Diluted        | 7,567                | 7,640              | 7,574              | 7,624              |
| Anti-dilutive Common Stock Equivalents      | 509                  | 436                | 481                | 440                |

Shareholders' Equity: On July 31, 2012, the Company retired all of its treasury stock. Upon retirement, the excess of purchase price over par value for the shares retired was charged to capital in excess of par value, to the extent the Company had amounts in capital in excess of par value from the original issuance of the shares, with the remaining excess cost being charged to retained earnings.

#### NOTE 2 – DEBT

Description: On September 20, 2012, Transcat entered into a credit agreement (the “M&T Credit Agreement”) with Manufacturers and Traders Trust Company. The M&T Credit Agreement provides for a three-year revolving credit facility in the amount of \$20.0 million (the “M&T Revolving Credit Facility”) and replaced the credit agreement dated as of November 20, 2006, as amended, (the “Chase Credit Agreement”) with JP Morgan Chase Bank, N.A. As of September 29, 2012, \$7.2 million was outstanding under the M&T Credit Agreement and is included in long-term debt on the Consolidated Balance Sheet.

Interest and Other Costs: Interest on the M&T Revolving Credit Facility accrues, at Transcat’s election, at either the one-month London Interbank Offered Rate (“LIBOR”), adjusting daily, or a fixed rate for a designated period at the LIBOR corresponding to such period, in each case, plus a margin. Commitment fees accrue based on the average daily amount of unused credit available on the M&T Revolving Credit Facility. Commitment fees and interest rate margins are determined on a quarterly basis based upon the Company’s calculated leverage ratio, as defined in the M&T Credit Agreement. The one-month LIBOR as of September 29, 2012 was 0.2%. The Company’s interest rate for the first six months of fiscal year 2013, including interest associated with the Chase Credit Agreement, ranged from 1.1% to 2.8%.

Covenants: The M&T Credit Agreement has certain covenants with which the Company has to comply, including a fixed charge ratio covenant and a leverage ratio covenant. The Company was in compliance with all loan covenants and requirements, including those associated with the Chase Credit Agreement, throughout the first six months of fiscal year 2013.

Loan Costs: Costs associated with the M&T Credit Agreement, totaling less than \$0.1 million, are being amortized over the term of the agreement. On September 20, 2012, unamortized costs associated with the Chase Credit

Agreement totaling less than \$0.1 million were written off and recorded as other expense in the Consolidated Statement of Operations.

Other Terms: The Company has pledged all of its U.S. tangible and intangible personal property, the equity interests of its U.S.-based subsidiaries, and a majority of the common stock of Transmation (Canada) Inc. as collateral security for the loans made under the M&T Revolving Credit Facility.

## NOTE 3 – STOCK-BASED COMPENSATION

The Transcat, Inc. 2003 Incentive Plan, as Amended and Restated (the “2003 Plan”), provides for, among other awards, grants of restricted stock units and stock options to directors, officers and key employees at the fair market value at the date of grant. At September 29, 2012, the number of shares available for future grant under the 2003 Plan totaled 0.2 million.

**Restricted Stock:** The Company grants performance-based restricted stock units as a primary component of executive compensation. The units generally vest following the third fiscal year from the date of grant subject to certain cumulative diluted earnings per share growth targets over the eligible period.

Compensation cost ultimately recognized for these performance-based restricted stock units will equal the grant date fair market value of the unit that coincides with the actual outcome of the performance conditions. On an interim basis, the Company records compensation cost based on an assessment of the probability of achieving the performance conditions. The Company achieved 75% of the target level for the performance-based restricted stock units granted in the fiscal year ended March 27, 2010 (“fiscal year 2010”) and as a result, issued 52 thousand shares of common stock to executive officers and certain key employees during the first quarter of fiscal year 2013. At September 29, 2012, the Company estimated the probability of achievement for the units granted in fiscal years 2013 and 2012 to be 100% of the target levels and 75% of the target level for the units granted in the fiscal year ended March 26, 2011 (“fiscal year 2011”). Total expense relating to performance-based restricted stock units, based on grant date fair value and the estimated probability of achievement, was \$0.1 million in the first six months of fiscal years 2013 and 2012. Unearned compensation totaled \$0.5 million as of September 29, 2012.

On April 4, 2011, the Company granted restricted stock awards, which vested immediately, to its executive officers and certain key employees. Total expense related to these restricted stock awards, based on grant date fair value, was \$0.1 million in the first six months of fiscal year 2012.

**Stock Options:** Options generally vest over a period of up to four years, using either a graded schedule or on a straight-line basis, and expire ten years from the date of grant. The expense relating to options is recognized on a straight-line basis over the requisite service period for the entire award.

The following table summarizes the Company’s options as of and for the six months ended September 29, 2012:

|                                      | Number<br>of<br>Shares | Weighted<br>Average<br>Exercise<br>Price Per<br>Share | Weighted<br>Average<br>Remaining<br>Contractual<br>Term (in years) | Aggregate<br>Intrinsic<br>Value |
|--------------------------------------|------------------------|---|--|---------------------------------|
| Outstanding as of March 31, 2012     | 597                    | \$ 5.94   |  |                                 |
| Granted                              | -                      | -   |  |                                 |
| Exercised                            | (10 )                  | 4.03  |  |                                 |
| Cancelled/Forfeited                  | (20 )                  | 6.65  |  |                                 |
| Outstanding as of September 29, 2012 | 567                    | 5.95  | 4  | \$ 279                          |
| Exercisable as of September 29, 2012 | 560                    | 5.94  | 4  | 279                             |

The aggregate intrinsic value in the table above represents the total pre-tax intrinsic value (the difference between the Company’s closing stock price on the last trading day of the second quarter of fiscal year 2013 and the exercise price, multiplied by the number of in-the-money stock options) that would have been received by the option holders had all holders exercised their options on September 29, 2012. The amount of aggregate intrinsic value will change based on the fair market value of the Company’s common stock.

Total unrecognized compensation cost related to non-vested stock options as of September 29, 2012 was less than \$0.1 million, which is expected to be recognized over a weighted average period of less than one year. The aggregate intrinsic value of stock options exercised in the first six months of fiscal year 2013 was less than \$0.1 million. Cash received from the exercise of options in the first six months of fiscal year 2013 was less than \$0.1 million.



## NOTE 4 – SEGMENT INFORMATION

Transcat has two reportable segments: Distribution Products (“Product”) and Calibration Services (“Service”). The Company has no inter-segment sales. The following table presents segment information for the second quarter and the six months ended September 29, 2012 and September 24, 2011:

|                                 | Second Quarter Ended     |                       | Six Months Ended         |                       |
|---------------------------------|--------------------------|-----------------------|--------------------------|-----------------------|
|                                 | September<br>29,<br>2012 | September 24,<br>2011 | September<br>29,<br>2012 | September 24,<br>2011 |
| <b>Total Revenue:</b>           |                          |                       |                          |                       |
| Product Sales                   | \$ 16,948                | \$ 16,969             | \$33,313                 | \$ 34,151             |
| Service Revenue                 | 9,840                    | 8,214                 | 18,572                   | 16,637                |
| <b>Total</b>                    | <b>26,788</b>            | <b>25,183</b>         | <b>51,885</b>            | <b>50,788</b>         |
| <b>Gross Profit:</b>            |                          |                       |                          |                       |
| Product                         | 3,723                    | 4,311                 | 7,933                    | 8,579                 |
| Service                         | 2,355                    | 1,842                 | 4,352                    | 3,872                 |
| <b>Total</b>                    | <b>6,078</b>             | <b>6,153</b>          | <b>12,285</b>            | <b>12,451</b>         |
| <b>Operating Expenses:</b>      |                          |                       |                          |                       |
| Product (1)                     | 2,876                    | 2,854                 | 6,234                    | 6,301                 |
| Service (1)                     | 2,022                    | 2,058                 | 4,277                    | 4,339                 |
| <b>Total</b>                    | <b>4,898</b>             | <b>4,912</b>          | <b>10,511</b>            | <b>10,640</b>         |
| <b>Operating Income (Loss):</b> |                          |                       |                          |                       |
| Product                         | 847                      | 1,457                 | 1,699                    | 2,278                 |
| Service                         | 333                      | (216 )                | 75                       | (467 )                |
| <b>Total</b>                    | <b>1,180</b>             | <b>1,241</b>          | <b>1,774</b>             | <b>1,811</b>          |
| <b>Unallocated Amounts:</b>     |                          |                       |                          |                       |
| Interest and Other Expense, net | 51                       | 38                    | 98                       | 83                    |
| Provision for Income Taxes      | 384                      | 457                   | 570                      | 657                   |
| <b>Total</b>                    | <b>435</b>               | <b>495</b>            | <b>668</b>               | <b>740</b>            |
| <b>Net Income</b>               | <b>\$ 745</b>            | <b>\$ 746</b>         | <b>\$ 1,106</b>          | <b>\$ 1,071</b>       |

(1) Operating expense allocations between segments were based on actual amounts, a percentage of revenues, headcount, and management’s estimates.

## NOTE 5 – ACQUISITIONS

On July 16, 2012, the Company acquired substantially all of the assets of Anacor Compliance Services, Inc. (“Anacor”), a nationally recognized provider of specialized analytical, calibration, validation and remediation services to the life sciences sector including the biotechnology, medical device, and pharmaceutical industries.

The total purchase price paid for this business was approximately \$3.1 million. The assets acquired were recorded under the acquisition method of accounting at their estimated fair values as of the date of acquisition. Goodwill, totaling \$1.9 million, represents consideration paid in excess of the fair value assigned to the underlying net assets of the acquired business. Other intangible assets, namely customer base and covenants not to compete, represent an allocation of purchase price to identifiable intangible assets of the acquired business. Intangible assets, totaling \$0.6

million, are being amortized for financial reporting purposes on an accelerated basis over the estimated useful life of up to 10 years. Goodwill and the intangible assets are deductible for tax purposes. During the first six months of fiscal year 2013, acquisition costs, totaling \$0.1 million, were recorded as incurred as an administrative expense in the Consolidated Statement of Operations. The results of operations of the acquired business were included in Transcat's consolidated operating results as of the date the business was acquired. Pro forma information as of the beginning of the period presented and the operating results since the date of acquisition have not been disclosed as the acquisition was not considered significant.

In connection with certain of its previous business acquisitions, the Company entered into earn out agreements with the former owners of the acquired businesses. These agreements entitle the former owners to receive earn out payments subject to continued employment and certain post-closing financial targets, as defined in the agreements. During the first six months of fiscal year 2012, payments totaling \$0.2 million were earned and recorded as compensation expense in the Consolidated Statement of Operations. There were no amounts earned in the first six months of fiscal year 2013. Earn out consideration unpaid as of September 29, 2012 totaled less than \$0.1 million and was included in other current liabilities in the Consolidated Balance Sheet.

In addition, certain of these previous business acquisitions contain holdback provisions, as defined in the respective purchase agreements. The Company accrues contingent consideration relating to the holdback provisions based on their estimated fair value as of the date of acquisition. During the first six months of fiscal years 2013 and 2012, the Company paid less than \$0.1 million in contingent consideration. There was no unpaid contingent consideration as of September 29, 2012.

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

**Forward-Looking Statements:** This report and, in particular, the Management's Discussion and Analysis of Financial Condition and Results of Operations section of this report, contains forward-looking statements as defined by the Private Securities Litigation Reform Act of 1995. These include statements concerning expectations, estimates, and projections about the industry, management beliefs and assumptions of Transcat, Inc. ("Transcat", "we", "us", or "our"). Words such as "anticipates", "expects", "intends", "plans", "believes", "seeks", "estimates", and variations of such words and similar expressions are intended to identify such forward-looking statements. These statements are not guarantees of future performance and are subject to certain risks, uncertainties and assumptions that are difficult to forecast. Therefore, our actual results and outcomes may materially differ from those expressed or forecasted in any such forward-looking statements. When considering these risks, uncertainties and assumptions, you should keep in mind the cautionary statements contained elsewhere in this report and in any documents incorporated herein by reference. New risks and uncertainties arise from time to time and we cannot predict those events or how they may affect us. For a more detailed discussion of the risks and uncertainties that may affect Transcat's operating and financial results and its ability to achieve its financial objectives, interested parties should review the "Risk Factors" sections in Transcat's reports filed with the Securities and Exchange Commission, including the Annual Report on Form 10-K for the fiscal year ended March 31, 2012. We undertake no obligation to publicly update any forward-looking statements, whether as a result of new information, future events or otherwise.

### CRITICAL ACCOUNTING POLICIES AND ESTIMATES

**Accounts Receivable:** Accounts receivable represent amounts due from customers in the ordinary course of business. These amounts are recorded net of the allowance for doubtful accounts and returns in the Consolidated Balance Sheets. The allowance for doubtful accounts is based upon the expected collectibility of accounts receivable. We apply a specific formula to our accounts receivable aging, which may be adjusted on a specific account basis where the formula may not appropriately reserve for loss exposure. After all attempts to collect a receivable have failed, the receivable is written-off against the allowance for doubtful accounts. The returns reserve is calculated based upon the historical rate of returns applied to revenues over a specific timeframe. The returns reserve will increase or decrease as a result of changes in the level of revenues and/or the historical rate of returns.

**Stock-Based Compensation:** We measure the cost of services received in exchange for all equity awards granted, including stock options and restricted stock, based on the fair market value of the award as of the grant date. We record compensation cost related to unvested stock awards by recognizing, on a straight-line basis, the unamortized grant date fair value over the remaining service period of each award. Excess tax benefits from the exercise of stock awards are presented in the Consolidated Statements of Cash Flows as a financing activity. Excess tax benefits are realized benefits from tax deductions for exercised awards in excess of the deferred tax asset attributable to stock-based compensation costs for such awards. We did not capitalize any stock-based compensation costs as part of an asset. We estimate forfeiture rates based on our historical experience.

We grant performance-based restricted stock units as a primary component of executive compensation. The units generally vest following the third fiscal year from the date of grant subject to certain cumulative diluted earnings per share growth targets over the eligible period. Compensation cost ultimately recognized for these performance-based restricted stock units will equal the grant-date fair market value of the unit that coincides with the actual outcome of the performance conditions. On an interim basis, we record compensation cost based on an assessment of the probability of achieving the performance conditions. We achieved 75% of the target level for the performance-based restricted stock units granted in fiscal year 2010 and as a result, issued 52 thousand shares of common stock to executive officers and certain key employees during the first quarter of fiscal year 2013. At September 29, 2012, we estimated the probability of achievement for the units granted in fiscal years 2013 and 2012 to be 100% of the target levels and 75% of the target level for the units granted in fiscal year 2011.

Revenue Recognition: Product sales are recorded when a product's title and risk of loss transfer to the customer. We recognize the majority of our service revenue based upon when the calibration or other activity is performed and then shipped and/or delivered to the customer. Some service revenue is generated from managing customers' calibration programs in which we recognize revenue in equal amounts at fixed intervals. We generally invoice our customers for freight, shipping, and handling charges. Provisions for customer returns are provided for in the period the related revenues are recorded based upon historical data.

## RESULTS OF OPERATIONS

The following table presents, for the second quarter and first six months of fiscal years 2013 and 2012, the components of our Consolidated Statements of Operations.

|   | (Unaudited)<br>Second Quarter Ended |                       | (Unaudited)<br>Six Months Ended |                       |
|---|-------------------------------------|-----------------------|---------------------------------|-----------------------|
|   | September<br>29,<br>2012            | September 24,<br>2011 | September<br>29,<br>2012        | September 24,<br>2011 |
| <b>Gross Margin:</b>                      |                                     |                       |                                 |                       |
| Product Gross Margin                      | 22.0 %                              | 25.4 %                | 23.8 %                          | 25.1 %                |
| Service Gross Margin                      | 23.9 %                              | 22.4 %                | 23.4 %                          | 23.3 %                |
| Total Gross Margin                        | 22.7 %                              | 24.4 %                | 23.7 %                          | 24.5 %                |
| <b>As a Percentage of Total Revenue:</b>  |                                     |                       |                                 |                       |
| Product Sales                             | 63.3 %                              | 67.4 %                | 64.2 %                          | 67.2 %                |
| Service Revenue                           | 36.7 %                              | 32.6 %                | 35.8 %                          | 32.8 %                |
| Total Revenue                             | 100.0 %                             | 100.0 %               | 100.0 %                         | 100.0 %               |
| Selling, Marketing and Warehouse Expenses | 11.1 %                              | 12.1 %                | 12.3 %                          | 13.1 %                |
| Administrative Expenses                   | 7.2 %                               | 7.4 %                 | 8.0 %                           | 7.8 %                 |
| Total Operating Expenses                  | 18.3 %                              | 19.5 %                | 20.3 %                          | 20.9 %                |
| Operating Income                          | 4.4 %                               | 4.9 %                 | 3.4 %                           | 3.6 %                 |
| Interest and Other Expense, net           | 0.2 %                               | 0.1 %                 | 0.2 %                           | 0.2 %                 |
| Income Before Income Taxes                | 4.2 %                               | 4.8 %                 | 3.2 %                           | 3.4 %                 |
| Provision for Income Taxes                | 1.4 %                               | 1.8 %                 | 1.1 %                           | 1.3 %                 |
| Net Income                                | 2.8 %                               | 3.0 %                 | 2.1 %                           | 2.1 %                 |

SECOND QUARTER ENDED SEPTEMBER 29, 2012 COMPARED TO SECOND QUARTER ENDED SEPTEMBER 24, 2011 (dollars in thousands):

Revenue:

|                 | Second Quarter Ended     |                       |
|-----------------|--------------------------|-----------------------|
|                 | September<br>29,<br>2012 | September 24,<br>2011 |
| <b>Revenue:</b> |                          |                       |
| Product Sales   | \$ 16,948                | \$ 16,969             |
| Service Revenue | 9,840                    | 8,214                 |
| Total Revenue   | \$ 26,788                | \$ 25,183             |

Total revenue increased \$1.6 million, or 6.4%, from the second quarter of fiscal year 2012 to the second quarter of fiscal year 2013.

Our product sales accounted for 63.3% of our total revenue in the second quarter of fiscal year 2013 and 67.4% of our total revenue in the second quarter of fiscal year 2012. Product segment sales were \$16.9 million in the second quarter of fiscal year 2013, consistent with the prior-year period. In the prior-year period, sales were strengthened by one-time opportunistic orders. Excluding those orders, product segment sales increased by 3.6%. Our fiscal years 2013 and 2012 product sales (decline) growth in relation to prior fiscal year quarter comparisons is as follows:

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|                                | FY 2013 |         |        |        | FY 2012 |        |  |  |
|--------------------------------|---------|---------|--------|--------|---------|--------|--|--|
|                                | Q2      | Q1      | Q4     | Q3     | Q2      | Q1     |  |  |
| Product Sales (Decline) Growth | (0.1 %) | (4.8 %) | 19.2 % | 17.0 % | 26.0 %  | 32.4 % |  |  |

Our average product sales per business day were unchanged at \$269 in the second quarter of fiscal years 2013 and 2012. Our product sales per business day for each fiscal quarter during the fiscal years 2013 and 2012 are as follows:

|                                | FY 2013 |       |       | FY 2012 |       |       |
|--------------------------------|---------|-------|-------|---------|-------|-------|
|                                | Q2      | Q1    | Q4    | Q3      | Q2    | Q1    |
| Product Sales Per Business Day | \$269   | \$260 | \$295 | \$308   | \$269 | \$268 |

Customer product orders include orders for instruments that we routinely stock in our inventory, customized products, and other products ordered less frequently, which we do not stock. Pending product shipments are primarily backorders, but also include products that are requested to be calibrated in our laboratories prior to shipment, orders required to be shipped complete or at a future date, and other orders awaiting final credit or management review prior to shipment. Our total pending product shipments for the second quarter of fiscal year 2013 decreased by \$1.0 million, or 29.8%, from the second quarter of fiscal year 2012. This decrease was primarily driven by a decline in backorders. Overall, variations in pending product shipments can be impacted by several factors, including the timing of when product orders are placed in relation to the end of the fiscal period, specialized product orders that are not stocked, or production issues experienced by manufacturers. The following table presents the percentage of total pending product shipments that were backorders at the end of the second quarter of fiscal year 2013 and our historical trend of total pending product shipments:

|  | FY 2013 |         |         |         | FY 2012 |         |  |  |
|--|---------|---------|---------|---------|---------|---------|--|--|
|  | Q2      | Q1      | Q4      | Q3      | Q2      | Q1      |  |  |
| Total Pending Product Shipments                    | \$2,365 | \$2,806 | \$2,670 | \$3,572 | \$3,368 | \$3,002 |  |  |
| % of Pending Product Shipments that are Backorders | 68.6 %  | 68.8 %  | 70.9 %  | 65.6 %  | 73.6 %  | 67.9 %  |  |  |

Service revenue increased to \$9.8 million in the second quarter of fiscal year 2013, a \$1.6 million, or 19.8% increase, when compared to \$8.2 million in the second quarter of fiscal year 2012. The growth can be attributed to expansion of our existing customer base and incremental revenue associated with our recent business acquisitions, partially offset by the loss of \$0.3 million in low margin revenue from services we were outsourcing for a customer. Also, within any year, while we add new customers, we also have customers from the prior year whose calibrations may not repeat for any number of reasons. Among those reasons are variations in the timing of customer periodic calibrations on instruments and other services, customer capital expenditures and customer outsourcing decisions. Because the timing of calibration orders and segment expenses can vary on a quarter-to-quarter basis, we believe a trailing twelve-month trend provides a better indication of the progress of this segment. Service segment revenue for the twelve months ended September 29, 2012 was \$38.3 million, up 16.7% when compared with \$32.9 million for the twelve months ended September 24, 2011. Our fiscal years 2013 and 2012 service revenue growth in relation to prior fiscal year quarter comparisons is as follows:

|                        | FY 2013 |       |        |        | FY 2012 |        |  |  |
|------------------------|---------|-------|--------|--------|---------|--------|--|--|
|                        | Q2      | Q1    | Q4     | Q3     | Q2      | Q1     |  |  |
| Service Revenue Growth | 19.8 %  | 3.7 % | 20.1 % | 24.0 % | 10.3 %  | 10.1 % |  |  |

Within the calibration industry, there is a broad array of measurement disciplines making it costly and inefficient for any one provider to invest the needed capital for facilities, equipment and uniquely trained personnel necessary to address all measurement disciplines with in-house calibration capabilities. Our strategy has been to focus our investments in the core electrical, temperature, pressure and dimensional disciplines. Accordingly, over the



long-term, we expect to outsource 15% to 20% of Service segment revenue to third party vendors for calibration beyond our chosen scope of capabilities. During any individual quarter, we could fluctuate beyond these percentages. We will continue to evaluate the need for capital investments that could provide more in-house capabilities for our staff of technicians and reduce the need for third party vendors in certain instances. The following table presents the source of our Service segment revenue and the percent of Service segment revenue for each quarter during fiscal years 2013 and 2012:

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|                             | FY 2013 |         |         |         | FY 2012 |         |   |  |  |
|-----------------------------|---------|---------|---------|---------|---------|---------|---|--|--|
|                             | Q2      | Q1      | Q4      | Q3      | Q2      | Q1      |   |  |  |
| Percent of Service Revenue: |         |         |         |         |         |         |   |  |  |
| Depot/Onsite                | 82.6    | % 79.1  | % 80.5  | % 77.9  | % 79.0  | % 77.7  | % |  |  |
| Outsourced                  | 14.9    | % 18.3  | % 16.7  | % 19.7  | % 18.5  | % 19.8  | % |  |  |
| Freight Billed to Customers | 2.5     | % 2.6   | % 2.8   | % 2.4   | % 2.5   | % 2.5   | % |  |  |
|                             | 100.0   | % 100.0 | % 100.0 | % 100.0 | % 100.0 | % 100.0 | % |  |  |

Gross Profit:

|               | Second Quarter Ended |                    |
|---------------|----------------------|--------------------|
|               | September 29, 2012   | September 24, 2011 |
| Gross Profit: |                      |                    |
| Product       | \$ 3,723             | \$ 4,311           |
| Service       | 2,355                | 1,842              |
| Total         | \$ 6,078             | \$ 6,153           |

Total gross profit in the second quarter of fiscal year 2013 decreased \$0.1 million, or 1.2%, from the second quarter of fiscal year 2012. Total gross margin in the second quarter of fiscal year 2013 decreased 170 basis points from the second quarter of fiscal year 2012.

We evaluate product gross profit from two perspectives. Channel gross profit includes net sales less the direct cost of inventory sold. Our total product gross profit includes channel gross profit as well as the impact of vendor rebates, cooperative advertising income, freight billed to customers, freight expenses and direct shipping costs. In general, our product gross margin can vary based upon the mix of products sold, price discounting and the timing of periodic vendor rebates and cooperative advertising income received from suppliers.

Product segment gross profit declined \$0.6 million, or 13.6%, in the second quarter of fiscal year 2013 compared to the second quarter of fiscal year 2012. As a percentage of product sales, gross profit decreased to 22.0% in the second quarter of fiscal year 2013 compared with 25.4% in the second quarter of fiscal year 2012. Our product gross profit includes a point-of-sale rebate program with a key vendor that is based on Product segment sales growth on a calendar year-over-year basis. We experienced a decrease in our annual rebates which caused declines in our Product segment gross profit and gross margin. The following table reflects the quarterly historical trend of our product gross margin:

|                                | FY 2013 |        |        |        | FY 2012 |        |   |  |
|--------------------------------|---------|--------|--------|--------|---------|--------|---|--|
|                                | Q2      | Q1     | Q4     | Q3     | Q2      | Q1     |   |  |
| Channel Gross Margin (1)       | 21.5    | % 22.7 | % 23.3 | % 22.5 | % 23.1  | % 23.0 | % |  |
| Total Product Gross Margin (2) | 22.0    | % 25.7 | % 24.7 | % 25.6 | % 25.4  | % 24.8 | % |  |

(1) Channel gross margin is calculated as net sales less purchase costs divided by net sales.

(2) Includes vendor rebates, cooperative advertising income, freight billed to customers, freight expenses, and direct shipping costs.

Service segment gross profit increased \$0.5 million, or 27.9%, from the second quarter of fiscal year 2012 to the second quarter of fiscal year 2013. Service segment gross margin increased 150 basis points over the same time period as a result of strong organic revenue growth combined with incremental revenue from acquired businesses. Because the timing of calibration orders and segment expenses can vary on a quarter-to-quarter basis, we believe a trailing twelve month trend provides a better indication of the progress of this segment. Service segment gross profit

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for the twelve months ended September 29, 2012 was \$9.1 million, up 11.1% when compared with \$8.2 million for the twelve months ended September 24, 2011. Service segment gross margin was 23.7% and 24.9% for the twelve months ended September 29, 2012 and September 24, 2011, respectively. The following table reflects the quarterly historical trend of our calibration services gross margin as a percent of service revenues:

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|                      | FY 2013 |        |        | FY 2012 |        |        |
|----------------------|---------|--------|--------|---------|--------|--------|
|                      | Q2      | Q1     | Q4     | Q3      | Q2     | Q1     |
| Service Gross Margin | 23.9    | % 22.9 | % 27.3 | % 20.1  | % 22.4 | % 24.1 |

Operating Expenses:

|                                  | Second Quarter Ended |                    |
|----------------------------------|----------------------|--------------------|
|                                  | September 29, 2012   | September 24, 2011 |
| Operating Expenses:              |                      |                    |
| Selling, Marketing and Warehouse | \$ 2,959             | \$ 3,042           |
| Administrative                   | 1,939                | 1,870              |
| Total                            | \$ 4,898             | \$ 4,912           |

Operating expenses in the second quarter of fiscal year 2013 were consistent with the second quarter of fiscal year 2012. As a percentage of total revenue, operating expenses were 18.3% and 19.5% in the second quarter of fiscal years 2013 and 2012, respectively.

Taxes:

|                            | Second Quarter Ended |                    |
|----------------------------|----------------------|--------------------|
|                            | September 29, 2012   | September 24, 2011 |
| Provision for Income Taxes | \$ 384               | \$ 457             |

Our effective tax rates for the second quarter of fiscal years 2013 and 2012 were 34.0% and 38.0%, respectively. We continue to evaluate our tax provision on a quarterly basis and make adjustments, as deemed necessary, to our effective tax rate given changes in facts and circumstances expected for the entire fiscal year.

SIX MONTHS ENDED SEPTEMBER 29, 2012 COMPARED TO SIX MONTHS ENDED SEPTEMBER 24, 2011  
(dollars in thousands):

Revenue:

|                 | Six Months Ended   |                    |
|-----------------|--------------------|--------------------|
|                 | September 29, 2012 | September 24, 2011 |
| Revenue:        |                    |                    |
| Product Sales   | \$ 33,313          | \$ 34,151          |
| Service Revenue | 18,572             | 16,637             |
| Total Revenue   | \$ 51,885          | \$ 50,788          |

Total revenue increased \$1.1 million, or 2.2%, from the first six months of fiscal year 2012 to the first six months of fiscal year 2013. Revenue increases in the Service segment were partially offset by lower sales in the Product segment.

Our product sales accounted for 64.2% and 67.2% of our total revenue in the first six months of fiscal years 2013 and 2012, respectively. For the first six months of fiscal year 2013, product sales decreased \$0.8 million, or 2.5%, compared with the first six months of fiscal year 2012. Sales to both direct and reseller customers declined, reflecting economic conditions and unusually strong product sales, due to opportunistic orders, in the first half of fiscal year 2012.

Service revenue increased \$1.9 million, or 11.6%, from the first six months of fiscal year 2012 to the first six months of fiscal year 2013. The growth is attributed to higher organic revenue combined with incremental revenue from recent acquisitions, partially offset by the loss of \$0.6 million in low margin revenue from services that we were outsourcing for a customer.

## Gross Profit:

|               | Six Months Ended         |                       |
|---------------|--------------------------|-----------------------|
|               | September<br>29,<br>2012 | September 24,<br>2011 |
| Gross Profit: |                          |                       |
| Product       | \$7,933                  | \$ 8,579              |
| Service       | 4,352                    | 3,872                 |
| Total         | \$12,285                 | \$ 12,451             |

Total gross profit in the first six months of fiscal year 2013 decreased \$0.2 million, or 1.3%, from the first six months of fiscal year 2012. Total gross margin declined 80 basis points in the first six months of fiscal year 2013 compared to the same time period in the previous fiscal year.

Product gross margin in the first six months of fiscal year 2013 was 23.8% and declined 130 basis points when compared with 25.1% in the first six months of fiscal year 2012. Product gross profit decreased \$0.6 million in the first six months of fiscal year 2013 compared to the first six months of fiscal year 2012, as a result of a decline in manufacturer rebates as well as increased price discounts extended to customers, partially offset by an increase in cooperative advertising income.

Service segment gross profit increased \$0.5 million, or 12.4%, from the first six months of fiscal year 2012 to the first six months of fiscal year 2013. Service segment gross margin increased 10 basis points over the same time period to 23.4%. Revenue growth in the Service segment reflected incremental revenue from acquisitions, which provided limited margin expansion opportunity.

## Operating Expenses:

|                                  | Six Months Ended         |                       |
|----------------------------------|--------------------------|-----------------------|
|                                  | September<br>29,<br>2012 | September 24,<br>2011 |
| Operating Expenses:              |                          |                       |
| Selling, Marketing and Warehouse | \$6,400                  | \$ 6,668              |
| Administrative                   | 4,111                    | 3,972                 |
| Total                            | \$10,511                 | \$ 10,640             |

Operating expenses declined \$0.1 million from the first six months of fiscal year 2012 to the first six months of fiscal year 2013. As a percentage of total revenue, operating expenses during the first six month of fiscal year 2013 were 20.3%, down from 20.9% in the first six months of fiscal year 2012 reflecting lower performance-based compensation and acquisition-related expenses, partially offset by a one-time Service segment sales organization restructuring charge and increased investments in sales and marketing activities.

## Taxes:

|                            | Six Months Ended         |                       |
|----------------------------|--------------------------|-----------------------|
|                            | September<br>29,<br>2012 | September 24,<br>2011 |
| Provision for Income Taxes | \$570                    | \$ 657                |

Our effective tax rates for the first six months of fiscal years 2013 and 2012 were 34.0% and 38.0%, respectively. We continue to evaluate our tax provision on a quarterly basis and make adjustments, as deemed necessary, to our effective tax rate given changes in facts and circumstances expected for the entire fiscal year.

#### LIQUIDITY AND CAPITAL RESOURCES

On September 20, 2012, we entered into a new three-year revolving credit facility in the amount of \$20.0 million. We believe that amounts available under our new credit facility and our cash on hand are sufficient to satisfy our expected working capital and capital expenditure needs as well as our lease commitments for the foreseeable future.

Cash Flows: The following table is a summary of our Consolidated Statements of Cash Flows:

|                             | Six Months Ended   |                    |
|-----------------------------|--------------------|--------------------|
|                             | September 29, 2012 | September 24, 2011 |
| Cash Provided by (Used in): |                    |                    |
| Operating Activities        | \$654              | \$ 892             |
| Investing Activities        | (4,475 )           | (4,022 )           |
| Financing Activities        | 3,987              | 3,158              |

Operating Activities: Net cash provided by operations was \$0.7 million for the first six months of fiscal year 2013 compared to \$0.9 million in the first six months of fiscal year 2012. Significant working capital fluctuations were as follows:

- **Accounts Receivable:** The higher accounts receivable balance as of September 29, 2012 compared to the balance as of September 24, 2011 is reflective of an increase in quarterly revenues. In addition, our quarter-end days sales outstanding reflects improved collections. The following table illustrates our days sales outstanding for the fiscal quarters ended September 29, 2012 and September 24, 2011:

|   | September 29, 2012 | September 24, 2011 |
|---|--------------------|--------------------|
| Net Sales, for the last two fiscal months | \$ 19,340          | \$ 18,065          |
| Accounts Receivable, net                  | \$ 12,466          | \$ 11,988          |
| Days Sales Outstanding                    | 39                 | 40                 |

- **Inventory/Accounts Payable:** Our inventory balance at September 29, 2012 was \$7.1 million, an increase of \$0.7 million when compared to \$6.4 million on-hand at March 31, 2012. Our inventory strategy includes making appropriate larger quantity, higher dollar based purchases with key manufacturers for various reasons, including maximizing on-hand availability of key products, reducing backorders for those products with long lead times and optimizing vendor volume discounts. As a result, inventory levels from quarter-to-quarter will vary based on the timing of these larger orders in relation to the quarter-end. In general, our accounts payable balance increases or decreases as a result of timing of vendor payments for inventory receipts. However, this correlation may vary at a quarter-end due to the timing of vendor payments for inventory receipts and inventory shipped directly to customers, as well as the timing of product sales.

Investing Activities: During the first six months of fiscal years 2013 and 2012, we invested \$1.3 million and \$0.9 million, respectively, primarily for additional service capabilities and technology and infrastructure improvements. We also invested \$3.1 million on business acquisitions during the first six months of fiscal years 2013 and 2012. See Note 5 of our Consolidated Financial Statements in this report for more information on acquisitions.

Financing Activities: During the first six months of fiscal years 2013 and 2012, financing activities provided approximately \$4.0 million and \$3.2 million, respectively, primarily to fund business acquisitions.

## OUTLOOK

As we look toward the second half of our fiscal year, we expect that growth in our Product segment will continue to be challenged due to economic uncertainty. Given the current state of the marketplace, we anticipate competitive pricing will continue, putting pressure on segment margins.



Looking at the balance of our fiscal year, our Service segment revenue, inclusive of our recent acquisition, should continue to generate double-digit growth based on organically generated and acquired revenue. With a strategic focus on increasing cash flow and executing our acquisition strategy, we believe we can leverage our existing infrastructure to continue delivering improved Service segment operating income.

### ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

#### INTEREST RATES

Our exposure to changes in interest rates results from our borrowing activities. In the event interest rates were to move by 1%, our yearly interest expense would increase or decrease by less than \$0.1 million assuming our average borrowing levels remained constant. As of September 29, 2012, \$20.0 million was available under our credit facility, of which \$7.2 million was outstanding and included in long-term debt on the Consolidated Balance Sheet.

We mitigate our interest rate risk by electing to borrow from our credit facility at the one-month LIBOR, adjusting daily, or a fixed rate for a designated period at the LIBOR corresponding to such period, in each case, plus a margin. Our interest rate margin is determined on a quarterly basis based upon our calculated leverage ratio. As of September 29, 2012, the one-month LIBOR was 0.2%. Our interest rate for the first six months of fiscal year 2013 ranged from 1.1% to 2.8%. On September 29, 2012, we had no hedging arrangements in place to limit our exposure to upward movements in interest rates.

#### FOREIGN CURRENCY

Over 90% of our net revenue for the first six months of fiscal years 2013 and 2012 was denominated in U.S. dollars, with the remainder denominated in Canadian dollars. A 10% change in the value of the Canadian dollar to the U.S. dollar would impact our net revenue by less than 1%. We monitor the relationship between the U.S. and Canadian currencies on a continuous basis and adjust sales prices for products and services sold in Canadian dollars as we believe to be appropriate.

We utilize foreign exchange forward contracts to reduce the risk that future earnings would be adversely affected by changes in currency exchange rates. We do not apply hedge accounting and therefore the change in the fair value of the contracts, which totaled less than \$0.1 million during the first six months of fiscal years 2013 and 2012, was recognized as a component of other expense in the Consolidated Statements of Operations. The change in the fair value of the contracts is offset by the change in fair value on the underlying accounts receivables denominated in Canadian dollars being hedged. On September 29, 2012, we had a foreign exchange forward contract, which matured in October 2012, outstanding in the notional amount of \$1.8 million. We do not use hedging arrangements for speculative purposes.

### ITEM 4. CONTROLS AND PROCEDURES

(a) **Conclusion Regarding the Effectiveness of Disclosure Control and Procedures:** Our principal executive officer and our principal financial officer evaluated our disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) as of the end of the period covered by this quarterly report. Disclosure controls and procedures are designed to ensure that information required to be disclosed in our reports filed under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms and that such information is accumulated and communicated to our principal executive officer and principal financial officer to allow timely decisions regarding required disclosure. Based on this evaluation, our principal executive officer and our principal financial officer concluded that our disclosure controls and procedures were effective as of such date.

(b) **Changes in Internal Control over Financial Reporting:** There has been no change in our internal control over financial reporting that occurred during the last fiscal quarter covered by this quarterly report (our second fiscal quarter) that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

ITEM 6. EXHIBITS

See Index to Exhibits.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

TRANSCAT, INC.

Date: November 9, 2012

/s/ Charles P. Hadeed  
Charles P. Hadeed  
Chief Executive Officer  
(Principal Executive Officer)

Date: November 9, 2012

/s/ John J. Zimmer  
John J. Zimmer  
Senior Vice President of Finance and Chief Financial  
Officer  
(Principal Financial Officer and Principal Accounting  
Officer)

INDEX TO EXHIBITS

|       |   |  |
|-------|---|--|
| (10)  | Material contracts                      |  |
|       | 10.1                                    | Credit Facility Agreement dated as of September 20, 2012 by and between Transcat, Inc. and Manufacturers and Traders Trust Company   |
|       | 10.2                                    | Master Security Agreement dated September 20, 2012 by and between Transcat, Inc., United Scale & Engineering Corporation, WTT Real Estate Acquisition Corp., Anacor Acquisition, LLC and Manufacturers and Traders Trust Company |
| (31)  | Rule 13a-14(a)/15d-14(a) Certifications |  |
|       | 31.1                                    | Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002   |
|       | 31.2                                    | Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002   |
| (32)  | Section 1350 Certifications             |  |
|       | 32.1                                    | Certification Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002  |
| (101) | Interactive Data File                   |  |
|       | * 101.INS                               | XBRL Instance Document   |
|       | * 101.SCH                               | XBRL Taxonomy Extension Schema Document  |
|       | * 101.CAL                               | XBRL Taxonomy Extension Calculation Linkbase Document  |
|       | * 101.DEF                               | XBRL Taxonomy Extension Definition Linkbase Document   |
|       | * 101.LAB                               | XBRL Taxonomy Extension Label Linkbase Document  |
|       | * 101.PRE                               | XBRL Taxonomy Extension Presentation Linkbase Document   |

\*Pursuant to Rule 406T of Regulation S-T, the information in this exhibit is deemed not filed or part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933, as amended, is deemed not filed for purposes of Section 18 of the Securities and Exchange Act of 1934, as amended, and otherwise is not subject to liability under these sections.