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AMERICAN TECHNICAL CERAMICS CORP

Form 10-Q

February 12, 2004

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

FORM 10-Q

(Mark One)

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

FOR THE QUARTERLY PERIOD ENDED DECEMBER 31, 2003

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 1-9125  
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AMERICAN TECHNICAL CERAMICS CORP.  
-----

(Exact Name of Company as Specified in Its Charter)

DELAWARE  
-----

(State or Other Jurisdiction of Incorporation or Organization)

17 STEPAP PLACE, HUNTINGTON STATION, NY  
-----

(Address of Principal Executive Offices)

11-2113382  
-----

(I.R.S. Employer Identification Number)

11746  
-----

(Zip Code)

(631) 622-4700

(Telephone Number, Including Area Code)

Indicate by check mark whether the Company (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 Company 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 Company is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes  No

As of February 2, 2004, the Company had outstanding 8,133,268 shares of Common Stock, par value \$0.01 per share.

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PART 1 - FINANCIAL INFORMATION

Item 1. Financial Statements

AMERICAN TECHNICAL CERAMICS CORP. AND SUBSIDIARIES  
 CONSOLIDATED BALANCE SHEETS  
 (in thousands, except per share data)

	DEC. 31, 2003	JUNE 30, 2003
	-----	-----
	(unaudited)	
<b>ASSETS</b>		
Current assets		
Cash (including cash equivalents of \$999 and \$996, respectively)	\$ 7,654	\$ 8,312
Investments	3,003	3,003
Accounts receivable, net	6,748	6,748
Inventories	15,719	15,719
Deferred income taxes, net	1,989	1,989
Other current assets	1,404	1,404
	-----	-----
TOTAL CURRENT ASSETS	36,517	36,517
	-----	-----
Property, plant and equipment, net of accumulated depreciation and amortization of \$39,604 and \$37,213, respectively	25,856	27,125
Other assets, net	39	39
	-----	-----
TOTAL ASSETS	\$ 62,412	\$ 63,681
	=====	=====
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities		
Current portion of long-term related party debt	\$ 374	\$ 374
Accounts payable	883	1,000
Accrued expenses	3,396	2,900
Income taxes payable	293	293
	-----	-----
TOTAL CURRENT LIABILITIES	4,946	5,567
	-----	-----
Long-term related party debt, net of current portion	3,098	3,098
Deferred income taxes	3,299	3,299
	-----	-----
TOTAL LIABILITIES	11,343	11,964
	-----	-----
Commitments and Contingencies		
Stockholders' Equity		
Common Stock -- \$0.01 par value; authorized 20,000 shares; issued 8,540 and 8,503 shares, outstanding 8,126 and 8,089 shares, respectively	85	85
Capital in excess of par value	11,674	11,674
Retained earnings	40,441	41,122
Accumulated other comprehensive income/(loss):		
Unrealized loss on investments available-for-sale, net	(2)	(2)
Cumulative foreign currency translation adjustment	330	330
	-----	-----
	328	328
	-----	-----
Less: Treasury stock, at cost (414 and 414 shares, respectively)	1,396	1,396
Deferred compensation	63	63

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TOTAL STOCKHOLDERS' EQUITY

-----	-----
51,069	51
-----	-----
\$ 62,412	\$ 63
=====	=====

See accompanying notes to unaudited consolidated financial statements.

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AMERICAN TECHNICAL CERAMICS CORP. AND SUBSIDIARIES  
 UNAUDITED CONSOLIDATED STATEMENTS OF OPERATIONS  
 (in thousands, except per share data)

	For the Three Months Ended Dec. 31, 2003	2002	For
	-----	-----	
Net sales	\$ 13,516	\$ 11,561	\$
Cost of sales	9,873	8,132	
	-----	-----	
Gross profit	3,643	3,429	
	-----	-----	
Selling, general and administrative expenses	3,445	2,813	
Research and development expenses	742	664	
Other	(63)	342	
	-----	-----	
Operating expenses	4,124	3,819	
	-----	-----	
(Loss)/ income from operations	(481)	(390)	
	-----	-----	
Other (income) expense:			
Interest expense	92	104	
Interest income	(23)	(21)	
Other	2	--	
	-----	-----	
	71	83	
	-----	-----	
(Loss)/ income before provision for income taxes	(552)	(473)	
(Benefit from)/ provision for income taxes	(106)	(143)	
	-----	-----	
Net (loss)/ income	\$ (446)	\$ (330)	\$
	=====	=====	==
Basic net (loss)/ income per common share	\$ (0.05)	\$ (0.04)	\$
	=====	=====	==
Diluted net (loss)/ income per common share	\$ (0.05)	\$ (0.04)	\$
	=====	=====	==
Basic weighted average common shares outstanding	8,116	8,073	
	=====	=====	==

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Diluted weighted average common shares outstanding	8,116	8,073
	=====	=====

See accompanying notes to unaudited consolidated financial statements.

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AMERICAN TECHNICAL CERAMICS CORP. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF CASH FLOWS

	For the Six Months Ended December 31	
	2003	2002
	-----	-----
	(In thousands)	
	(unaudited)	
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net (loss)/income	\$ (1,229)	\$ 8
Adjustments to reconcile net (loss)/income to net cash provided by operating activities:		
Depreciation and amortization	2,529	2,663
Loss on disposal of fixed assets	69	391
Stock award compensation expense	96	8
Changes in operating assets and liabilities:		
Accounts receivable	(27)	695
Inventories	(575)	359
Other assets	(476)	(226)
Accounts payable and accrued expenses	411	16
Income taxes payable	(474)	--
	-----	-----
Net cash provided by operating activities	324	3,914
	-----	-----
CASH FLOWS FROM INVESTING ACTIVITIES:		
Capital expenditures	(1,444)	(674)
Purchase of investments	(1,986)	(993)
Proceeds from sale of investments	2,000	1,000
Proceeds from sale of fixed assets	22	--
	-----	-----
Net cash used in investing activities	(1,408)	(667)
	-----	-----
CASH FLOWS FROM FINANCING ACTIVITIES:		
Repayment of debt	(173)	(4,229)
Proceeds from the exercise of stock options	83	13
	-----	-----
Net cash used in financing activities	(90)	(4,216)
	-----	-----
	-----	-----
Effect of exchange rate changes on cash	143	92
	-----	-----
Net decrease in cash and cash equivalents	(1,031)	(877)

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CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	8,685	7,129
	-----	-----
CASH AND CASH EQUIVALENTS, END OF PERIOD	\$ 7,654	\$ 6,252
	=====	=====
Supplemental cash flow information:		
Interest paid	\$ 187	\$ 201
Taxes paid	\$ 39	\$ --

See accompanying notes to unaudited consolidated financial statements.

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AMERICAN TECHNICAL CERAMICS CORP. AND SUBSIDIARIES  
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS  
(In thousands, except per share data)

(1) BASIS OF PRESENTATION:

The accompanying unaudited interim consolidated financial statements of American Technical Ceramics Corp. and subsidiaries (the "Company") reflect all adjustments (consisting of normal recurring accruals) which are, in the opinion of management, necessary for a fair presentation of its consolidated financial position as of December 31, 2003, and the results of its operations for the three and six month periods ended December 31, 2003 and 2002. These consolidated financial statements should be read in conjunction with the summary of significant accounting policies and notes to consolidated financial statements included in the Company's Annual Report on Form 10-K for the fiscal year ended June 30, 2003. Results for the three and six month periods ended December 31, 2003 are not necessarily indicative of results which could be expected for the entire year.

(2) IMPACT OF NEW ACCOUNTING STANDARDS:

In January 2004, the Company adopted the Financial Accounting Standards Board Interpretation No. 46, "Consolidation of Variable Interest Entities" (FIN No. 46). Previously, consolidation of variable interest entities was largely based on controlling voting rights. This interpretation clarifies the application of Accounting Research Bulletin No. 51, "Consolidated Financial Statements", to entities where the Company is vulnerable to a majority of the entity's risk of loss or is entitled to receive a majority of the entity's residual returns even if there is no controlling voting interest. The adoption of FIN No. 46 did not have any impact on the Company's consolidated results of operations or financial position.

(3) SUPPLEMENTAL CASH FLOW INFORMATION:

During the six months ended December 31, 2003, the Company (i) granted deferred compensation stock awards with an aggregate value of \$41 with respect to which expense shall be recognized ratably throughout fiscal year 2004 (as of December 31, 2003, \$20 has been recognized as compensation expense), (ii) granted stock options with respect to which compensation expense of \$46 will be recognized evenly over the next five years (as of December 31, 2003, \$4 has been recognized as compensation expense), (iii) recognized \$116 in compensation expense (including \$44 relating to bonuses granted to defray taxes) in connection with the grant of stock awards totaling 12 shares of common stock,

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and (iv) recognized a \$15 reduction of income taxes payable related to stock options exercised.

(4) INVENTORIES:

Inventories included in the accompanying consolidated financial statements consist of the following:

	December 31, 2003	June 30, 2003
	----- (unaudited)	-----
Raw materials	\$ 7,642	\$ 7,055
Work-in-process	4,540	4,361
Finished goods	3,537	3,728
	-----	-----
	\$ 15,719	\$ 15,144
	=====	=====

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AMERICAN TECHNICAL CERAMICS CORP. AND SUBSIDIARIES  
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS  
(In thousands, except per share data)

(5) EARNINGS PER SHARE:

The following represents a reconciliation of the numerators and denominators of the basic and diluted earnings per share computation.

		For the Three Months Ended December 2003		
	Net Loss (Numerator)	----- Shares (Denominator)	Per-Share Amount	Net Loss (Numerator)
	-----	-----	-----	-----
Basic EPS	\$ (446)	8,116	\$ (0.05)	\$ (330)
			=====	
Effect of Dilutive Securities:				
Stock options	--	--		--
Deferred compensation stock awards	--	--		--
	-----	-----	-----	-----
Diluted EPS	\$ (446)	8,116	\$ (0.05)	\$ (330)
	=====	=====	=====	=====

Options covering 520 and 665 shares have been omitted from the calculation of dilutive EPS for the three months ended December 31, 2003 and 2002, respectively, because their inclusion would have been antidilutive.

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	For the Six Months Ended December 31,			
	2003		2002	
	Net Loss (Numerator)	Shares (Denominator)	Per-Share Amount	Net Income (Numerator)
	-----	-----	-----	-----
Basic EPS	\$ (1,229)	8,106	\$ (0.15)	\$ 8
			=====	
Effect of Dilutive Securities:				
Stock options	--	--		--
Deferred compensation stock awards	--	--		--
	-----	-----	-----	-----
Diluted EPS	\$ (1,229)	8,106	\$ (0.15)	\$ 8
	=====	=====	=====	=====

Options covering 552 and 906 shares have been omitted from the calculation of dilutive EPS for the six months ended December 31, 2003 and 2002, respectively, because their inclusion would have been antidilutive.

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AMERICAN TECHNICAL CERAMICS CORP. AND SUBSIDIARIES  
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS  
(In thousands, except per share data)

(6) COMPREHENSIVE LOSS:

The Company's comprehensive (loss)/income is as follows:

	For the Three Months Ended December 31,	
	2003	2002
	-----	-----
Net loss	\$ (446)	\$ (330)
	-----	-----
Other comprehensive income:		
Foreign currency translation adjustments	111	114
Unrealized losses on investments, net of tax	(1)	(1)
	-----	-----
Other comprehensive income	110	113
	-----	-----
Comprehensive loss	\$ (336)	\$ (217)
	=====	=====

	For the Six Months Ended December 31,	
	2003	2002
	-----	-----
Net (loss)/income	\$ (1,229)	\$ 8
	-----	-----
Other comprehensive income:		

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Foreign currency translation adjustments	154	98
Unrealized losses on investments, net of tax	(2)	--
	-----	-----
Other comprehensive income	152	98
	-----	-----
Comprehensive (loss)/income	\$ (1,077)	\$ 106
	=====	=====

(7) INDEBTEDNESS:

The Company leases an administrative office, manufacturing and research and development complex located in Jacksonville, Florida (the "Jacksonville Facility") from a partnership controlled by the Company's President, Chief Executive Officer and principal stockholder under a capital lease. At June 30, 2003, the Jacksonville Facility has an aggregate cost of \$5,104 and a net book value of \$2,705. The lease is for a period of 30 years, was capitalized using an interest rate of 10.5% and expires on September 30, 2010. The lease provides for base rent of approximately \$719 per annum. The lease further provides for annual increases in base rent for years beginning after May 1, 1999, based on the increase in the Consumer Price Index ("CPI") since May 1, 1998 applied to base rent. The lease also provides for increases to the base rent in connection with any new construction at the Jacksonville Facility. Under the lease, upon any new construction being placed into use, the base rental is subject to increase to the fair market rental of the Jacksonville Facility, including the new construction. Effective October 1, 2003, the Company is obligated to pay approximately \$734 per annum under this lease. The payments due over the remaining seven years of this capital lease, including the portion related to interest, total approximately \$4,956.

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AMERICAN TECHNICAL CERAMICS CORP. AND SUBSIDIARIES  
 NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS  
 (In thousands, except per share data)

(8) STOCK-BASED COMPENSATION:

On April 1, 1997, the Board of Directors approved the American Technical Ceramics Corp. 1997 Stock Option Plan (the "1997 Option Plan") pursuant to which the Company may grant options to purchase up to 800,000 shares of the Company's common stock. On April 11, 2000, the Board of Directors approved the American Technical Ceramics Corp. 2000 Incentive Stock Plan (the "2000 Plan", and collectively with the 1997 Option Plan, the "Plans") pursuant to which the Company may grant options or stock awards covering up to 1,200,000 shares of the Company's common stock. Each of the Plans is administered by the Board of Directors or by a committee appointed by the Board. Options granted under the Plans may be either incentive or non-qualified stock options. The term of each incentive stock option shall not exceed ten years from the date of grant (five years for grants to employees who own 10% or more of the voting power of the Company's common stock). Options vest in accordance with a vesting schedule established by the plan administrator (traditionally 25% per year during the first four years of their term). Unless terminated earlier by the Board, the 1997 Option Plan will terminate on March 31, 2007, and the 2000 Plan will



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terminate on April 10, 2010.

Disposition of shares acquired pursuant to the exercise of incentive stock options under both Plans may not be made by the optionees within two years following the date that the option is granted, nor within one year after the exercise of the option, without the written consent of the Company. The Company measures compensation cost for options granted prior to July 1, 2003 pursuant to Accounting Principals Board Opinion No. 25, "Accounting for Stock Issued to Employees ("Opinion No. 25"). The Company has not recognized compensation cost for these options upon grant as the exercise price was equal to the fair market value of the underlying stock at the date of grant.

Stock option activity for the three months ended December 31, 2003 and 2002 is as follows:

	December 31, 2003		December 31, 2002
	Shares Subject to Options	Weighted Average Exercise Price	Shares Subject to Options
Outstanding, beginning of period	1,384,800	\$ 6.63	1,395,050
Granted	---	--	--
Canceled	(5,250)	8.89	(11,750)
Expired	(8,850)	6.75	(3,750)
Exercised	(17,750)	3.41	(4,500)
Outstanding, end of period	1,352,950	\$ 6.67	1,375,050

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AMERICAN TECHNICAL CERAMICS CORP. AND SUBSIDIARIES  
 NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS  
 (In thousands, except per share data)

(8) STOCK-BASED COMPENSATION (CONTINUED):

Stock option activity for the six months ended December 31, 2003 and 2002 is as follows:

	December 31, 2003		December 31, 2002
	Shares Subject to Options	Weighted Average Exercise Price	Shares Subject to Options
Outstanding, beginning of period	1,381,200	\$ 6.64	919,800

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Granted	13,000	5.85	479,000
Canceled	(6,500)	9.87	(11,750)
Expired	(9,350)	8.08	(7,500)
Exercised	(25,400)	3.27	(4,500)
	-----		-----
Outstanding, end of period	1,352,950	\$ 6.67	1,375,050
	=====		=====

In July 2003, the Company adopted Statement of Financial Accounting Standard No. 123 ("SFAS No. 123"), using the prospective method as prescribed in Statement of Financial Accounting Standard No. 148 ("SFAS No. 148"). The Company applies SFAS No. 123 in accounting for employee stock-based compensation awarded or granted after June 30, 2003, and applies Opinion No. 25 in accounting for employee stock-based compensation awarded or granted prior to July 1, 2003, and makes pro-forma disclosures of net income and net income per share as if the fair value method under SFAS No. 123, as amended by SFAS No. 148, had been applied. The Company has recorded \$4 of compensation expense for options granted after June 30, 2003. Had compensation expense with respect to options and awards granted under the Plans been determined based on the fair value method on the date of grant consistent with the methodology prescribed under SFAS No. 123 prior to July 1, 2003, the Company's net loss and loss per share would have approximated the pro forma amounts indicated below:

	Three Months Ended De
	----- 2003 -----
Net loss, as reported	(446)
Add: Stock-based employee compensation expense included in reported net income, net of related tax effects	12
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	(439)
	-----
Pro forma loss	(873)
Loss per share:	
Basic - as reported	(0.05)
Basic - pro forma	(0.11)
Diluted - as reported	(0.05)
Diluted - pro forma	(0.11)

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Net (loss)/income, as reported	\$	(1,229)
Add: Stock-based employee compensation expense included in reported net income, net of related tax effects		75
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects		(926)
Pro forma loss	\$	(2,080)
(Loss)/income per share:		
Basic - as reported	\$	(0.15)
Basic - pro forma	\$	(0.26)
Diluted - as reported	\$	(0.15)
Diluted - pro forma	\$	(0.26)

The weighted-average fair value of each stock option included in the preceding pro forma amounts was estimated using the Black-Scholes option pricing model and is amortized over an expected grant life of five years.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL  
CONDITION AND RESULTS OF OPERATIONS  
(In thousands, except per share data)

The following discussion and analysis should be read in conjunction with the consolidated financial statements, related notes and other information included in this Quarterly Report on Form 10-Q.

Statements in this Quarterly Report on Form 10-Q that are not historical fact may constitute "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. All such forward-looking statements are subject to risks and uncertainties, including, but not limited to, market and economic conditions, the impact of competitive products, product demand and market acceptance risks, changes in product mix, costs and availability of raw materials, fluctuations in operating results, delays in development of highly complex products, risks associated with international sales and sales to the U.S. military, risk of customer contract or sales order cancellations and other risks detailed from time to time in the Company's filings with the Securities and Exchange Commission, including, without limitation, those contained under the caption "Item 1. BUSINESS - CAUTIONARY STATEMENTS REGARDING FORWARD - LOOKING STATEMENTS" in the Company's Annual Report on Form 10-K. These risks could cause the Company's actual results for future periods to differ materially from those expressed in any forward-looking statements made by, or on behalf of, the Company. Any forward-looking statement represents the Company's expectations or forecasts only as of the date it was made and should not be relied upon as representing its expectations or forecasts as of any subsequent date. The Company undertakes no obligation to correct or update any forward-looking statement, whether as a result of new information, future events or otherwise, even if its expectations or forecasts change.

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### Overview

Three years ago, the electronics components industry experienced a sharp downturn. As a result, the Company's average quarterly sales dropped approximately 40% and have remained at this reduced level for the past two and a half years. The decline was driven primarily by weakness in the wireless infrastructure and semiconductor equipment markets which are important markets for the Company's products.

There has been a trend of increasing bookings from the semiconductor equipment market over the past nine months and from the wireless infrastructure market over the past three months. Customers in these markets indicate that the higher level of activity is expected to continue through the end of the current fiscal year.

For the past three years, bookings have not been a useful indicator of future business as customers had been placing orders with very short lead times. The number of orders placed and shipped in the same month typically exceeded 40% during this period. Recently, the Company has received some orders with longer lead times. However, the ability to deliver product rapidly remains important in securing orders.

Prices have remained relatively stable during most of the economic downturn. However, as volume from selected wireless infrastructure customers increases, price pressure in this market will increase. In addition, in order to reduce costs many customers in the telecommunications market are outsourcing production to contract manufacturers who often attempt to renegotiate the prices agreed to with the customer, creating another source of price pressure.

In response to increased booking and quoting activity, the Company has increased headcount in production and sales. This has decreased gross margin and increased operating expenses. The Company believes that the additions to personnel have improved lead times and customer service which has positioned the Company to take advantage of opportunities in the coming quarters as demand increases and opportunities in the market surface.

In response to growing volume, the Company will soon begin renovating the building it purchased three years ago as part of its New York facility, as well as purchasing the building that houses its Microcap product line in Florida which it currently leases. These actions are designed to improve flexibility for future product expansion. A byproduct of these actions will be an increase in capacity which will enable the Company to produce certain products in higher volumes. During the first six months of fiscal year 2004, the Company operated at approximately one third of its equipment capacity.

The Company has benefited from lower precious metal costs for the past three years. As economic conditions continue to improve, the demand for precious metals used in the Company's manufacturing processes has increased. As a result, the Company has seen a rise in the market prices of these metals and has purchased quantities of them to protect against rising prices. Given current levels of demand, it is likely that additional purchases will be necessary in the near future.

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(In thousands, except per share data)

## RESULTS OF OPERATIONS

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### KEY COMPARATIVE PERFORMANCE INDICATORS

	Three Months Ended		
	Dec. 31, 2003	Dec. 31, 2002	Dec. 31, 2001
Sales \$	\$ 13,516	\$ 11,561	\$ 26,066
Bookings \$	\$ 14,186	\$ 13,248	\$ 26,466
Gross Margin \$	\$ 3,643	\$ 3,429	\$ 6,516
Gross Margin %	27.0%	29.7%	25.0%
Operating Expenses \$	\$ 4,124	\$ 3,819	\$ 8,036
Operating Expenses %	30.5%	33.0%	30.0%

### SIGNIFICANT HIGHLIGHTS

Sales for the three and six months ended December 31, 2003 increased 17% and 8%, respectively, over the comparable periods in the prior fiscal year.

Bookings for the three and six months ended December 31, 2003 increased 7% and 4%, respectively, over the comparable periods in the prior fiscal year.

### THREE MONTHS ENDED DECEMBER 31, 2003 COMPARED WITH THREE MONTHS ENDED DECEMBER 31, 2002

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Net sales for the three months ended December 31, 2003 increased 17% to \$13,516, compared to \$11,561 recorded in the comparable period in the prior fiscal year. The improvement was attributable to higher shipments to the wireless infrastructure, semiconductor equipment and military markets, a trend the Company expects to continue for the next several quarters.

Gross margin for the three months ended December 31, 2003 was 27.0% of net sales, compared to 29.7% for the comparable period in the prior fiscal year. The decrease in gross margin was principally due to increasing labor and overhead costs to support higher production levels. The Company has increased headcount to increase production volume in response to increased booking and quoting activity, to improve product delivery, and to support new products entering later stages of preproduction.

The Company has experienced lower raw material costs offset by lower precious metal recovery compared to the comparable period last fiscal year. Both decreases are primarily due to the lower carrying cost of palladium compared to a year ago. Precious metal recovery is also lower due to a lower quantity of metal reclaimed during the period compared to the second quarter of last fiscal year. Precious metal recovery last year was higher than normal due to higher than normal scrap reclamation from excess inventory.

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### MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (CONTINUED) (In thousands, except per share data)

Selling, general and administrative expenses for the three months ended December 31, 2003 increased 22% to \$3,445, compared to \$2,813 in the comparable period in the prior fiscal year. The increase was mainly due to increased selling expense. The Company has increased the number of sales personnel in its existing offices in the US and Europe and established a new sales office in the Far East. These actions were taken in response to increased booking and quoting activity and to take advantage of market opportunities in an improving economy. The Company believes that offering exceptional customer service and quick delivery will help increase sales volume.

Research and development expenses for the three months ended December 31, 2003 increased 12% to \$742, compared to \$664 in the comparable period in the prior fiscal year. The increase is due to increased efforts to develop new products and improve processes and materials. The Company strives to be a quality leader in the industry and must continually improve its products to maintain that position.

The Company recorded other income of \$63 for the three months ended December 31, 2003, compared to other expense of \$342 in the comparable period in the prior fiscal year. The other expense recorded during the second quarter of last fiscal year related primarily to a pretax charge of \$362 due to the disposal of certain assets no longer used in the Company's manufacturing processes.

The effective tax rate for the three months ended December 31, 2003 was approximately 19%. The decrease in the effective tax rate was primarily due to increased tax benefits in relation to income.

Bookings for the three months ended December 31, 2003 were \$14,186, compared to \$13,248 for the three months ended December 31, 2002. The increase is due to increased activity from the wireless infrastructure and semiconductor markets. Delivery times and price are key factors in obtaining orders. The Company is taking steps to maintain short delivery times in the face of increased demand. These steps include increasing inventory levels.

The backlog of unfilled orders was \$9,528 at December 31, 2003, compared to \$10,814 at December 31, 2002 and \$9,129 at June 30, 2003. The increase in backlog from June 30, 2003 was primarily due to the increase in orders from the wireless infrastructure and semiconductor equipment markets. Recently, customers have been placing some orders with longer lead times. This trend typically occurs when customers are anticipating higher production levels and want to secure a supply of material. It also provides the Company some forward planning ability. The decrease in backlog from December 31, 2003 is mainly due to shipments against a large military order received in the second quarter of last fiscal year.

As a result of the foregoing, net loss for the three months ended December 31, 2003 was \$446, or (\$0.05) per common share and per common share assuming dilution, compared to net loss of \$330, or (\$0.04) per common share and per common share assuming dilution, for the comparable period in the prior fiscal year.

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### MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (CONTINUED) (In thousands, except per share data)

SIX MONTHS ENDED DECEMBER 31, 2003 COMPARED WITH SIX MONTHS ENDED  
DECEMBER 31, 2002

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Net sales for the six months ended December 31, 2003 increased 8% to \$26,065, compared to \$24,048 in the comparable period in the prior fiscal year. The increase in net sales was primarily the result of higher shipments to the wireless infrastructure, semiconductor equipment and military markets.

Gross margin for the six months ended December 31, 2003 was 25.0% of net sales, compared to 31.3% for the comparable period in the prior fiscal year. The decrease in gross margin percentage was principally due to increasing labor and overhead costs to support higher production levels, offset partially by lower material costs. As mentioned above, the Company has increased headcount to increase production volume in response to increased booking and quoting activity, to improve product delivery, and to support new products entering later stages of preproduction.

The Company experienced lower raw material costs offset by lower precious metal recovery compared to the comparable period last fiscal year. Both decreases are primarily due to the lower carrying cost of palladium compared to a year ago. Precious metal recovery is also lower due to a lower quantity of metal reclaimed during the period compared to the second quarter of last fiscal year. Precious metal recovery last year was higher than normal due to higher than normal scrap reclamation from excess inventory.

Selling, general and administrative expenses for the six months ended December 31, 2003 increased 15% to \$6,654, compared to \$5,775 in the comparable period in the prior fiscal year. The increase was due mainly to increased selling expense. The Company has increased the number of sales personnel in response to increased booking and quoting activity and to take advantage of market opportunities in an improving economy.

Research and development expenses for the six months ended December 31, 2003 increased 9% to \$1,452, compared to \$1,333 in the comparable period in the prior fiscal year. The increase is due to increased efforts to develop new products and improve processes and materials.

The Company recorded other income of \$67 for the six months ended December 31, 2003, compared to other expense of \$291 in the comparable period in the prior fiscal year. The other expense for the six month period ended December 31, 2002 related primarily to a pretax charge of \$362 due to the disposal of certain assets no longer used in the Company's manufacturing processes.

The effective tax rate for the six months ended December 31, 2003 was approximately 26%. Income tax benefit for the six months ended December 31, 2003 included a \$65 gain related to tax audit settlements in the quarter ended September 30, 2003.

As a result of the foregoing, net loss for the six months ended December 31, 2003 was \$1,229, or (\$0.15) per common share and per common share assuming dilution, compared to net income of \$8, essentially breakeven on a per share basis, for the comparable period in the prior fiscal year.

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MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL  
CONDITION AND RESULTS OF OPERATIONS (CONTINUED)  
(In thousands, except per share data)

LIQUIDITY AND CAPITAL RESOURCES  
-----

	Dec. 31, 2003	Sept. 30, 2003	June 30, 2003
	-----	-----	-----
Cash and Investments	\$ 10,657	\$ 11,311	\$ 11,657
Working Capital	\$ 31,571	\$ 31,252	\$ 31,457
Quarter Ended:			
Operating Cash Flow	\$ (189)	\$ 513	\$ 853
Capital Expenditures	\$ 576	\$ 868	\$ 576
Depreciation	\$ 1,259	\$ 1,270	\$ 1,319
Current Ratio	7.4:1	7.4:1	7.3:1
Quick Ratio	3.5:1	3.7:1	3.7:1

The Company's financial position at December 31, 2003 remains strong as evidenced by working capital of \$31,571 and stockholders' equity of \$51,069. The Company's current and quick ratios at December 31, 2003 also remain strong.

Cash, cash equivalents and investments decreased by \$1,039 from June 30, 2003, primarily as a result of capital expenditures in excess of operating cash flows. Inventories increased by \$575 from June 30, 2003, primarily as the result of precious metal purchases during the quarter ended December 31, 2003. The purchases during the quarter were to bring precious metal stock to normal operating levels. Subsequent to December 31, 2003, the Company purchased additional supplies of palladium, gold and silver to protect against shortages and rising prices.

The Company has benefited from lower precious metal costs for the past three years. However, as economic conditions improve, the demand for the precious metals the Company uses in its manufacturing processes is increasing throughout the electronics industry and other industries. As a result, the Company has seen a rise in the market prices of these metals. The Company has purchased quantities of these metals to protect against rising prices. It is likely that additional purchases at the then available market price will be necessary in the near future.

Other current assets increased by \$464 from June 30, 2003, mainly due to the timing of payments for real estate taxes, value added tax and payroll. Accrued expenses increased by \$553 during the same period due to the timing of payments relating to vacation pay and payroll taxes as well as to increased commission accruals as the result of increased bookings and sales. Taxes payable decreased \$489 from June 30, 2003, primarily due to taxable losses incurred during the period.



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### MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (CONTINUED) (In thousands, except per share data)

The Company leases a facility in Jacksonville, Florida from a partnership controlled by the Company's President, Chief Executive Officer and principal stockholder under a capital lease. The rental payments under this lease have been adjusted several times, most recently as of October 2003, primarily to reflect fair market rental adjustments as a result of certain additions or improvements to the facility or annual increases based on the consumer price index as required by the terms of the lease. Each fair market rental adjustment has been based upon an independent appraisal of the fair market rental of the facility giving effect to the addition or improvement at issue. Effective October 1, 2003, the Company is obligated to pay approximately \$734 per annum under this lease. The payments due over the remaining seven years of this capital lease, including the portion related to interest, total approximately \$4,956.

Capital expenditures for the six months ended December 31, 2003 totaled \$1,444, including expenditures for machinery and equipment and leasehold improvements. The Company intends to use cash on hand and cash generated through operations to finance budgeted capital expenditures of approximately \$4,000 for the remainder of fiscal year 2004, primarily for equipment acquisitions and building acquisitions and renovations including \$500 for the purchase of the building in Jacksonville Florida and \$1,000 for the renovation of an existing idle building in New York.

Aggregate contractual obligations as of December 31, 2003 mature as follows:

Contractual Obligations	Total	Less than 1 year	1- 3 years
Bank Debt	\$ --	\$ --	\$ --
Capital Lease Obligations	3,472	374	1,386
Operating Leases	1,565	420	1,145
Total Contractual Obligations	\$ 5,037	\$ 794	\$ 2,531

The Company routinely enters into binding and non-binding purchase obligations in the ordinary course of business, primarily covering anticipated purchases of inventory and equipment. The terms of these commitments generally do not extend beyond six months. None of these obligations are individually significant. The Company does not expect that these commitments will materially adversely affect its liquidity in the foreseeable future.

#### CRITICAL ACCOUNTING POLICIES

The Securities and Exchange Commission (the "SEC") issued disclosure guidance for "critical accounting policies." The SEC defines "critical accounting policies" as those that require the application of management's most difficult, subjective or complex judgments, often as a result of the need to make estimates about the effect of matters that are inherently uncertain and may

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change in subsequent periods. The Company's significant accounting policies are described in Note 1 to its consolidated financial statements contained in its Annual Report on Form 10-K for the fiscal year ended June 30, 2003. The Company believes that the following accounting policies require the application of management's most difficult, subjective or complex judgments:

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### MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (CONTINUED) (In thousands, except per share data)

#### Allowances for Doubtful Accounts Receivable -----

The Company performs ongoing credit evaluations of its customers and adjusts credit limits based upon payment history and a customer's current creditworthiness, as determined by its review of the customer's current credit information. The Company continuously monitors collections and payments from its customers and maintains an allowance for estimated credit losses based upon its historical experience and any specific customer collection issues that the Company has identified. While such credit losses have historically been within the Company's expectations and the allowances established, the Company cannot guarantee that it will continue to experience the same credit loss rates that it has in the past. Should the financial position of its customers deteriorate resulting in an impairment of their ability to pay amounts due, the Company's revised estimate of such losses and any actual losses in excess of previous estimates may negatively impact its operating results.

#### Sales Returns and Allowances -----

In the ordinary course of business, the Company accepts returns of products sold for various reasons and grants sales allowances to customers. While the Company engages in extensive product quality control programs and processes, its level of sales returns is affected by, among other things, the quality of its manufacturing processes. The Company maintains an allowance for sales returns and allowances based upon historical returns and allowances granted. While such returns and allowances have historically been within the Company's expectations, actual return and allowance rates in the future may differ from current estimates, which could negatively impact its operating results.

#### Inventory Valuation -----

The Company values inventory at the lower of aggregate cost (first-in, first-out) or market. When the cost of inventory is determined by management to be in excess of its market value, such inventory is written down to its estimated net realizable value. This requires the Company to make estimates and assumptions about several factors (e.g., future sales quantities and selling prices, and percentage complete and failure rates for work in process) based upon historical experience and its projections for future periods. Changes in factors such as the level of order bookings, the product mix of order bookings and the Company's manufacturing processes could have a material impact on the Company's assessment of the net realizable value of inventory in the future.

#### Valuation of Deferred Tax Assets

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The Company regularly evaluates its ability to recover the reported amount of its deferred income taxes considering several factors, including its estimate of the likelihood of the Company generating sufficient taxable income in future years during the period over which temporary differences reverse. Presently, the Company believes that it is more likely than not that it will realize the benefits of its deferred tax assets based primarily on its history of and projections for taxable income in the future, and its intention to carry back net operating losses to generate refunds of income taxes previously paid. In the event that actual results differ from its estimates or the Company adjusts these estimates in future periods, the Company may need to establish a valuation allowance against a portion or all of its deferred tax assets, which could materially impact its financial position or results of operations in future periods.

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MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL  
CONDITION AND RESULTS OF OPERATIONS (CONTINUED)  
(In thousands, except per share data)

Valuation of Long-lived Assets  
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The Company assesses the recoverability of long-lived assets whenever the Company determines that events or changes in circumstances indicate that the carrying amount may not be recoverable. Its assessment is primarily based upon its estimate of future cash flows associated with these assets. The Company believes that the carrying amount of its long-lived assets is recoverable. However, should its operating results deteriorate, or anticipated new product launches not occur or not attain the commercial acceptance that the Company anticipates, the Company may determine that some portion of its long-lived assets are impaired. Such determination could result in non-cash charges to income that could materially affect its financial position or results of operations for that period.

IMPACT OF NEW ACCOUNTING STANDARDS  
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In January 2004, the Company adopted the Financial Accounting Standards Board Interpretation No. 46, "Consolidation of Variable Interest Entities" (FIN No. 46). Previously, consolidation of variable interest entities was largely based on controlling voting rights. This interpretation clarifies the application of Accounting Research Bulletin No. 51, "Consolidated Financial Statements", to entities where the Company is vulnerable to a majority of the entity's risk of loss or is entitled to receive a majority of the entity's residual returns even if there is no controlling voting interest. The adoption of FIN No. 46 did not have any impact on the Company's consolidated results of operations or financial position.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company's market risk exposure at December 31, 2003 as it relates to currency exchange rate and security price risks is consistent with the types of market risk and amount of exposures presented in its Annual Report on Form 10-K for the fiscal year ended June 30, 2003.

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Commodity price risk. The Company uses certain precious metals in the manufacturing of its products (primarily palladium and gold), and is therefore subject to certain commodity price risks. The Company believes that, based upon its current levels of production and inventories of palladium and gold, it will need to buy additional quantities of palladium and gold during the next year at prevailing market prices. The price of palladium and gold have begun to rise due to the higher demand coming from the electronics industry and other industries. Consequently, the Company has decided to purchase a quantity of these metals to protect against rising prices.

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### MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS (CONTINUED) (In thousands, except per share data)

#### ITEM 4. CONTROLS AND PROCEDURES

##### Evaluation of Disclosure Controls and Procedures

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In response to the requirements of the Sarbanes-Oxley Act of 2002, as of the end of the period covered by this Quarterly Report on Form 10-Q (the "Evaluation Date"), the Company's President and Chief Executive Officer and Vice President - Controller carried out an evaluation of the effectiveness of the Company's "disclosure controls and procedures" (as defined in the Securities Exchange Act of 1934 Rules 13a-15(e) and 15d-15(e)). Based on that evaluation, these officers concluded that, as of the Evaluation Date, the Company's disclosure controls and procedures were adequate and effective to ensure that material information relating to the Company and the Company's consolidated subsidiaries was made known to them by others within those entities, particularly during the period in which this report was being prepared.

##### Changes in Internal Controls

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There were no changes in the Company's internal controls over financial reporting identified in connection with the evaluation of such internal controls that occurred during the Company's last fiscal quarter that have materially affected, or are reasonably likely to materially affect, the Company's internal controls over financial reporting.

### PART II - OTHER INFORMATION

ITEMS 1. THROUGH 3. Not Applicable

#### ITEM 4. Submission of Matters to a Vote of Security Holders

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At the Company's Annual Meeting of Stockholders held on November 19, 2003 (the "Annual Meeting"), the stockholders elected the individuals named below as directors for one-year terms. Votes were cast as follows:

	For	Withheld
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Victor Insetta	7,809,194	68,307

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Dov S. Bacharach	7,831,386	46,115
Chester E. Spence	7,772,330	105,171
O. Julian Garrard III	7,831,386	46,115
Stuart P. Litt	7,772,330	105,171
Thomas J. Volpe	7,831,386	46,115

The stockholders also ratified the appointment of KPMG LLP as the independent public accountants to audit the Company's consolidated financial statements for the fiscal year ending June 30, 2004. The holders of 7,829,292 shares of Common Stock voted to ratify the appointment, 42,395 voted against ratification and the holders of 5,814 shares of Common Stock abstained from voting on the issue.

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ITEM 5. Not Applicable  
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ITEM 6. Exhibits and Reports on Form 8-K  
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(a) Exhibits  
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EXHIBIT NO. DESCRIPTION  
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10(h)	-	Employment Agreement, dated October 1, 2003, between the Company and Richard Monsorno.
10(ii)	-	Officers Profit Bonus Plan, dated October 30, 2003 and effective June 30, 1992.
10(t)	-	Severance Agreement, dated November 1, 2003, between the Company and Kathleen M. Kelly.
10(u)	-	Severance Agreement, dated November 1, 2003, between the Company and Andrew Perz.
10(v)	-	Severance Agreement, dated November 1, 2003, between the Company and Harrison Tarver.
31.1	-	Section 302 Certification of Principal Executive Officer.
31.2	-	Section 302 Certification of Principal Accounting Officer.
32.1	-	Section 906 Certification of Principal Executive Officer.
32.2	-	Section 906 Certification of Principal Accounting Officer.

(b) REPORTS ON FORM 8-K  
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1. On November 3, 2003, the Company furnished a report on Form 8-K together with the Company's Press Release announcing its first quarter financial results for the period ended September 30, 2003. The Form 8-K contained the

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information required by Item 9. "Regulation FD Disclosure" and Item 12. "Disclosure of Results of Operations and Financial Condition," in accordance with SEC Release 33-8216.

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SIGNATURES

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

AMERICAN TECHNICAL CERAMICS CORP.  
(Company)

DATE: February 12, 2003

BY: /s/ VICTOR INSETTA

-----  
Victor Insetta  
President and Director  
(Principal Executive Officer)

DATE: February 12, 2003

BY: /s/ ANDREW R. PERZ

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Andrew R. Perz  
Vice President, Controller  
(Principal Accounting Officer)

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