

MICROPAC INDUSTRIES INC  
Form 10-Q  
October 14, 2014

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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 August 30, 2014  
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 75-1225149  
(State of Incorporation) (IRS Employer Identification No.)

905 E. Walnut, Garland, Texas 75040  
(Address of Principal Executive Office) (Zip Code)

Registrant's Telephone Number, including (972) 272-3571  
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 x No o

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 x No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See 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)

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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 October 13, 2014 there were 2,578,315 shares of Common Stock, \$.10 par value outstanding.

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MICROPAC INDUSTRIES, INC.

FORM 10-Q

August 30, 2014

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## PART I - FINANCIAL INFORMATION

## ITEM 1 - FINANCIAL STATEMENTS

MICROPAC INDUSTRIES, INC.  
CONDENSED BALANCE SHEETS  
(Dollars in thousands)

ASSETS	08/30/14	11/30/13
	(Unaudited)	
<b>CURRENT ASSETS</b>		
Cash and cash equivalents	\$10,206	\$9,263
Short-term investments	2,008	2,006
Receivables, net of allowance for doubtful accounts of \$2 at August 30, 2014 and at November 30, 2013	2,508	2,946
Inventories:		
Raw materials and supplies	2,980	2,968
Work-in process	2,184	2,901
Total inventories	5,164	5,869
Deferred income taxes	597	738
Prepaid income tax	207	2
Prepaid expenses and other assets	215	171
Total current assets	20,905	20,995
<b>PROPERTY, PLANT AND EQUIPMENT, at cost:</b>		
Land	80	80
Buildings	498	498
Facility improvements	1,109	1,074
Machinery and equipment	8,334	8,171
Furniture and fixtures	702	677
Total property, plant, and equipment	10,723	10,500
Less accumulated depreciation	(8,775)	(8,537)
Net property, plant, and equipment	1,948	1,963
Total assets	\$22,853	\$22,958
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>CURRENT LIABILITIES:</b>		
Accounts payable	\$585	\$713
Accrued compensation	525	597
Deferred revenue	169	622
Other accrued liabilities	199	209
Income taxes payable	140	173
Total current liabilities	1,618	2,314
<b>DEFERRED INCOME TAXES</b>	440	454

SHAREHOLDERS' EQUITY

Common stock, (\$.10 par value), authorized 10,000,000 shares, 3,078,315 issued and 2,578,315 outstanding at August 30, 2014 and November 30, 2013	308		308
Additional paid-in capital	885		885
Treasury stock, 500,000 shares, at cost	(1,250	)	(1,250 )
Retained earnings	20,852		20,247
 Total shareholders' equity	 20,795		 20,190
 Total liabilities and shareholders' equity	 \$22,853		 \$22,958

See accompanying notes to financial statements.

MICROPAC INDUSTRIES, INC.  
CONDENSED STATEMENTS OF OPERATIONS  
(Dollars in thousands except share data)  
(Unaudited)

	Three months ended		Nine months ended	
	08/30/14	08/31/13	08/30/14	08/31/13
NET SALES	\$5,150	\$4,508	\$15,171	\$14,239
COST AND EXPENSES:				
Cost of goods sold	(3,390 )	(2,712 )	(9,373 )	(8,756 )
Research and development	(515 )	(380 )	(1,368 )	(1,153 )
Selling, general & administrative expenses	(983 )	(986 )	(3,089 )	(2,965 )
Total cost and expenses	(4,888 )	(4,078 )	(13,830 )	(12,874 )
OPERATING INCOME BEFORE INTEREST, OTHER INCOME AND INCOME TAXES	262	430	1,341	1,365
Interest (expense) income, net	14	21	8	22
INCOME BEFORE TAXES	\$276	\$451	\$1,349	\$1,387
Provision for taxes	(100 )	(162 )	(486 )	(499 )
NET INCOME	\$176	\$289	\$863	\$888
NET INCOME PER SHARE, BASIC AND DILUTED	\$0.07	\$0.11	\$0.33	\$0.34
DIVIDENDS PER SHARE	\$-	\$-	\$0.10	\$0.10
WEIGHTED AVERAGE OF SHARES, basic and diluted	2,578,315	2,578,315	2,578,315	2,578,315

See accompanying notes to financial statements.

MICROPAC INDUSTRIES, INC.  
CONDENSED STATEMENTS OF CASH FLOWS  
(Dollars in thousands)  
(Unaudited)

	Nine months ended	
	8/30/14	8/31/13
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net income	\$ 863	\$ 888
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	238	237
Deferred tax expense	127	135
Changes in certain current assets and liabilities		
Decrease (increase) in accounts receivable	438	(66 )
Decrease in inventories	705	310
(Increase) decrease in prepaid expenses and other current assets	(249 )	106
(Decrease) increase in deferred revenue	(453 )	342
Decrease accounts payable	(128 )	(141 )
Decrease in accrued compensation	(72 )	(6 )
Decrease in other accrued liabilities	(10 )	(15 )
Decrease in income taxes payable	(33 )	(51 )
Net cash provided by operating activities	1,426	1,739
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Proceeds from maturity of short term investment	4,011	-
Purchase of short term investment	(4,013 )	(2 )
Additions to property, plant and equipment	(223 )	(190 )
Net cash used in investing activities	(225 )	(192 )
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Cash dividend	(258 )	(258 )
Net cash used in financing activities	(258 )	(258 )
Net change in cash and cash equivalents	943	1,289
Cash and cash equivalents at beginning of period	9,263	7,415
Cash and cash equivalents at end of period	\$ 10,206	\$ 8,704
<b>Supplemental Cash Flow Disclosure:</b>		
Cash paid for income taxes	\$ 596	\$ 232



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 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 (200o 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 August 30, 2014, the results of operations for the three months and nine months ended August 30, 2014 and August 31, 2013, and the cash flows for the nine months ended August 30, 2014 and August 31, 2013. Unaudited financial statements are prepared on a basis substantially consistent with those audited for the year ended November 30, 2013. 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. However, management believes that the disclosures contained are adequate to make the information presented not misleading.

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 in accordance with Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) Subtopic 605-10-S99, Revenue Recognition (ASC 605-10-S99). ASC 605-10-S99 requires that four basic criteria must be met before sales can be recognized: (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 \$2,008,000 in short term investments at August 30, 2014. 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 impairment under ASC 360-10-35, Property, Plant and Equipment – Subsequent Measurement. When events or circumstances indicate that an asset may be impaired, an assessment is performed. 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 PRONOUNCEMENT

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 new standard is effective for the Company on December 1, 2017. Early application is not permitted. 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. The Company has not yet selected a transition method nor has it determined the effect of the standard on its ongoing financial reporting.

## Note 4 FAIR VALUE MEASUREMENT

The Company had no financial assets or liabilities measured at fair value on a recurring basis as of August 30, 2014 and November 30, 2013. 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 August 30, 2014 and November 30, 2013.

Note 5 COMMITMENTS

On January 23, 2013, the Company entered into a 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 and nine months ended August 30, 2014 and August 31, 2013, the Company had no dilutive potential common stock.

## Note 7 SHAREHOLDERS' EQUITY

On December 17, 2013, 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 15, 2014. The dividend was paid to the Company's shareholders on February 12, 2014.

On December 12, 2012, the Board of Directors of Micropac Industries, Inc. approved the payment of a \$0.10 per share special dividend to all shareholders of record as of January 15, 2013. The dividend was paid to shareholders on February 12, 2013.

## ITEM 2 - MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS 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 (200o 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 MIL-PRF-28750 (class K-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

	Three months ended		Nine months ended	
	8/30/2014	8/31/2013	8/30/2014	8/31/2013
NET SALES	100.0	% 100.0	% 100.0	% 100.0
COST AND EXPENSES:				
Cost of Goods Sold	65.8	% 60.2	% 61.8	% 61.5
Research and development	10.0	% 8.4	% 9.0	% 8.1
Selling, general & administrative expenses	19.1	% 21.9	% 20.4	% 20.8
Total cost and expenses	94.9	% 90.5	% 91.2	% 90.4
OPERATING INCOME BEFORE INTEREST AND INCOME TAXES	5.1	% 9.5	% 8.8	% 9.6

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Interest income	0.3	%	0.5	%	0.1	%	0.1	%
INCOME BEFORE TAXES	5.4	%	10.0	%	8.9	%	9.7	%
Provision for taxes	2.0	%	3.6	%	3.2	%	3.5	%
NET INCOME	3.4	%	6.4	%	5.7	%	6.2	%

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Sales for the three and nine month periods ended August 30, 2014 totaled \$5,150,000 and \$15,171,000, respectively. Sales for the third quarter increased \$642,000 compared to the same period of 2013, while sales for the first nine months of 2014 increased \$932,000 or 6.5% above the first nine months of 2013. The quarter to date increase was associated with higher sales of space level relay products and the year to date increase was associated with higher sales of space level relay products and one custom assembly product. Sales were 24% in the commercial market, 61% in the military market, and 15% in the space market for the nine months ended August 30, 2014 compared to 28% in the commercial market, 54% in the military market, and 18% in the space market for the nine months ended August 31, 2013.

Two customers accounted for 11% and 10% of the Company's sales for the three months ended August 30, 2014 and no customer accounted for 10% or more of the Company's sales for the nine months ended August 30, 2014. One customer accounted for 10% of the Company's sales for the three months ended August 30, 2013 and no customer accounted for 10% or more of the Company's sales for the nine months ended August 30, 2013

Cost of goods sold for the third quarters of 2014 and 2013 totaled 65.8% and 60.2% of net sales, respectively, while cost of goods sold for the nine months ended August 30, 2014 and August 31, 2013 totaled 61.8% and 61.5% of net sales, respectively. The increase in the third quarter cost of goods sold resulted from additional cost with lower yields on light emitting diode die produced in the Company's front end manufacturing area and one standard solid state relay product.

Research and development expense increased \$135,000 for the third quarter of 2014 versus 2013 and increased \$215,000 for the first nine months of 2014 compared to the same period of 2013. The research and development expenditures were associated with continued development of power management and control products and high voltage optocouplers to be sold to various existing or new customers. The Company plans to continue investing in the development of these and other new products and processes.

Selling, general and administrative expense for the third quarter and first nine months of 2014 totaled 19.1% and 20.4% of net sales, respectively, compared to 21.9% and 20.8% for the same periods in 2013. In actual dollars, selling, general and administrative expense decreased \$3,000 for the third quarter and increased \$124,000 for the first nine months of 2014 compared to the same periods in 2013. The increase was associated with an increase in sales and marketing activity including consultant and travel expenses.

#### Liquidity and Capital Resources

Cash and cash equivalents totaled \$10,206,000 as of August 30, 2014 compared to \$9,263,000 on November 30, 2013, an increase of \$943,000. The increase in cash and cash equivalents is attributable to \$1,426,000 of cash provided from operations, offset by a payment of a cash dividend of \$258,000, \$2,000 invested in certificates of deposit and capital expenditures of \$223,000, primarily for investment in new production equipment. The Company's short term investments totaled \$2,008,000 as of August 30, 2014.

There have been no material changes to our debt or other obligations described in our 2013 Form 10-K. Refer to Note 5 - Commitments in the accompanying unaudited interim financial statements for information on the Company's credit facility.

The Company expects to continue to generate adequate amounts of cash to meet its liquidity needs from the sale of products and services and the collection thereof for at least the next twelve months.

#### Outlook



New orders for the third quarter and year-to-date 2014 totaled \$6,388,000 and \$13,514,000, respectively, compared to \$7,844,000 and \$17,570,000 for the comparable periods of 2013. The major decrease is associated with the decrease of new orders for various power management space level products and delays in new orders for various custom products.

Backlog totaled \$10,877,000 on August 30, 2014 compared to \$12,531,000 on November 30, 2013 and \$13,184,000 as of August 30, 2013. The majority of the backlog is expected to be shipped in the next twelve months and is comprised of a distributed mix of the company's products and technologies with 6% in the commercial market, 81% in the military market, and 13% in the space market compared to 11% in the commercial market, 62% in the military market, and 27% in the space market at August 30, 2013.

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 availability 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.

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 August 30, 2014 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 August 30, 2014.

## 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 August 30, 2014 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, 2013.

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

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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.
- 101 Interactive data files pursuant to Rule 405 of Regulation S-T.

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.

October 14, 2014  
Date

/s/ Mark King  
Mark King  
Chief Executive Officer

October 14, 2014  
Date

/s/ Patrick Cefalu  
Patrick Cefalu  
Chief Financial Officer



