

MICROPAC INDUSTRIES INC  
Form 10-Q  
April 11, 2017

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 February 25, 2017*

**OR**

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

Commission File Number 0-5109

**MICROPAC INDUSTRIES, INC.**

Delaware  
(State of Incorporation)

75-1225149  
(IRS Employer Identification No.)

905 E. Walnut, Garland, Texas  
(Address of Principal Executive Office)

75040  
(Zip Code)

Registrant's Telephone Number, including Area Code (972) 272-3571

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

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

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

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

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

On April 10, 2017 there were 2,578,315 shares of Common Stock, \$0.10 par value outstanding.

**MICROPAC INDUSTRIES, INC.**

**FORM 10-Q**

**February 25, 2017**

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**PART I - FINANCIAL INFORMATION****ITEM 1. FINANCIAL STATEMENTS****MICROPAC INDUSTRIES, INC.****CONDENSED BALANCE SHEETS**

(Dollars in thousands)

**ASSETS**

CURRENT ASSETS	<u>2/25/17</u>	<u>11/30/16</u>
	(Unaudited)	
Cash and cash equivalents	\$9,160	\$10,012
Short-term investments	2,017	2,014
Receivables, net of allowance for doubtful accounts of \$0 at February 25, 2017 and November 30, 2016	2,523	2,177
Inventories:		
Raw materials and supplies	3,978	4,179
Work-in process	3,547	3,438
Total inventories	7,525	7,617
Prepaid income tax	527	521
Prepaid expenses and other assets	135	152
Total current assets	21,887	22,493
PROPERTY, PLANT AND EQUIPMENT, at cost:		
Land	80	80
Buildings	498	498
Facility improvements	1,109	1,109
Furniture and fixtures	669	669
Construction in process equipment	418	401
Machinery and equipment	8,565	8,565
Total property, plant, and equipment	11,339	11,322
Less accumulated depreciation	(9,207 )	(9,136 )
Net property, plant, and equipment	2,132	2,186
Deferred income taxes	273	273
Total assets	\$24,292	\$24,952

## LIABILITIES AND SHAREHOLDERS' EQUITY

## CURRENT LIABILITIES:

Accounts payable	\$429	\$612
Accrued compensation	420	454
Deferred revenue	1,179	1,282
Property Taxes	15	94
Other accrued liabilities	108	98
Total current liabilities	2,151	2,540

## SHAREHOLDERS' EQUITY

Common stock, \$.10 par value, authorized 10,000,000 shares, 3,078,315 issued and 2,578,315 outstanding at February 25, 2017 and November 30, 2016	308	308
Additional paid-in capital	885	885
Treasury stock, 500,000 shares, at cost	(1,250 )	(1,250 )
Retained earnings	22,198	22,469
Total shareholders' equity	22,141	22,412
Total liabilities and shareholders' equity	\$24,292	\$24,952

See accompanying notes to financial statements.

**MICROPAC INDUSTRIES, INC.****CONDENSED STATEMENTS OF OPERATIONS**

(Dollars in thousands except share data)

(Unaudited)

	<u>Three months ended</u>	
	<u>02/25/17</u>	<u>02/27/16</u>
NET SALES	\$3,908	\$4,205
<b>COST AND EXPENSES:</b>		
Cost of goods sold	(2,502 )	(2,894 )
Research and development	(440 )	(307 )
Selling, general & administrative expenses	(989 )	(1,003 )
Total cost and expenses	(3,931 )	(4,204 )
OPERATING (LOSS) INCOME	(23 )	1
Other income	4	7
Expense, net	(1 )	—
(LOSS) INCOME BEFORE TAXES	(20 )	8
Provision for taxes	7	(3 )
NET (LOSS) INCOME	\$(13 )	\$5
NET (LOSS) INCOME PER SHARE, BASIC AND DILUTED	\$(0.01 )	\$0.00
DIVIDENDS PER SHARE	\$0.10	\$0.10
WEIGHTED AVERAGE OF SHARES, basic and diluted	2,578,315	2,578,315

See accompanying notes to financial statements.

**MICROPAC INDUSTRIES, INC.****CONDENSED STATEMENTS OF CASH FLOWS**

(Dollars in thousands)

(Unaudited)

	<u>Three months</u> <u>ended</u>	
	<u>2/25/17</u>	<u>2/27/16</u>
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net (loss) income	\$ (13 )	\$ 5
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation	71	74
Changes in certain current assets and liabilities		
Accounts receivable	(346 )	(5 )
Inventories	92	105
Prepaid expense and other current assets	17	18
Prepaid income taxes	(6 )	—
Deferred revenue	(103 )	(134 )
Accounts payable	(200 )	62
Accrued compensation	(34 )	(255 )
Other accrued liabilities	(69 )	(49 )
Income taxes payable	—	(107 )
Net cash (used) provided by operating activities	(591 )	(286 )
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Sale of short term investments	2,014	2,004
Purchase of short term investments	(2,017 )	(2,007 )
Additions to property, plant and equipment	—	(14 )
Net cash used in investing activities	(3 )	(17 )
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Cash dividend	(258 )	(258 )
Net cash used in financing activities	(258 )	(258 )

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Net change in cash and cash equivalents	(852 )	(561 )
Cash and cash equivalents at beginning of period	10,012	12,651
Cash and cash equivalents at end of period	\$ 9,160	\$12,090
Supplemental Cash Flow Disclosure:		
Cash paid for income taxes	\$ —	\$110
Supplemental Non Cash Flow Disclosure:		
Accrued additions to equipment	\$ 17	\$(14)

See accompanying notes to financial statements.

**MICROPAC INDUSTRIES, INC.**

**NOTES TO CONDENSED FINANCIAL STATEMENTS**

(Unaudited)

**Note 1 BASIS OF PRESENTATION**

**Business Description**

Micropac Industries, Inc. (the “Company”), a Delaware corporation, manufactures and distributes various types of hybrid microelectronic circuits, solid state relays, power controllers, and optoelectronic components and assemblies. The Company’s products are used as components in a broad range of military, space and industrial systems, including aircraft instrumentation and navigation systems, power supplies, electronic controls, computers, medical devices, and high-temperature (200° C) products.

In the opinion of management, the unaudited financial statements include all adjustments (consisting of only normal, recurring adjustments) necessary to present fairly the financial position as of February 25, 2017, the results of operations and cash flows for the three months ended February 25, 2017 and February 27, 2016. Unaudited financial statements are prepared on a basis substantially consistent with those audited for the year ended November 30, 2016. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles in the United States have been condensed or omitted pursuant to the rules and regulations promulgated by the Securities and Exchange Commission. The Company’s fiscal year ends on the last day of November. The quarterly results end on the last Saturday of the quarter.

It is suggested that these financial statements be read in conjunction with the November 30, 2016 Form 10-K filed with the SEC, including the audited financial statements and the accompanying notes thereto.

**Note 2 SIGNIFICANT ACCOUNTING POLICIES**

**Use of Estimates**

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management 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 the financial statements and the reported amounts of sales and expenses during the reporting period. Actual results could differ from those estimates.

### **Revenue Recognition**

Sales are recorded as shipments are made based upon contract prices. Any losses anticipated on fixed price contracts are provided for currently. Sales are recorded net of sales returns, allowances and discounts.

The Company recognizes sales when four basic criteria must be met: (1) persuasive evidence of an arrangement exists; (2) shipment has occurred or services have been rendered; (3) the fee is fixed and determinable; and (4) collectibility is reasonably assured.

Deferred revenue represents prepayments from customers and will be recognized as sales when the products are shipped per the terms of the contract.

### **Short-Term Investments**

The Company has \$2,017,000 in short term investments at February 25, 2017. Short-term investments consist of certificates of deposits with initial maturities greater than 90 days. These investments are reported at historical cost, which approximates fair value. All highly liquid investments with initial maturities of 90 days or less are classified as cash equivalents. All short-term investments are securities which the Company has the ability and intent to hold to maturity and mature within one year.

### **Inventories**

Inventories are stated at lower of cost or market value and include material, labor and manufacturing overhead. All inventories are valued using the FIFO (first-in, first-out) method of inventory valuation. The Company determines the need to write inventory down below its cost via an analysis based on the usage of inventory over a three year period and projected usage based on current backlog.



### **Income Taxes**

The Company accounts for income taxes using the asset and liability method. Under this method the Company records deferred income taxes for the temporary differences between the financial reporting basis and the tax basis of assets and liabilities at enacted tax rates expected to be in effect when such amounts are realized or settled. The resulting deferred tax liabilities and assets are adjusted to reflect changes in tax law or rates in the period that includes the enactment date.

### **Property, Plant, and Equipment**

Property, plant, and equipment are carried at cost, and depreciation is provided using the straight-line method at rates based upon the following estimated useful lives (in years) of the assets:

Buildings	15
Facility improvements	8-15
Machinery and equipment	5-10
Furniture and fixtures	5-8

The Company assesses long-lived assets for when events or circumstances indicate that an asset may be impaired. The estimated future undiscounted cash flows associated with the asset are compared to the asset's net book value to determine if a write down to market value less cost to sell is required.

Repairs and maintenance are expensed as incurred. Improvements which extend the useful life of property, plant, and equipment are capitalized.

### **Research and Development Costs**

Costs for the design and development of new products and processes are expensed as incurred.

### **Note 3 NEW ACCOUNTING PRONOUNCEMENTS**

On May 28, 2014, the FASB issued ASU No. 2014-09, *Revenue from Contracts with Customers*, which requires an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods and services to customers. The ASU will replace most existing revenue recognition guidance in U.S. GAAP when it becomes effective. The standard permits the use of either the retrospective or cumulative effect transition method. The Company is evaluating the effect that ASU 2014-09 will have on its consolidated financial statements and related disclosures. On July 9, 2015 the FASB agreed to defer the effective date to annual reporting periods beginning after December 15, 2017 and the interim periods within that year. The Company has not yet selected a transition method nor has it determined the effect of the standard on its ongoing financial reporting. The standard will be effective for the Company for fiscal year November 30, 2019.

In November 2015, the FASB issued ASU No. 2015-17, *Income Taxes (Topic 740): Balance Sheet Classification of Deferred Taxes*. The ASU requires entities to classify deferred tax liabilities and assets as noncurrent in a classified statement of financial position. This ASU is effective for fiscal years beginning after December 15, 2016, and interim periods within those annual periods. Early adoption is permitted for all entities as of the beginning of an interim or annual reporting period. We early adopted this guidance as of December 1, 2016. Our adoption of this guidance did not have a material impact on our consolidated financial statements. We reclassified \$417 thousand of noncurrent deferred tax liability from noncurrent liability to reduce the carrying value of deferred tax assets as of November 30, 2016 to conform to current financial statement presentation.

In July 2015, the FASB issued ASU No. 2015-11, *Inventory (Topic 330): Simplifying the Measurement of Inventory*. This ASU does not apply to inventory that is measured using last-in, first-out (LIFO) or the retail inventory method. The amendments apply to all other inventory, which includes inventory that is measured using first-in, first-out (FIFO) or average cost. This ASU eliminates from GAAP the requirement to measure inventory at the lower of cost or market. Market under the previous requirement could be replacement cost, net realizable value, or net realizable value less an approximately normal profit margin. Entities within scope of this update will now be required to measure inventory at the lower of cost and net realizable value. Net realizable value is the estimated selling prices in the ordinary course of business, less reasonably predictable costs of completion, disposal, and transportation. Subsequent measurement is unchanged for inventory using LIFO or the retail inventory method. The amendments in this update are effective for fiscal years beginning after December 15, 2016, with early adoption permitted, and should be applied prospectively. The Company does not expect the adoption of this guidance to have a material impact on its consolidated financial statements.

In February 2016, the FASB issued Accounting Standards Update (ASU) 2016-02, Leases (Topic 842). Under the new standard, lessees will be required to recognize lease assets and liabilities for all leases, with certain exceptions, on their balance sheets. Public business entities<sup>1</sup> are required to adopt the standard for reporting periods beginning after December 15, 2018. The Company does not expect the adoption of this guidance to have a material impact on its consolidated financial statements.

#### **Note 4 FAIR VALUE MEASUREMENT**

The Company had no financial assets or liabilities measured at fair value on a recurring basis as of February 25, 2017 and November 30, 2016. The fair value of financial instruments such as cash and cash equivalents, short term investments, accounts receivable, and accounts payable approximate their carrying amount based on the short maturity of these instruments. There were no nonfinancial assets measured at fair value on a nonrecurring basis at February 25, 2017 and November 30, 2016.

#### **Note 5 COMMITMENTS**

On April 23, 2016, the Company renewed the Loan Agreement with a Texas banking institution. The Loan Agreement provides for revolving credit loans, in amounts not to exceed a total principal balance of \$6,000,000, and specific advance loans for acquisitions with an aggregate amount not to exceed \$7,500,000 in a single advance or in multiple advances. The Loan Agreement also contains financial covenants to maintain at all times including (i) minimum working capital of not less than \$4,000,000, (ii) a ratio of senior funded debt, minus the Company's balance sheet cash on hand to the extent in excess of \$2,000,000 to EBITDA of not more than 3.0 to 1.0, and (iii) a ratio of free cash flow to debt service of not less than 1.2 to 1.0. The Company has not, to date, drawn any amounts under the loan agreement or the revolving line of credit and is currently in compliance with the financial covenants.

#### **Note 6 EARNINGS PER COMMON SHARE**

Basic and diluted earnings per share are computed based upon the weighted average number of shares outstanding during the respective periods. Diluted earnings per share gives effect to all dilutive potential common shares. For the three months ended February 25, 2017 and February 27, 2016, the Company had no dilutive potential common stock.

**Note 7 SHAREHOLDERS' EQUITY**

On December 15, 2015, the Board of Directors of Micropac Industries, Inc. approved the payment of a special dividend of \$0.10 per share for shareholders of record as of January 12, 2016. The dividend was paid to shareholders on February 11, 2016.

On December 13, 2016, the Board of Directors of Micropac Industries, Inc. approved the payment of a special dividend of \$0.10 per share for shareholders of record as of January 10, 2017. The dividend was paid to shareholders on February 9, 2017.

**MICROPAC INDUSTRIES, INC.**

(Unaudited)

**ITEM MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS  
2. OF OPERATIONS**

**Business**

Micropac Industries, Inc. (the “Company”), a Delaware corporation, manufactures and distributes various types of hybrid microelectronic circuits, solid state relays, power management products, and optoelectronic components and assemblies. The Company’s products are used as components in a broad range of military, space and industrial systems, including aircraft instrumentation and navigation systems, power supplies, electronic controls, computers, medical devices, and high-temperature (200° C) products. The Company’s products are either custom (being application specific circuits designed and manufactured to meet the particular requirements of a single customer) or standard, proprietary components such as catalog items.

The Company’s facilities are certified and qualified by Defense Logistics Agency (DLA) to MIL-PRF-38534 (class K-space level), MIL-PRF-19500 JANS (space level) and is certified to ISO 9001-2002. Micropac is a NASA core supplier, and is registered to AS9100-Aerospace Industry standard for supplier certification. The Company has UL approval on the new isolated solid state industrial power controllers.

The Company’s core technology is the packaging and interconnecting of miniature electronic components, utilizing thick film substrates, forming microelectronics circuits. Other technologies include light emitting and light sensitive materials and products, including light emitting diodes and silicon phototransistors used in the Company’s optoelectronic components and assemblies

**Results of Operations**

	<u>Three months ended</u>			
	<u>2/25/2017</u>		<u>2/27/2016</u>	
NET SALES	100.0	%	100.0	%

## COST AND EXPENSES:

Cost of Goods Sold	64.0	%	68.9	%
Research and development	11.3	%	7.3	%
Selling, general & administrative expenses	25.3	%	23.8	%
Total cost and expenses	100.6	%	100.0	%
OPERATING INCOME	(0.6	)%	0.0	%
Other income	0.1	%	0.2	%
INCOME BEFORE TAXES	(0.5	)%	0.2	%
Provision for taxes	0.2	%	0.1	%
NET INCOME	(0.3	)%	0.1	%

Sales for the first quarter ended February 25, 2017 totaled \$3,908,000. Sales for the first quarter decreased 7.0% or \$297,000 below sales for the first quarter of 2016 primarily due to a decrease in sales to one customer's custom product. Sales were 12% in the commercial market, 62% in the military market, and 26% in the space market in the first quarter of 2017 compared to 18% in the commercial market, 67% in the military market, and 15% in the space market for the same period of 2016.

Two customers accounted for 11% and 10% of the Company's sales for the first quarter of 2017 and 2016.

Cost of goods sold for the first quarter of 2017 and 2016 totaled 64.0% and 68.9% of net sales, respectively. Cost of goods sold decreased \$392,000 in the first quarter of 2017 as compared to 2016 due to product mix and the decrease in sales to one customer's custom product.

Research and development cost increased \$133,000 for the first quarter of 2017 compared to the same period of 2016. The research and development expenditures were associated with the continued development of power management products, high voltage optocouplers and process automation improvements.

Selling, general and administrative expenses for the first quarter of 2017 totaled 25.3% of net sales, compared to 23.8% for the same period in 2016. Selling, general and administrative expenses decreased \$14,000 in the first quarter of 2017 as compared to 2016.

Provisions for taxes decreased \$10,000 for the first quarter of 2017 compared to the same period in 2016. The estimated effective tax rate was 32% for the first quarter of 2017 and 2016.

Income for the first quarter of 2017 was a net loss of \$13,000 compared to a net income of \$5,000 in the first quarter of 2016, a decrease of \$18,000 from the first quarter of 2016.

### **Liquidity and Capital Resources**

Cash and cash equivalents totaled \$9,160,000 as of February 25, 2017 compared to \$10,012,000 on November 30, 2016, a decrease of \$852,000. The decrease in cash and cash equivalents is attributable to \$591,000 cash used in operations, a payment of a cash dividend of \$258,000 and net payments for short-term investment of \$3,000.

In addition to cash on hand, the Company also has the ability to borrow under a loan agreement as discussed in note 5 to the condensed financial statements.

### **Outlook**

New orders for the first quarter of 2017 totaled \$2,595,000 compared to \$2,837,000 for the comparable period of 2016. Backlog totaled \$15,787,000 on February 25, 2017 compared to \$17,558,000 as of February 27, 2016 and \$17,102,000 on November 30, 2016. The majority of the backlog is expected to be completed and shipped in the next twelve months.

The Company cannot assure that the results of operations for the interim period presented are indicative of total results for the entire year due to fluctuations in customer delivery schedules, or other factors over which the Company has no control.

**Cautionary Statement**

This Form 10-Q contains forward-looking statements that are made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. Actual results could differ materially. Investors are warned that forward-looking statements involve risks and unknown factors including, but not limited to, customer cancellation or rescheduling of orders, problems affecting delivery of vendor-supplied raw materials and components, unanticipated manufacturing problems and availability of direct labor resources.

The Company produces silicon phototransistors and light emitting diode die for use in certain military, standard and custom products. Fabrication efforts sometimes may not result in successful results, limiting the Company's ability to make timely delivery of these components. Competitors offer commercial level alternatives and our customers may purchase our competitors' products if the Company is not able to manufacture the products using these technologies to meet the customer demands. Approximately \$1,700,000 of the Company's backlog is dependent on these semiconductors.

The Company disclaims any responsibility to update the forward-looking statements contained herein, except as may be required by law.

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

Not applicable

**ITEM 4. CONTROLS AND PROCEDURES**

- (a) Evaluation of disclosure controls and procedures.

The Chief Executive Officer and Chief Financial Officer of the Company evaluated the Company's disclosure controls and procedures (as defined in Exchange Act Rule 13a-15) as of February 25, 2017 and, based on this evaluation, concluded that the Company's disclosure controls and procedures are functioning in an effective manner to ensure that the information required to be disclosed by the Company in the reports that it files or submits under the Exchange Act, is recorded, processed, summarized and reported, within the time periods specified in the SEC's rules and forms.

- (b) Changes in internal controls.

There has been no change in the Company's internal control over financial reporting that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting during the three month period ended February 25, 2017.

**PART II - OTHER INFORMATION**

**ITEM 1. LEGAL PROCEEDINGS**

The Company is not involved in any material current or pending legal proceedings.

**ITEM 1A RISK FACTORS**

Information about risk factors for the three months ended February 25, 2017 does not differ materially from that set forth in Part I, Item 1A, of our Annual Report on Form 10-K for the year ended November 30, 2016.

**ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

None

**ITEM 3. DEFAULTS UPON SENIOR SECURITIES**

None

**ITEM 4. MINE SAFETY DISCLOSURE**

Not Applicable

**ITEM 5. OTHER INFORMATION**

None

**ITEM 6. EXHIBITS**

(a) Exhibits

31.1 Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

31.2 Certification of Chief Accounting Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

32.1 Certification of Chief Executive Officer pursuant to 18 U.S.C. section 1350, as adopted pursuant to section 906 of the Sarbanes-Oxley act of 2002.

32.2 Certification of Chief Accounting Officer pursuant to 18 U. S. C. section 1350, as adopted pursuant to section 906 of the Sarbanes-Oxley act of 2002.

**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 duly authorized.

MICROPAC INDUSTRIES, INC.

April 11, 2017

Date            /s/ Mark King  
Mark King  
Chief Executive Officer

April 11, 2017

Date            /s/ Patrick Cefalu  
Patrick Cefalu  
  
Chief Financial Officer

