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INNOVEX INC
Form 10-Q
August 18, 2009

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

FORM 10-Q

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

for the quarterly period ended July 4, 2009

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 0-13143

Innovex, Inc.
(Exact name of registrant as specified in its charter)

Minnesota 41-1223933
(State or other jurisdiction of (IRS Employer
incorporation or organization) Identification No.)

3033 Campus Drive, Suite E180, Plymouth, MN 55441
(Address of principal executive offices)

(763) 383-4000
(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 definition of "accelerated filer" and "large accelerated filer" in rule 12b-2 of the Exchange Act. Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company

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

As of August 4, 2009, 19,443,153 shares of the Company's common stock, \$.04 par value per share, were outstanding.

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PART 1
FINANCIAL INFORMATION

ITEM 1 FINANCIAL STATEMENTS

INNOVEX, INC. AND SUBSIDIARIES
Condensed Consolidated Balance Sheets
(Unaudited)

| | | Jul 20 ----- |
|---|----|--------------------|
| ASSETS | | |
| ----- | | |
| Current assets: | | |
| Cash and equivalents, including restricted cash of \$463,774 and \$464,745 | \$ | 1 |
| Accounts receivable, less allowance for doubtful accounts of \$206,000 and \$190,000 | | 2 |
| Inventories | | 4 |
| Other current assets | | 1 |
| | | ----- |
| Total current assets | | 10 |
| Property, plant and equipment, net of accumulated depreciation of \$62,541,000 and \$56,599,000 | | 31 |
| Assets held for sale | | |
| Other assets | | |
| | | ----- |
| | \$ | 41 |
| | | ===== |

LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT)

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| | |
|--|-------|
| Current liabilities: | |
| Current maturities of long-term debt | \$ 5 |
| Line of credit | 34 |
| Accounts payable | 14 |
| Accrued compensation | 1 |
| Other accrued liabilities | 3 |
| | ----- |
| Total current liabilities | 59 |
| Long-term debt, less current maturities | 15 |
| Stockholders' equity (deficit): | |
| Common stock, \$.04 par value; 30,000,000 shares authorized, 19,443,153 and 19,418,799 shares issued and outstanding | |
| Capital in excess of par value | 62 |
| Accumulated deficit | (96) |
| | ----- |
| Total stockholders' equity (deficit) | (33) |
| | ----- |
| | \$ 41 |
| | ===== |

See accompanying notes to condensed consolidated financial statements.

INNOVEX, INC. AND SUBSIDIARIES
Condensed Consolidated Statements of Operations
(Unaudited)

| | Three |
|--|--------------|
| | July 4, 2009 |
| | ----- |
| Net sales | \$ 10,662,6 |
| Costs and expenses: | |
| Cost of sales | 13,888,3 |
| Selling, general and administrative | 1,633,7 |
| Royalty expense | |
| Engineering | 390,8 |
| Asset impairment and restructuring charges | |
| Net (gain) loss on sale of assets | |
| Interest expense | 1,242,2 |
| Interest income | (7 |
| Net other (income) expense | 2,208,3 |
| | ----- |
| Net loss before taxes | (8,700,0 |
| Income taxes | |
| Net loss | \$ (8,700,0 |
| | ----- |
| Net loss per share: | |
| Basic | \$ (0. |
| | ----- |
| Diluted | \$ (0. |
| | ----- |
| | ===== |

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| | | |
|--|----|--------------|
| Weighted average shares outstanding: | | |
| Basic | | 19,443,1 |
| | | ===== |
| Diluted | | 19,443,1 |
| | | ===== |
| | | Nine |
| | | ----- |
| | | July 4, 2009 |
| | | ----- |
| Net sales | \$ | 33,206,8 |
| Costs and expenses: | | |
| Cost of sales | | 41,905,0 |
| Selling, general and administrative | | 5,286,1 |
| Royalty expense | | |
| Engineering | | 1,252,6 |
| Asset impairment and restructuring charges | | 1,311,5 |
| Net (gain) loss on sale of assets | | |
| Interest expense | | 2,920,3 |
| Interest income | | (23,0 |
| Net other (income) expense | | 399,7 |
| | | ----- |
| Net loss before taxes | | (19,845,3 |
| Income taxes | | |
| | | ----- |
| Net loss | \$ | (19,845,3 |
| | | ===== |
| Net loss per share: | | |
| Basic | \$ | (1. |
| | | ===== |
| Diluted | \$ | (1. |
| | | ===== |
| Weighted average shares outstanding: | | |
| Basic | | 19,439,1 |
| | | ===== |
| Diluted | | 19,439,1 |
| | | ===== |

See accompanying notes to condensed consolidated financial statements.

INNOVEX, INC. AND SUBSIDIARIES
Condensed Consolidated Statements of Cash Flows
(Unaudited)

| | | |
|---|----|--------------|
| | | Nine M |
| | | ----- |
| | | July 4, 2009 |
| | | ----- |
| CASH FLOWS FROM OPERATING ACTIVITIES: | | |
| Net loss | \$ | (19,845,3 |
| Adjustments to reconcile net loss to net cash used in operating activities: | | |
| Depreciation and amortization | | 5,763,1 |
| Asset impairment charge | | 700,0 |
| Stock compensation expense | | 108,2 |

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| | |
|--|------------|
| (Gain) loss on disposal of equipment | 2,4 |
| Changes in operating assets and liabilities: | |
| Accounts receivable | 11,540,1 |
| Inventories | 5,580,9 |
| Other current assets | 509,8 |
| Other long term assets | 7,8 |
| Accounts payable | (8,344,5 |
| Accrued compensation and other accrued liabilities | (182,3 |
| Net cash used in operating activities | (4,159,6 |
| CASH FLOWS FROM INVESTING ACTIVITIES: | |
| Capital expenditures | (1,150,1 |
| Change in restricted cash | 9 |
| Proceeds from sale of assets | |
| Net cash used in investing activities | (1,149,1 |
| CASH FLOWS FROM FINANCING ACTIVITIES: | |
| Principal payments on long-term debt | (1,082,3 |
| Issuance of long-term debt | |
| Effect of currency translation on long-term debt | (116,8 |
| Net activity on line of credit | 1,530,4 |
| Proceeds from exercise of stock options and employee stock purchase plan | |
| Net cash provided by financing activities | 331,3 |
| Decrease in cash and equivalents | (4,977,5 |
| Cash and equivalents (net of restricted cash) at beginning of period (1) | 6,066,8 |
| Cash and equivalents (net of restricted cash) at end of period (2) | \$ 1,089,3 |
| SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION: | |
| Cash paid for: | |
| Interest | \$ 2,318,0 |
| Income taxes | \$ |

- (1) Net of restricted cash of \$464,745 and \$0 respectively.
(2) Net of restricted cash of \$463,774 and \$469,940 respectively.

INNOVEX, INC. AND SUBSIDIARIES
Notes to Condensed Consolidated Financial Statements

NOTE 1 - FINANCIAL INFORMATION

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with the instructions on Form 10-Q and do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. The unaudited condensed consolidated financial statements include the accounts of Innovex, Inc. and its subsidiaries (the "Company") after elimination of all significant intercompany transactions and accounts. In the opinion of management, all adjustments (consisting of normal recurring adjustments) necessary for a fair presentation of operating results have been made. Operating results for interim periods are

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not necessarily indicative of results that may be expected for the year as a whole.

The Company utilizes a fiscal year that ends on the Saturday nearest to September 30 which results in a 52 or 53 week year rather than a twelve-month fiscal year. The Company's actual fiscal quarters end on the Saturday closest to the end of the calendar quarter. All quarters presented in these financial statements contain 13 or 14 weeks. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted. For further information, refer to the consolidated financial statements and footnotes included in the Company's Annual Report on Form 10-K for the year ended September 27, 2008.

Preparation of the Company's condensed consolidated financial statements requires management to make estimates and assumptions that affect reported amounts of assets and liabilities and related revenues and expenses. Actual results could differ from these estimates.

NOTE 2 - LIQUIDITY

The Company's ability to continue as a going concern depends upon its ability to obtain additional financing or to further restructure its credit facilities with its lenders, as well as its ability to secure new customers, generate significant revenue from existing and new customers, and manage expenses.

The Company has historically financed its operations primarily through cash from operating activities, sales of equity securities, bank credit facilities and employee stock option exercises. Cash and equivalents, including restricted cash, were \$1.6 million at July 4, 2009 and \$6.5 million at September 27, 2008. Long-term debt was \$15.4 million at July 4, 2009 and \$19.0 million at September 27, 2008 excluding current maturities of \$5.9 million and \$3.5 million, respectively. During the nine months ended July 4, 2009 and June 28, 2008, the Company incurred losses from continuing operations of \$19.8 million and \$21.5 million, respectively. Operating activities used cash of \$4.2 million and \$14.3 million during the nine months ended July 4, 2009 and June 28, 2008, respectively. As of July 4, 2009, the Company had a working capital deficit of \$49.2 million.

Total unused debt availability as of July 4, 2009 was approximately \$1.0 million under the Company's short-term packing credit and working capital facilities. Utilization of the packing credit facility availability is dependent on presenting qualifying customer purchase orders to the banks for draw down. In addition to resolution of its long-term capital needs, the Company requires immediate additional working capital to help resolve immediate requirements that are critical in providing assurance of supply to the Company's customers.

The Company completed restructuring its long-term credit facilities with its Thai lenders in June 2008. The restructuring reduced the required principal payments for fiscal year 2008 and fiscal year 2009 by approximately \$6.0 million and \$9.0 million, respectively. In addition, on December 30, 2008, the Company's Thai lenders provided the Company with an approval to extend to February 27, 2009 the repayment date of certain amounts under the packing credit facilities that were originally due on December 29, 2008. The sixty day payment date extension affected 173.1 million Baht, or approximately \$5.0 million, owed to both banks. As required by the credit agreements, as amended, the Company paid all 173.1 million Baht, or approximately \$5.0 million, under the packing credit facility by the extended repayment date of February 27, 2009.

During the months of February, March and April of 2009, the Company received verbal approval from its Thai lenders to extend repayment of amounts due under the packing credit facilities of approximately 563.1 million Baht, or

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approximately \$16.1 million. Furthermore, in the month of June 2009, the Company received formal approval from the Bank of Ayudhya to extend repayment dates of certain amounts under the short term packing credit facilities that were originally due in the months of April, May and June of 2009 to July 31, 2009. The extension affected 447.8 million Baht or approximately \$13.0 million owed under the Company's short term packing credit facilities. However, TMB Bank did not provide the Company with similar extensions on the scheduled repayments due under its short term packing credit facilities. In addition, both banks did not provide the Company with formal extensions on the scheduled repayments owing under the Company's long term loan facility that were originally due during the fiscal quarter ending July 4, 2009. Although the Company was delinquent with the

repayments required under the long term loan facility with both banks as well as the short term working capital facility with the TMB Bank, the Company did not receive any formal written notification of default. The Company believes the Thai banks will not demand immediate payment of the obligations under the bank facilities, or apply any foreclosure process until the debt restructuring process is completed.

In addition, during the month of June 2009, the Company appointed PricewaterhouseCoopers FAS Limited to act as the Company's financial advisor, to provide assistance in restructuring the Company's existing debt and to explore additional capital structure alternatives. The Company is currently working closely with the appointed financial advisor to complete the debt restructuring process as soon as possible, within the target completion time, by the end of the fiscal year. No assurance can be given that the Company's debt will be restructured on terms acceptable to the Company, if at all or that additional working capital will be obtained in an amount that is sufficient for the Company's needs, in a timely manner or on terms and conditions acceptable to the Company or its shareholders.

To secure new customers and generate more revenue, the Company has made significant changes to the organization of its personnel and changes in the incentives available to its sales personnel during the fiscal 2009 second quarter. The Company believes the changes will enable the Company to be more responsive to customers' requirements and enable the Company to close new business earlier. In order to better manage its overall cost structure, the Company will continue to work with key suppliers on volume-based cost reduction and also further improve on the inventory turns and usage in the future fiscal quarters.

The Company's financing needs and the financing alternatives available to it are subject to change depending on, among other things, general economic and market conditions, changes in industry buying patterns, customer demand for its AFC, stacked memory flex, FPD flex and other new products, the Company's ability to meet its loan covenant requirements, cash flow from operations and management estimates as to future revenue and expenses.

NOTE 3 - RESTRUCTURING CHARGES

Corporate business functions relocation:

On October 1, 2007, the Company announced a plan to relocate some of its corporate business functions, including administrative, sales and engineering to Thailand and discontinue manufacturing activity at its Korat, Thailand facility as the FSA product was expected to reach its end of life by the end of the fiscal 2008 second quarter. The restructuring was triggered by the previous move of the Company's manufacturing operations to Thailand and the presence of its banking sources and most of its customers and suppliers in Asia. In addition, incremental cost reductions were required for the Company to enhance its

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viability. Total restructuring charges related to the corporate business functions relocation and Korat restructuring for the nine months ended July 4, 2009 were \$0.2 million. These charges were mostly comprised of \$0.2 million of one time termination benefits and some minimal charges for moving and closing costs. The Company expects to incur minimal expenditure in relation to the restructuring plan for the remaining fiscal year 2009.

Litchfield and Eastlake restructuring:

On January 16, 2006, the Company announced a plan to move prototyping and high volume manufacturing from its Litchfield, Minnesota facilities to its Lamphun, Thailand facilities. On September 25, 2006, the Company expanded the previously announced Litchfield restructuring to close the entire Litchfield facility and move the remaining development efforts to its Thailand facilities. The plan announced in September 2006 was to accelerate the end of life production for FSA flexible circuits in Litchfield and discontinue use of that facility by the end of April 2007. The plan also included acceleration of production end-of-life at the Company's Eastlake, Ohio laminate material manufacturing facility. The restructuring was triggered by the Company's need to reduce its cost structure in order to compete effectively and as a result of lower than expected revenue.

The Company accounts for long-lived assets in accordance with SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets ("SFAS No. 144"). Long-lived assets, including property and equipment, are amortized over their expected lives. The Company also makes estimates of the impairment of long-lived assets whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable, based primarily upon whether expected future undiscounted cash flows are sufficient to support the asset's recovery. If the actual useful life of a long-lived asset is shorter than the useful life estimated by the Company, the asset may be deemed to be impaired, and, accordingly, a write-down of the value of the asset determined by a discounted cash flow analysis, or a shorter amortization period, may be required.

The Company entered into a purchase agreement in May 2007 to sell the Litchfield facility for approximately \$2.3 million. In April 2009, the buyer under the purchase agreement, and also the tenant of this facility, vacated the property

and has not proceeded to close on its purchase of the facility. Based on the potential cancellation of the purchase agreement, the Company recorded an asset impairment charge of \$0.7 million related to the Litchfield facility in the fiscal 2009 second quarter.

Management is in the process of performing an impairment analysis, under SFAS No. 144, for all their long lived assets since the performance of the Company is falling below previous projections. This analysis is expected to be completed in the fourth quarter of fiscal 2009.

Total restructuring charges related to the Eastlake and Litchfield restructuring, excluding asset impairment charges, for the nine months ended July 4, 2009 were \$0.4 million. These charges were comprised of \$0.3 million for costs related to the Eastlake facility lease and \$0.1 million for charges incurred to complete the transfer of equipment from Litchfield to Thailand. Remaining expenditures of approximately \$0.5 million are expected as part of the plan primarily related to completing the transfer of equipment to Thailand. The accrued restructuring charges related to Litchfield and Eastlake were \$0.5 million at July 4, 2009.

NOTE 4 - NET INCOME (LOSS) PER SHARE

The Company's basic net income (loss) per share is computed by dividing net income (loss) by the weighted average number of outstanding common shares. The Company's diluted net income (loss) per share is computed by dividing net income

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(loss) by the weighted average number of outstanding common shares and common share equivalents relating to stock options when dilutive. Options to purchase 1,477,140 and 1,766,772 shares of common stock were outstanding during the three month and nine month periods ending July 4, 2009, respectively, but were excluded from the computation of common share equivalents because they were not dilutive. Options to purchase 1,403,772 and 1,738,484 shares of common stock were outstanding during the three and nine month periods ending June 28, 2008, respectively, but were excluded from the computation of common share equivalents because they were not dilutive.

NOTE 5 - STOCK BASED COMPENSATION

The Company recorded \$25,000 and \$108,000 of related compensation expense for the three and nine month periods ended July 4, 2009, respectively, and \$50,000 and \$266,000 for the three and nine month periods ended June 28, 2008, respectively. This expense is included in selling, general and administrative expense. There was no tax benefit from recording this non-cash expense. The compensation expense did not result in any significant increase in both basic and diluted net loss per share for the three months and nine months ended July 4, 2009 and three months ended June 28 2008, but increased both basic and diluted net loss per share by \$0.01 for the nine months ended June 28, 2008. As of July 4, 2009, \$249,000 of total unrecognized compensation costs related to non-vested awards is expected to be recognized over a weighted average period of approximately 1.6 years.

The Company uses the Black-Scholes option pricing model to determine the weighted average fair value of options. The fair value of options at date of grant and the assumptions utilized to determine such values are indicated in the following table. No adjustment was made to the Black-Scholes calculation to reflect that the options are not freely traded:

| | Three Months Ended | | Nine July 4, 2009 |
|--|--------------------|---------------|----------------------|
| | July 4, 2009 | June 28, 2008 | |
| Risk-free interest rate | 1.60% | 1.83% | 1.06% |
| Expected volatility | 159% | 108% | 166% |
| Expected life (in years) | 2.5 | 2.9 | 2.5 |
| Dividend yield | -- | -- | -- |
| Weighted average fair value of options granted | \$0.17 | \$0.24 | \$0.13 |

The Company has options outstanding under its 1987 Employee Stock Option Plan and its 1994 Stock Option Plan. The Company's stock option plans provide for incentive and non-qualified stock options to be granted to directors, officers and other key employees or consultants. The stock options granted generally have a ten-year life, vest over a period of six months to five years, and have an exercise price equal to the fair market value of the stock on the date of grant. New shares are issued under existing registration statements upon exercise. At July 4, 2009, the Company had 642,203 shares of common stock available for issuance under the plans.

Additionally, on November 25, 2008, the Company granted Mr. Dauenhauer an option to purchase 250,000 shares of the Company's common stock outside of any existing shareholder-approved plan. The November 25, 2008 option was issued in consideration of the cancellation by the Company of an option granted to Mr. Dauenhauer in April 2008. The November 25, 2008 option was structured to have substantially the same terms as the cancelled April 2008 option, including an exercise price of \$0.365 per share and vesting with respect to one-third of the option shares on April 16, 2009, 2010 and 2011. On November 25, 2008, the

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Company also approved a grant to Mr. Dauenhauer of an option to purchase 25,000 shares of the Company's common stock outside of any existing shareholder-approved plan, but with substantially the same terms as an option granted on October 23, 2008, including an exercise price of \$0.165 per share and vesting with respect to one-third of the underlying shares on October 23, 2009, 2010 and 2011. At July 4, 2009, there were options to purchase a total of 275,000 shares of the Company's common stock outstanding that were granted outside any existing shareholder-approved plan.

The Company also has a restricted stock plan that provides for grants of common stock to key employees of the Company other than the Chief Executive Officer and the four highest paid executives of the Company. The common stock grants vest over three years. At July 4, 2009, the Company had 25,078 shares of common stock available for issue under the plan.

Transactions under the stock option and restricted stock plans during the nine months ended July 4, 2009 are summarized as follows:

| | Number of Shares Under Option | Weighted Average Exercise Price |
|-----------------------------------|-------------------------------------|---------------------------------------|
| Outstanding at September 27, 2008 | 1,637,842 | 2.29 |
| Granted | 890,050 | 0.22 |
| Forfeited | (317,848) | 1.38 |
| Exercised | (24,354) | -- |
| Outstanding at January 3, 2009 | 2,185,690 | 1.60 |
| Granted | 57,000 | 0.13 |
| Forfeited | (117,995) | 0.61 |
| Exercised | -- | -- |
| Outstanding at April 4, 2009 | 2,124,695 | 1.62 |
| Granted | 265,000 | 0.22 |
| Forfeited | (233,079) | 2.32 |
| Exercised | -- | -- |
| Outstanding at July 4, 2009 | 2,156,616 | 1.37 |

The following table summarizes information concerning currently outstanding and exercisable stock options:

| | Options Outstanding | | | | Options |
|-----------------------------|-----------------------|---|--|--|-----------------------|
| Range of Exercise Prices | Number Outstanding | Weighted Average Remaining Contractual Life | Weighted Average Exercise Price | | Number Exercisable |
| \$0.00 - \$0.91 | 1,639,201 | 9.1 years | \$ 0.31 | | 312, |
| 1.44 - 2.41 | 185,385 | 6.2 years | 2.21 | | 132, |
| 3.06 - 4.84 | 177,130 | 5.7 years | 3.81 | | 130, |
| 5.29 - 7.81 | 52,500 | 3.4 years | 6.40 | | 52, |

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| | | | | |
|---------------|-----------|-----------|-------|-------|
| 8.90 - 9.80 | 79,850 | 4.4 years | 9.23 | 79, |
| 12.59 - 13.03 | 22,550 | 1.3 years | 13.03 | 22, |
| | ----- | | | ----- |
| | 2,156,616 | | 1.37 | 730, |
| | ===== | | | ===== |

NOTE 6 - INVENTORIES

Inventories are comprised of the following (in thousands):

| | July 4, 2009 | September 27, 2008 |
|------------------------------------|-----------------|-----------------------|
| Raw materials and purchased parts | \$ 3,002 | \$ 5,569 |
| Work-in-process and finished goods | 1,416 | 4,430 |
| | ----- | ----- |
| | \$ 4,418 | \$ 9,999 |
| | ===== | ===== |

NOTE 7 - DERIVATIVE INSTRUMENTS - FOREIGN CURRENCY TRANSLATION

The Company had, during the previous fiscal year, entered into forward exchange contracts. These forward exchange contracts were recorded at fair value with related fair value gains or losses recorded in income within the caption net other (income) expense. Generally, these contracts had maturities of six months or less. These contracts were entered into to offset the gains or losses on foreign currency denominated assets and liabilities. The Company does not enter into forward exchange contracts for trading purposes and the contracts are not designated as hedges. As at end of July 4, 2009, the Company did not have any open forward exchange contracts to buy Thai baht in return for U.S. dollars. All remaining forward exchange contracts purchased during the previous fiscal year have matured and were settled by December 4, 2008 and no additional forward exchange contracts were purchased during the fiscal quarter ended July 4, 2009.

Foreign currency translation gains or (losses) included in net other (income) expense (in thousands):

| | Three months ended | | |
|---|--------------------|---------------|---------|
| | July 4, 2009 | June 28, 2008 | July 4, |
| | ----- | ----- | ----- |
| (Gain) or loss from forward exchange contracts | \$ -- | \$ 2,077 | \$ |
| Other foreign currency (gain) or loss | 2,188 | (3,913) | |
| | ----- | ----- | ----- |
| Net (gain) or loss from foreign currency transactions | \$ 2,188 | \$ (1,836) | \$ |
| | ===== | ===== | ===== |

NOTE 8 - REVENUE RECOGNITION

The Company makes electronic components (flexible circuits) based on customer specifications. The Company's revenue recognition policy is consistently applied regardless of sales channels utilized and product destination. In recognizing revenue in any period, the Company applies the provisions of SEC Staff Accounting Bulletin 104, "Revenue Recognition." Revenue from product sales is recognized when persuasive evidence of an arrangement exists, the product has been delivered, the fee is fixed and determinable and collection of the resulting receivable is reasonably assured.

For all sales, a binding purchase order is used as evidence of an arrangement.

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The Company also stores inventory in warehouses (JIT hubs - third party owned warehouses) that are located close to the customer's manufacturing facilities. Revenue is recognized on sales from JIT hubs upon the transfer of title and risk of loss, following the customer's acknowledgement of the receipt of the goods. The Company has an implied warranty that the products meet the customer's specification. Credits are issued for customer returns.

NOTE 9 - INCOME TAXES

The Company records income taxes in accordance with the liability method of accounting. Deferred taxes are provided for temporary differences between the financial reporting and tax bases of assets and liabilities. A valuation allowance is established when the realization of a deferred tax asset becomes less likely than not to occur. The valuation allowance is analyzed periodically by the Company and may result in income tax expense different than statutory rates. The Company's current deferred tax asset valuation allowance fully offsets its deferred tax assets. With the exception of the Alternative Minimum Tax and certain state taxes, the Company will not use cash for domestic income taxes until its net operating losses are fully realized on its tax returns.

NOTE 10- RECENT ACCOUNTING PRONOUNCEMENTS

In December 2007, the FASB issued SFAS No. 141(R), Business Combinations, or SFAS No. 141(R). SFAS No. 141(R) establishes principles and requirements for how an acquirer recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, any non-controlling interest in the acquiree and the goodwill acquired. SFAS No. 141(R) also establishes disclosure requirements to enable the evaluation of the nature and financial effects of the business combination. SFAS No. 141(R) is effective for fiscal years beginning after December 15, 2008. The adoption of SFAS No. 141(R) would change the Company's accounting treatment for business combinations on a prospective basis beginning in the period it is adopted.

In March 2008, the FASB issued SFAS No. 161, "Disclosures about Derivative Instruments and Hedging Activities--an amendment of FASB Statement No. 133" ("FAS 161"). FAS 161 changes the disclosure requirements for derivative instruments and hedging activities. Entities are required to provide enhanced disclosures about (a) how and why an entity uses derivative instruments, (b) how derivative instruments and related hedged items are accounted for under Statement 133 and its related interpretations, and (c) how derivative instruments and related hedged items affect an entity's financial position, financial performance, and cash flows. The guidance in FAS 161 is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008, with early application encouraged. This Statement encourages, but does not require, comparative disclosures for earlier periods at initial adoption. The Company adopted this statement and determined it did not have a material impact on the company's consolidated financial statements.

In September 2006, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 157, Fair Value Measurement (SFAS 157). This standard clarifies the principle that fair value should be based on the assumptions that market participants would use when pricing an asset or liability. Additionally, it establishes a fair value hierarchy that prioritizes the information used to develop those assumptions. SFAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007. The adoption of SFAS 157 as it relates to financial assets and liabilities did not have a material impact on its results of operations or financial condition. The FASB approved the issuance of FASB Staff Position 157-2, which defers the effective date of SFAS 157 until Fiscal Years beginning after November 15, 2008 for non-financial assets and non-financial liabilities. The Company does not expect the adoption of SFAS 157 as it relates to non-financial assets and non-financial liabilities to have a material impact on its results of operations or financial condition.

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In April 2009, the FASB issued SFAS No. 157-4, "Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly" ("FAS 157-4"). FAS 157-4 provides additional guidance for estimating fair value in accordance with FASB Statement No. 157, "Fair Value Measurements," when the volume and level of activity for the asset or liability have significantly decreased. This FSB also includes guidance on identifying circumstances that indicate a transaction is not orderly. FAS 157-4 is effective for interim and annual reporting periods ending after June 15, 2009, and is to be applied prospectively. The Company adopted this statement and determined it did not have a material impact on the Company's consolidated financial statements.

The Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 159, Fair Value Option for Financial Assets and Financial Liabilities (SFAS 159). This standard addresses earnings volatility caused by existing accounting standards that require related financial assets and liabilities to be measured using different measurement attributes (such as historical cost and fair value). SFAS 159 is intended to improve financial reporting by giving all entities the option to recognize most financial assets and liabilities and certain other items at fair value. Unrealized gains and losses on items for which the fair value option has been elected should be reported in earnings. SFAS 159 is effective for the first quarter of our fiscal 2009 beginning October 1, 2008. The adoption of SFAS 159 did not have a material effect on our financial condition or results of operations.

In April 2009, the FASB issued FAS No. 107-1 and APB 28-1, "Interim disclosures about Fair Value of Financial Instruments." FAS 107-1 expands current requirements to require disclosures about the fair value of all financial instruments within the scope of Statement 107 for interim reporting periods. The FSP requires entities to disclose the methods and significant assumptions used to estimate the fair value of financial instruments and describe changes in method(s) and significant assumptions, if any, during the period. FAS 107-1 and APB 28-1 is effective for interim and annual reporting periods ending after June 15, 2009, and is to be applied prospectively. The Company adopted FAS 107-1 and APB 28-1 and determined it did not have a material impact on the Company's consolidated financial statements.

In May 2009, the FASB issued SFAS No. 165, "Subsequent Events" (FAS 165). FAS 165 is intended to establish general standards of accounting for and disclosure of events that occur after the balance sheet date, but before financial statements are issued or are available to be issued. In particular, FAS 165 sets forth the period after the balance sheet date during which management of a reporting entity should evaluate events or transactions that may occur for a potential recognition or disclosure in the financial statements, the circumstances under which an entity should recognize events or transactions occurring after the balance sheet date in its financial statements, and the disclosures that an entity should make about events or transactions that occurred after the balance sheet date. FAS 165 is effective for interim or annual financial periods ending after June 15, 2009, and is applied prospectively. The company adopted FAS 165 during the fiscal second quarter of 2009 and determined that it did not have a material impact on the company's consolidated financial statements.

In June 2009, the FASB issued SFAS No. 168, "The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles" ("FAS 168"). FAS 168 replaces SFAS No. 162, "The Hierarchy of Generally Accepted Accounting Principles." FAS 168 formally establishes the FASB Accounting Standards Codification as the single source of authoritative, nongovernmental

GAAP, except for rules and interpretive releases of the SEC, which are sources

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of authoritative GAAP for SEC registrants. The Codification did not change GAAP, but reorganizes the literature. FAS 168 is effective for financial statements issued for interim and annual periods ending after September 15, 2009. The Company does not expect that the adoption of FAS 168 will have a material effect on the Company's consolidated financial statements or related disclosures.

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

You should read the following discussion of our financial condition and results of operations in conjunction with the consolidated financial statements and notes to those statements included in this report. This discussion may contain forward-looking statements that involve risks and uncertainties. Our actual results may differ materially from those anticipated in these forward-looking statements as a result of certain factors, including those described under the heading "Risks Related to Our Business" in our Annual Report on Form 10-K for the year ended September 27, 2008, as well as others not now anticipated.

We utilize a fiscal year that ends on the Saturday nearest to September 30. The fiscal 2009 first quarter contains 14 weeks while the remaining quarters contain 13 weeks each.

Overview

We are a leading worldwide provider of flexible circuit interconnect solutions to OEMs in the electronics industry. We offer a full range of customized flexible circuit applications and services from initial design, development and prototype to fabrication, assembly and test on a global basis. We target high-volume markets where miniaturization, form and weight are driving factors and flexible circuits are an enabling technology. Applications for flexible circuits currently addressed by us include data storage devices such as hard disk drives, liquid crystal displays (LCDs) for mobile communication devices, tape drives and arrays, flat panel displays (FPDs) and printers. Our customers include Entorian, Hitachi, HP, TPO, Quantum, SAE Magnetics (a subsidiary of TDK), Samsung, Seagate, StorageTek, Western Digital and other leading electronic OEMs.

Net Sales and Revenue Recognition

We manufacture flexible circuits and perform certain additional assembly and test functions on these flexible circuits based on customer specifications. We sell our products directly throughout the world, primarily in North America, Europe and the Pacific Rim countries. We use non-exclusive sales representatives to augment our direct sales efforts. We recognize revenue from the sale of our products upon shipment or delivery of our product to our customers, depending on the customer agreement or shipping terms. We store some inventory in third party owned warehouses that are located close to customers' manufacturing facilities. Sales from third party warehouses are recognized upon the transfer of title and risk of loss which follows the customer's acknowledgment of the receipt of the goods.

Costs and Expenses

Cost of sales consists primarily of:

- o material costs for raw materials and semi-finished components used for assembly of our products;
- o labor costs directly related to manufacture, assembly and inspection of our products;

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- o costs of general utilities, production supplies and chemicals consumed in the manufacturing processes;
- o costs related to the maintenance of our manufacturing equipment and facilities;
- o costs related to material and product handling and shipment;
- o depreciation costs related to facilities, machinery and equipment used to manufacture, assemble and inspect our products; and
- o salaries and overhead attributed to our supply chain, process engineering and manufacturing personnel.

Selling, general and administrative expenses primarily consist of:

- o salaries and related selling (commissions, travel, business development and program management), administrative, finance, human resources, regulatory, information services and executive personnel expenses;
- o other significant expenses related to external accounting, software maintenance and legal and regulatory fees; and
- o overhead attributed to our selling, general and administrative personnel.

Engineering expenses include costs associated with the design, development and testing of our products and processes. These costs consist primarily of:

- o salaries and related development personnel expenses;
- o overhead attributed to our development and test engineering personnel; and
- o prototyping costs related to the development of new products.

Restructuring charges are those costs primarily related to manufacturing facility closures, severance and product discontinuations. On October 1, 2007, we announced a plan to relocate some of our corporate business functions, including administrative, sales and engineering, to Lamphun, Thailand and discontinue manufacturing activity at our Korat, Thailand location as the Flex Suspension Assembly product reached its end of life by the end of the fiscal 2008 second quarter. On January 16, 2006, we announced a plan to transfer our high volume manufacturing operations from Litchfield, Minnesota to Thailand. On September 25, 2006, we announced a plan to accelerate the end of life production for our FSA flexible circuits in Litchfield and discontinue the use of that facility by the end of March 2007. Concurrently, we also planned to accelerate the end of life production of flexible circuit laminate material at our Eastlake, Ohio facility and reduce indirect labor and general and administrative expenses at our other U.S. and Thailand locations.

Results of Operations

The following table sets forth certain operating data as a percentage of net sales for the periods indicated:

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| | For the Three Months Ended | | For |
|---|----------------------------|---------------|--------|
| | July 4, 2009 | June 28, 2008 | July 4 |
| Net Sales | 100.0% | 100.0% | |
| Cost of goods sold | 130.3 | 114.6 | |
| Gross profit | (30.3) | (14.6) | |
| Operating expenses: | | | |
| Selling, general and administrative and royalty expense | 15.3 | 12.9 | |
| Engineering | 3.7 | 3.9 | |
| Restructuring and asset impairment | -- | 2.9 | |
| Net (gain) loss on sale of assets | -- | -- | |
| Total operating expenses | 19.0 | 19.7 | |
| Loss from operations | (49.3) | (34.3) | |
| Interest and other expense, net | (32.4) | 6.7 | |
| Loss before provision (benefit) for income taxes | (81.7) | (27.6) | |
| Provision (benefit) for income taxes | -- | -- | |
| Net loss | (81.7)% | (27.6)% | |

Comparison of Three Months Ended July 4, 2009 and June 28, 2008

Net Sales

Our net sales were \$10.7 million for the three months ended July 4, 2009, compared to \$16.2 million for the three months ended June 28, 2008, a decrease of 34%. This decline was primarily driven by a \$3.4 million decrease in actuator flex circuit (AFC) revenue, a \$0.9 million decrease in flat panel displays (FPD) revenue, a \$1.1 million decrease in integrated circuit packaging, network system application and other application revenue and a \$0.1 million decrease in flex suspension assembly (FSA) revenue. The decline in FSA revenue reflects the completion of our FSA customer's transition to its next generation of disk drive products which use an alternative technology. The decline in AFC, FPD and other product lines was due to working capital constraints and operational inefficiencies experienced during the fiscal third quarter of 2009 which had impacted our ability to fulfill all of the customers' requirements.

FPD application generated 76% of our net sales for the three months ended July 4, 2009, compared to 56% for the three months ended June 28, 2008. Sales of AFC's to the disk drive industry were 20%, compared to 34%, FSA sales to disk drive industry were 0% compared to 1%, sales from integrated circuit packaging, network system application and sales from other industry applications were 4% and 9% for the three months ended July 4, 2009 and June 28, 2008, respectively.

Gross Profit (Loss)

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Our gross loss was \$3.2 million for the three months ended July 4, 2009 compared to a gross loss of \$2.4 million for the three months ended June 28, 2008. Our gross margin for the three months ended July 4, 2009 decreased to (30.3%), from (14.6%) for the three months ended June 28, 2008. The decrease in gross margin as compared to the prior year reflects the decreased fixed cost absorption driven by lower revenue resulting in a higher level of excess manufacturing capacity and labor.

Selling, General and Administrative and Royalty Expense

Selling, general and administrative expenses including royalty expenses for the three months ended July 4, 2009 were \$1.6 million, compared to \$2.1 million in the three months ended June 28, 2008, a decrease of 23.8%. As a percentage of net sales, selling, general and administrative expenses were 15.3% for the three months ended July 4, 2009, an increase of 2.4% from 12.9% from the same period in the prior year. The increase as a percentage of net sales was primarily due to the decrease in revenue more than offsetting the decrease in expenses. Royalty expense was zero for the three months ended July 4, 2009 and three months ended June 28, 2009 due to the end of life cycle for the FSA product which was royalty bearing. The dollar decrease in selling, general and administrative expenses from the prior year primarily reflects lower payroll expenses related to reductions in U.S. sales and administrative positions.

Engineering

Engineering expenses for the three months ended July 4, 2009 were \$391,000, compared to \$635,000 for the three months ended June 28, 2008, a decrease of 38%. The decrease was primarily the result of reducing or transferring engineering positions to our lower salary base Thailand facility as a result of closing our U.S. facilities. As a percentage of net sales, engineering expenses were 3.7% of sales for the three months ended July 4, 2009 compared to 3.9% for the same period in the prior year.

Restructuring and Asset Impairment

Corporate business functions relocation:

On October 1, 2007, we announced a plan to relocate some of our corporate business functions, including administrative, sales and engineering, to Thailand and discontinue manufacturing activity at our Korat, Thailand facility as the FSA product was expected to reach its end of life by the end of the fiscal 2008 second quarter. The restructuring was triggered by the previous move of our manufacturing operations to Thailand and the presence of our banking sources and most of our customers and suppliers in Asia. In addition, incremental cost reductions were required for us to enhance our viability.

There were no restructuring charges related to the corporate business functions relocation and Korat restructuring recorded during the fiscal 2009 third quarter. Restructuring charges of \$0.4 million related to the planned corporate business functions and Korat restructuring were recorded in the third quarter of fiscal 2008. These charges were comprised of \$0.3 million one time termination benefits and \$0.1 million for moving and closing costs. Total restructuring charges related to the corporate office relocation restructuring through July 4, 2009 were \$3.8 million. These charges were comprised of \$3.2 million for one time termination benefits, \$0.2 million for moving and closing costs and \$0.4 million of asset impairment charges. Future expenditures expected to be incurred in relation to the restructuring plan are anticipated to be minimal.

The restructuring plan called for the elimination of 594 positions in the

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U.S. and Thailand consisting of 466 direct labor positions, 97 indirect labor production support positions and 31 administrative positions. As of July 4, 2009, all of these positions have been eliminated.

Litchfield and Eastlake restructuring:

On January 16, 2006, we announced a plan to move prototyping and high volume manufacturing from our Litchfield, Minnesota facilities to our Lamphun, Thailand facilities. On September 25, 2006, we expanded the previously announced Litchfield restructuring to close the entire Litchfield facility and move the remaining development efforts to our Thailand facilities. The plan announced in September 2006 was to accelerate the end of life production for FSA flexible circuits in Litchfield and discontinue use of that facility by the end of April 2007. The plan also included acceleration of production end-of-life at our Eastlake, Ohio laminate material manufacturing facility. In June 2006, as part of the plan, we divested our low-volume etched metal product line also located at our Litchfield facilities. The restructuring was triggered by our need to reduce our cost structure in order to compete effectively and as a result of our lower than expected level of revenue.

While several action items related to the expanded restructuring plan remain open, all of the expected savings were realized as of September 29, 2007.

Manufacturing operations were completed in the Eastlake facility in February 2007 and decommission of the facility was substantially completed by the end of March 2008. Manufacturing operations in the Litchfield facilities were completed during April 2007 and decommission of the facilities was completed by the end of the fiscal 2007 third quarter. The Company entered into a purchase agreement in May 2007 to sell the Litchfield facility for approximately \$2.3 million. In April 2009, the buyer under the purchase agreement, and also the tenant of this facility, vacated the property and has

not proceeded to close on its purchase of the facility. Based on the potential cancellation of the purchase agreement, the Company recorded an asset impairment charge of \$0.7 million related to the Litchfield facility in the fiscal 2009 second quarter.

There were no restructuring charges related to Litchfield and Eastlake restructuring recorded in the fiscal 2009 third quarter. Restructuring charges of \$0.1 million related to the Litchfield and Eastlake restructuring were recorded in the fiscal 2008 third quarter. Total restructuring charges related to the Eastlake and Litchfield restructuring excluding asset impairments charges through July 4, 2009 were \$8.7 million. These charges were comprised of \$3.3 million for one time termination benefits, \$4.0 million for moving and closing costs and \$1.4 million contract termination costs related to the Eastlake facility lease. Remaining expenditures of approximately \$0.5 million are expected as part of the plan primarily related to completing the transfer of equipment to Thailand.

Net (Gain) Loss on the Sale of Assets

There were no sales of assets recorded in the three months ended July 4, 2009 and June 28, 2008.

Net Interest and Other (Income) Expense

Net interest expense was \$1.2 million for the three months ended July 4, 2009 and \$0.8 million for the three months ended June 28, 2008. Other net expenses were \$2.2 million in the three months ended July 4, 2009 as compared to other net income of \$1.9 million in the three months ended June 28, 2008. The change was related to a foreign currency valuation loss of approximately \$2.2

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million being recorded during the fiscal 2009 third quarter which was driven by the strengthening of the Thai baht against the value of the U.S. dollar, resulting in an increase in the value of our baht denominated debt. The foreign valuation gain of \$3.9 million in the three months ended June 28, 2008 was partly offset by the loss of approximately \$2.1 million associated with the forward contracts that were placed previously. Our Thailand debt is denominated in Thai baht, and as a result, we have a significant short position in Thai baht. We made the decision in fiscal 2007 to reduce the level of forward contracts we place to purchase Thai baht to offset this short position because of the short term cash risks associated with placing these contracts. As of July 4, 2009, there were no forward exchange contracts outstanding. As a result, large changes in the value of the U.S. dollar versus the Thai baht will drive significant foreign currency valuation gains or losses as the value of our baht denominated debt increases or decreases.

Income Taxes

No net income tax expense or benefit was recorded for the three months ended July 4, 2009 and June 28, 2008. The deferred tax assets continue to be fully reserved.

Comparison of Nine Months Ended July 4, 2009 and June 28, 2008

Net Sales

Our net sales were \$33.2 million for the nine months ended July 4, 2009, compared to \$50.2 million for the nine months ended June 28, 2008, a decrease of 34%. This decrease primarily reflects an \$8.7 million decrease in flex suspension assembly (FSA) revenue, \$6.8 million decrease in actuator flex circuit (AFC) revenue and a \$1.4 million decrease in integrated circuit packaging, network system application and other application revenue. The decline in FSA revenue reflects the completion of our FSA customer's transition to its next generation of disk drive products which use an alternative technology. The decline in the revenue for the other product lines was primarily related to low demand experienced during the fiscal first and second quarter of 2009 and partly due to working capital constraints and operational inefficiencies experienced during the fiscal third quarter of 2009 which had impacted our ability to fulfill all of the customers' requirements.

FPD application generated 60% of our net sales for the nine months ended July 4, 2009, compared to 40% for the nine months ended June 28, 2008. Sales of AFC's to the disk drive industry were 34%, compared to 37%, FSA sales to disk drive industry were 0% compared to 17%, sales from integrated circuit packaging, network system application and sales from other industry applications were 6% for both nine months ended July 4, 2009 and June 28, 2008.

Gross Profit (Loss)

Our gross loss was \$8.7 million for the nine months ended July 4, 2009 compared to a gross loss of \$6.3 million for the nine months ended June 28, 2008. Our gross margin for the nine months ended July 4, 2009 decreased to (26.2%), from (12.6%) for the nine months ended June 28, 2008. The decrease in gross margin as compared to the prior year reflects the decreased fixed cost absorption driven by lower revenue resulting in a higher level of excess manufacturing capacity and labor.

Selling, General and Administrative and Royalty Expense

Selling, general and administrative expenses including royalty expenses for the nine months ended July 4, 2009 were \$5.3 million, compared to \$6.8 million

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in the nine months ended June 28, 2008, a decrease of 22%. As a percentage of net sales, selling, general and administrative expenses were 15.9% for the nine months ended July 4, 2009, an increase from 13.9% in the same period in the prior year. The increase as a percentage of net sales was primarily due to the decrease in revenue more than offset the decrease in expenses, partially offset by no royalty expense for the nine months ended July 4, 2009, as compared to \$128,000 for the nine months ended June 28, 2008. Royalty expense was zero for the nine months ended July 4, 2009 due to the end of life cycle for the FSA product which was royalty bearing. The dollar decrease in selling, general and administrative expenses from the prior year primarily reflects lower payroll expenses related to reductions in U.S. sales and administrative positions.

Engineering

Engineering expenses for the nine months ended July 4, 2009 were \$1.3 million, compared to \$1.9 million for the nine months ended June 28, 2008, a decrease of 32%. The decrease was primarily the result of reducing or transferring engineering positions to our lower salary base Thailand facility as a result of closing our U.S. facilities. As a percentage of net sales, engineering expenses were 3.8% of sales for the nine months ended July 4, 2009 and June 28, 2008.

Restructuring and Asset Impairment

Corporate business functions relocation:

As discussed above, on October 1, 2007, we announced a plan to relocate some of our corporate business functions, including administrative, sales and engineering, to Thailand and discontinue manufacturing activity at our Korat, Thailand facility as the FSA product was expected to reach its end of life by the end of the fiscal 2008 second quarter. Restructuring charges of \$0.2 million were recorded during the first nine months of fiscal 2009 were related to the corporate business functions relocation. These charges were mostly comprised of \$0.2 million of one time employee termination benefits and some minimal charges relating to moving and closing costs. Restructuring charges of \$3.0 million were recorded during the first nine months of fiscal 2008 related to the corporate office restructuring. These charges were comprised of \$2.8 million of one time employee termination benefits and \$0.2 million for moving and closing costs.

Litchfield and Eastlake restructuring:

As discussed above, on January 16, 2006, we announced a plan to move prototyping and high volume manufacturing from our Litchfield, Minnesota facilities to our Lamphun, Thailand facilities. On September 25, 2006, we expanded the previously announced Litchfield restructuring to close the entire Litchfield facility and our Eastlake, Ohio facility. Restructuring charges related to the Eastlake and Litchfield restructuring, excluding asset impairment charges, of \$0.4 million were recorded during the first nine months of fiscal 2009. These charges were comprised of \$0.1 million related to the transfer of equipment to Thailand and \$0.3 million pertained mostly to the one-time provision made in relation to the remaining lease expenses for Eastlake property. Restructuring charges related to the Eastlake and Litchfield restructuring, excluding asset impairment charges, of \$0.5 million were recorded during the first nine months of fiscal 2008. These charges were comprised of \$0.3 million for moving and closing costs and \$0.2 million contract termination costs related to the Eastlake facility lease.

In addition, based on a potential cancellation of the Litchfield purchase agreement, an asset impairment charge of \$0.7 million was recorded in the fiscal 2009 second quarter. There was no asset impairment charge recorded during the first nine months of fiscal 2008.

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Net (Gain) Loss on the Sale of Assets

There were no sales of assets recorded during the nine months ended July 4, 2009 compared to a net gain on the sale of assets of \$125,000 for the nine months ended June 28, 2008.

Net Interest and Other Expense

Net interest expense was \$2.9 million for the nine months ended July 4, 2009 and \$2.2 million for the nine months ended June 28, 2008. Other net expenses were \$0.4 million in the nine months ended July 4, 2009 as compared to other net expenses of \$0.8 million in the nine months ended June 28, 2008. The change was related to a foreign currency revaluation gain or loss that was driven by the value of the U.S. dollar against the Thai Baht, resulting in the change in value of our Baht denominated debt. The foreign currency valuation gain of approximately \$30,000 in the nine months ended July 4, 2009 was offset by the loss of approximately \$350,000 associated with our forward contracts placed previously. The foreign currency valuation loss of approximately \$1.1 million in the nine months ended June 28, 2008 was partly offset by the gain of

\$0.2 million associated with our forward contracts placed previously. Our Thailand debt is denominated in Thai baht, and as a result, we have a significant short position in Thai baht. We made the decision in fiscal 2007 to reduce the level of forward contracts we place to purchase Thai baht to offset this short position because of the short term cash risks associated with placing these contracts. As of July 4, 2009, there were no forward exchange contracts outstanding. As a result, large changes in the value of the U.S. dollar versus the Thai baht will drive significant foreign currency valuation gains or losses as the value of our baht denominated debt increases or decreases.

Income Taxes

No net income tax expense or benefit was recorded for the nine months ended July 4, 2009 and minimal net income tax expense was recorded in the nine months ended June 28, 2008 as the deferred tax valuation allowance was increased to offset the tax benefit generated during the quarter. The deferred tax assets continue to be fully reserved.

Critical Accounting Policies and Estimates

Our significant accounting policies and estimates are described in Note A to the Consolidated Financial Statements and the Management's Discussion and Analysis of Financial Condition and Results of Operations included in our Annual Report for the year ended September 27, 2008. The accounting policies used in preparing our interim 2009 Consolidated Financial Statements is the same as those described in our Annual Report.

Liquidity and Capital Resources

We have historically financed our operations primarily through cash from operating activities, sales of equity securities, bank credit facilities and employee stock option exercises. Cash and equivalents, including restricted cash, were \$1.6 million at July 4, 2009 and \$6.5 million at September 27, 2008. Cash and equivalents, net of restricted cash, were \$1.1 million at July 4, 2009 and \$6.1 million at September 27, 2008. As of July 4, 2009, the Company had a working capital deficit of \$49.2 million.

For the nine months ended July 4, 2009, net cash used in operating activities of \$4.2 million primarily resulted from the net loss for the period net of non-cash charges and a \$8.5 million decrease in accounts payable and liabilities, partially offset by a \$5.6 million reduction in inventory and \$11.5

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million decrease in accounts receivable. The reduction in inventory level was primarily driven by improved inventory turns and usage during the quarters. The decline in accounts payable was mainly due to the pay down of our liabilities and partly due to the lower inventory purchases made during the quarters. The decrease in accounts receivable was partly driven by the lower revenue and partly due to the improvement in our Days Sales Outstanding (DSO) from 62 days in the fiscal 2008 fourth quarter to 24 days in the fiscal 2009 third quarter.

Net cash used in investing activities was \$1.1 million in the first nine months of fiscal 2009, compared to \$1.7 million in the first nine months of fiscal 2008. In fiscal 2009, net cash used in investing activities mostly pertained to capital spending related to process improvements at our Thailand facility. In fiscal 2008, net cash used in investing activities was attributed to the capital spending of \$1.4 million for process improvements at our Thailand facility, a \$0.4 million increase in restricted cash balance and partly offset by the gain on the sale of assets of \$0.1 million.

Net cash provided by financing activities was \$0.3 million in the first nine months of fiscal 2009, compared to net cash provided by financing activities of \$10.7 million in the first nine months of fiscal 2008. For the first nine months of fiscal 2009, net cash provided in financing activities was the result of \$1.5 million borrowed under our short-term Thailand packing credit facilities, and partially offset by the scheduled debt repayments of \$1.1 million on our existing long-term Thailand debt facilities and U.S. based debt and a \$0.1 million decrease in the U.S. dollar foreign exchange valuation of the Thai baht denominated debt. For the first nine months of fiscal 2008, net cash provided by financing activities was primarily related to the \$14.5 million borrowed under our short-term Thailand packing credit facilities, a \$1.5 million draw down under our long-term Thailand credit facilities and a \$0.7 million increase in the U.S. dollar foreign exchange valuation of the Thai baht denominated debt partially offset by the normally scheduled debt payments of approximately \$6.0 million on our existing long-term Thailand debt facilities and U.S. based debt.

In December 2006, we entered into a new credit facility with Bank of Ayudhya Public Company Limited (BAY) and TMB Bank Public Company Limited (TMB) which expanded our existing credit facilities with these banks. The new Third Credit Facilities Agreement provided for an additional 600 million baht facility to be used for procurement of equipment within 24 months from the December 19, 2006 effective date. We drew down approximately \$9.5 million under this new credit facility in fiscal 2007 and \$1.5 million in the fiscal 2008 first and second quarters. In June 2004, we entered into the Second Credit Facilities Agreement with BAY and TMB which expanded the existing credit facility with these banks. The Second Credit Facilities Agreement is now comprised of a 660 million baht long-term facility, a 400 million baht long-term facility, packing credit facilities totaling 1,100 million baht, short-term working capital facilities totaling 90 million baht and a 10 million baht overdraft facility.

The Thailand facilities are secured by certain receivables, inventory and assets held by us in Thailand. As of July 4, 2009, we had approximately \$21.3 million (or 724 million baht) outstanding under our long-term Thailand credit facilities and a \$34.2 million (or 1,167 million baht) outstanding balance under our packing and short-term Thailand credit facilities. Total unused availability as of July 4, 2009 was approximately \$1.0 million (or 33 million baht) under our short-term packing credit and working capital facilities. Utilization of the packing credit facility availability is dependent on presenting qualifying customer purchase orders to the banks for draw down.

In June 2008, we completed the restructuring of our long-term debt facility with our Thai lenders. As part of the restructuring, our debt repayment schedules were modified resulting in a \$6.0 million reduction in repayments

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required to be made in the remainder of the fiscal 2008 and \$9.0 million reduction in payments required to be made in fiscal 2009. In addition, the undrawn portion available under the Third Credit Facilities Agreement of 600 million baht will be cancelled as part of the bank restructuring. No gain or loss was recorded as a result of the restructuring because it was determined by the Company to be a modification under EITF-96-19.

On December 30, 2008, both Thai lenders provided us with an approval to extend to February 27, 2009 the repayment date of certain amounts under the packing credit facilities that were originally due on December 29, 2008. The sixty day payment date extension affected approximately 173.1 million baht or \$5.0 million owed to both banks. As required by the credit agreements, as amended, the Company paid 173.1 million Baht, or approximately \$5.0 million, under the packing credit facility by the extended repayment date of February 27, 2009.

During the months of February, March and April of 2009, we received verbal approval from both Thai lenders to extend repayment of amounts due under the packing credit facilities of approximately 563.1 million Baht, or approximately \$16.1 million. Furthermore, in the month of June 2009, we received formal approval from the Bank of Ayudhya to extend repayment dates of certain amounts under the short term packing credit facilities that were originally due in the months of April, May and June of 2009 to July 31, 2009. The extension affected 447.8 million Baht or approximately \$13.0 million owed under our short term packing credit facilities. However, TMB Bank did not provide us with similar extensions on the scheduled repayments due under our short term packing credit facilities. In addition, both banks did not provide us with formal extensions on the scheduled repayments owing under our long term loan facility that were originally due during the fiscal quarter ending July 4, 2009. Although we were delinquent with the repayments required under the long term loan facility with both banks as well as the short term packing credit facility with the TMB Bank, we believe the Thai banks will not demand immediate payment of the obligations under the bank facilities, or apply any foreclosure process until the debt restructuring process is completed.

In addition, during the month of June 2009, we appointed PricewaterhouseCoopers FAS Limited to act as our financial advisor, to provide assistance in restructuring the existing debt and to explore additional capital structure alternatives. We are currently working closely with PricewaterhouseCoopers to complete the debt restructuring process as soon as possible, within the estimated target completion time, by the end of the fiscal year.

In January 2005, we entered into a financing agreement with US Federal Credit Union under which we borrowed \$4.0 million. An additional \$3.1million was borrowed under that agreement on April 15, 2005. In addition to normally scheduled payments, a principal payment of \$1.5 million was made on June 27, 2006 related to sale of the business, facility and assets of our etched metal components business. An additional principal payment of \$4 million was made on May 18, 2007 related to the sale of the Maple Plain facility. As of July 4, 2009, \$0.1 million was outstanding under our US Federal credit facility. While the note is due February 1, 2010, the final payment is scheduled to be made during the fourth quarter of fiscal 2009 as a result of the prepayments. Payments under the underlying note are calculated using a 25 year amortization with the remaining principal amount due at maturity. The note is secured by our Litchfield facilities and any proceeds from the sale of those facilities will be used to pay down the outstanding note balance.

We will require additional capital resources for our business. Our ability to continue as a going concern depends mainly on our ability to obtain additional financing or to further restructure our credit facilities with our lenders, as well as our ability to secure new customers, generate significant

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revenue from existing and new customers and manage expenses.

To secure new customers and generate more revenue, the management made significant changes to the organization of the internal team structure starting from the fiscal 2009 second quarter. The new organizational structure, which includes the implementation of a pay-for-performance system for the customer-facing teams, will be more customer-focused, making us more responsive to customers' requirements which we believe will enable us to close new business earlier. In order to better manage overall cost structure, we will continue to work with key suppliers on volume based cost reduction and also further improve on inventory turns and usage in future fiscal quarters. We will also continue to work with our financial advisor and Thai lenders to explore additional restructuring of our existing debt as well as to consider an additional working capital facility or long-term financing. While we work with the financial advisor and Thai lenders to restructure existing debt and to obtain additional working capital, we anticipate that we may also require additional extensions with respect to payments which otherwise become due and are not paid pending the resolution of the restructuring discussions. We believe that our immediate need

for capital to finance our day-to-day business activities over the next quarter could potentially be provided, if at all, by our Thai lenders in the form of a restructuring of our debt to reduce required payments and to provide additional lending. No assurance can be given that additional working capital will be obtained in an amount that is sufficient for our needs, in a timely manner or on terms and conditions acceptable to us or our shareholders, if at all. If we are unable to obtain additional financing or restructure our credit facilities (including additional extensions for the amounts that become due and are not paid pending the resolution of the restructuring discussions), our ability to make the required payments on our debt will be impaired and may result in payment or covenant defaults, acceleration of our indebtedness, seizure by the banks of assets that secure our indebtedness, loss of control of our business, cessation of business or bankruptcy. Our financial statements have been prepared assuming that we will continue as a going concern. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

Contractual Obligations

The table below discloses a summary of the Company's specified contractual obligations at July 4, 2009 (in thousands):

| | Under 1 Year | 1 to 3 Years | 3 to 5 Years | After 5 |
|--------------------------------|--------------|--------------|--------------|---------|
| | ----- | ----- | ----- | ----- |
| Long-term Debt Obligations (1) | \$ 5,934 | \$ 13,437 | \$ 1,937 | |
| Operating Leases | 349 | 452 | 154 | |
| | ----- | ----- | ----- | ----- |
| Total | \$ 6,283 | \$ 13,889 | \$ 2,091 | |
| | ===== | ===== | ===== | ===== |

(1) Includes interest at a fixed rate of 7% on a portion of the debt and excludes interest rates.

Recent Accounting Pronouncements

In March 2008, the FASB issued SFAS No. 161, "Disclosures about Derivative Instruments and Hedging Activities--an amendment of FASB Statement No. 133" ("FAS 161"). FAS 161 changes the disclosure requirements for derivative

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instruments and hedging activities. Entities are required to provide enhanced disclosures about (a) how and why an entity uses derivative instruments, (b) how derivative instruments and related hedged items are accounted for under Statement 133 and its related interpretations, and (c) how derivative instruments and related hedged items affect an entity's financial position, financial performance, and cash flows. The guidance in FAS 161 is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008, with early application encouraged. This Statement encourages, but does not require, comparative disclosures for earlier periods at initial adoption. The Company is currently evaluating the provisions of FASB 161 to determine the impact on the company's consolidated financial statements.

In September 2006, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 157, Fair Value Measurement (SFAS 157). This standard clarifies the principle that fair value should be based on the assumptions that market participants would use when pricing an asset or liability. Additionally, it establishes a fair value hierarchy that prioritizes the information used to develop those assumptions. SFAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007. The adoption of SFAS 157 did not have a material effect on the financial condition or results of operations. The FASB approved the issuance of FASB Staff Position 157-2, which defers the effective date of SFAS 157 until Fiscal Years beginning after November 15, 2008 for non-financial assets and non-financial liabilities. The Company does not expect the adoption of SFAS 157 as it relates to non-financial assets and non-financial liabilities to have a material impact on its results of operations or financial condition.

The Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 159, Fair Value Option for Financial Assets and Financial Liabilities (SFAS 159). This standard addresses earnings volatility caused by existing accounting standards that require related financial assets and liabilities to be measured using different measurement attributes (such as historical cost and fair value). SFAS 159 is intended to improve financial reporting by giving all entities the option to recognize most financial assets and liabilities and certain other items at fair value. Unrealized gains and losses on items for which the fair value option has been elected should be reported in earnings. SFAS 159 is effective for the first quarter of our fiscal 2009 beginning October 1, 2008. The adoption of SFAS 159 did not have a material effect on our financial condition or results of operations.

Forward Looking Statements

Statements included in this Management's Discussion and Analysis of Financial Condition and Results of Operations, elsewhere in this report and in future filings by the Company with the SEC, except for the historical information contained herein and therein, are "forward-looking statements" that involve risks and uncertainties. These risks and uncertainties include: our need for significant additional working capital and our need to restructure of our existing indebtedness to continue as a going concern, continued cash

availability under our credit facilities, any interruption in the operations of the Company's single source suppliers or any failure of any of the Company's single source suppliers to timely deliver an adequate supply of components, the timely availability and acceptance of new products, the impact of competitive products and pricing, changes in our customers' market share, impact of restructuring charges, changes in manufacturing efficiencies, fluctuations in currency rates, ability of the Company to restructure its credit facilities and obtain a short term working capital facility, continued forbearance by the Company's banks from declaring default and demanding immediate payment or applying any foreclosure process, and other risks detailed from time to time in

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our reports filed with the Securities and Exchange Commission, including those risks described under Part I, Item 1A. "Risk Factors" in our Annual Report on Form 10-K for the year ended September 27, 2008. In addition, a significant portion of the our revenue is generated from the disk drive, flat panel display, stacked memory substrate, consumer electronics and data storage industries and the global economic softness has had and may have in the future, an adverse impact on our operations. We disclaim any obligation subsequently to revise any forward-looking statements to reflect subsequent events or circumstances or the occurrence of unanticipated events.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK

The following discusses our exposure to market risk related to changes in interest rates and foreign currency exchange rates. These exposures may change over time as business practices evolve and could have a material adverse impact on our business, financial condition and results of operations.

Our earnings and cash flows are subject to fluctuations resulting from changes in foreign currency exchange rates. While we transact business primarily in U.S. dollars, a portion of our sales and expenses are denominated in foreign currencies. Changes in the relation of foreign currencies to the U.S. dollar will affect our cost of sales and operating margins and could result in exchange gains or losses. To reduce the impact of certain foreign currency fluctuations, we may enter into short-term forward foreign currency exchange contracts in the regular course of business to manage our risk exposure, not as speculative instruments. Typically, these contracts have maturities of 6 months or less. The forward exchange contracts generally require us to exchange Thailand baht for U.S. dollars or U.S. dollars for Thailand baht at maturity, at rates agreed to at inception of the contracts. These contracts are not designated as hedges, therefore, the gains and losses on foreign currency transactions are included in income.

We periodically review the outlook for expected currency exchange rate movements as well as the policy on desired future foreign currency cash flow positions (long, short or balanced) for those currencies in which we have significant activity. Expected future cash flow positions and strategies are continuously monitored. At July 4, 2009, the Company did not have any open forward exchange contracts to buy Thai baht in return for U.S. dollars. All remaining forward exchange contracts purchased during previous fiscal quarters have matured and were settled by December 4, 2008. No assurance can be given that our strategies will prevent future currency fluctuations from adversely affecting our business, financial condition and results of operations.

We are exposed to interest rate risk as a large portion of our interest-bearing debt is subject to interest rates which fluctuate with changes in market interest rates or are periodically reset based on market interest rates. A large change in market interest rates could have an adverse impact on our business, financial condition and results of operations.

ITEM 4. CONTROLS AND PROCEDURES

(a) Evaluation of Disclosure Controls and Procedures

The Company's Chief Executive Officer, Terry M. Dauenhauer, and Chief Financial Officer, Randy L. Acres, have evaluated the Company's disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934) as of the end of the period covered by this report. Based upon this review, they have concluded that these controls and procedures are effective.

(b) Changes in Internal Control Over Financial Reporting

There have been no changes in internal control over financial reporting that occurred during the fiscal period covered by this report that have materially

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affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II - OTHER INFORMATION

Responses to Items 1A, 2, 3, 4 and 5 are omitted since these items are either inapplicable or the response thereto would be negative.

ITEM 1. LEGAL PROCEEDINGS

We are party of certain lawsuits in the ordinary course of business. We do not believe that these proceedings, individually or in the aggregate, will have a material adverse effect on our business, financial condition or results of operations.

ITEM 6. EXHIBITS

The following exhibits are included herein:

- 31.1 Certification of Chief Executive Officer pursuant Rules 13a-14 and 15d-14 of the Exchange Act.
- 31.2 Certification of Principal Financial Officer pursuant Rules 13a-14 and 15d-14 of the Exchange Act.
- 32 Certification pursuant to 18 U.S.C. Section 1350.

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.

INNOVEX, INC.

Date: August 18, 2009

By /s/ Terry M. Dauenhauer

Terry M. Dauenhauer
President and Chief Executive Officer

By /s/ Randy Acres

Randy Acres
Senior Vice President and Chief Financial Officer