NORTECH SYSTEMS INC
Form 10-Q
May 06, 2015
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D. C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2015

OR

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

For the transition period from to

NORTECH SYSTEMS INCORPORATED

Commission file number 0-13257

State of Incorporation: **Minnesota**

IRS Employer Identification No. **41-1681094**

Executive Offices: **1120 Wayzata Blvd E., Suite 201, Wayzata, MN 55391**

Telephone number: **(952) 345-2244**

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

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

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

Large Accelerated Filer o	Accelerated Filer o
Non-accelerated Filer o	Smaller Reporting Company x

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

Number of shares of $.01 par value common stock outstanding at May 1, 2015 - 2,746,324

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PART 1

ITEM 1. FINANCIAL STATEMENTS

NORTECH SYSTEMS INCORPORATED AND SUBSIDIARY

CONSOLIDATED BALANCE SHEETS

	MARCH 31 2015 (Unaudited)	DECEMBER 31 2014
ASSETS		
Current Assets		
Cash	$ 47,462	$ 66,371
Accounts Receivable, Less Allowance for Uncollectible Accounts	16,410,140	17,367,668
Inventories	19,517,217	18,528,418
Prepaid Expenses	968,673	816,775
Income Taxes Receivable	603,976	465,236
Deferred Income Taxes	436,000	436,000
Total Current Assets	37,983,468	37,680,468
Property and Equipment, Net	11,252,116	10,888,717
Other Assets	115,804	117,127
Total Assets	$ 49,351,388	$ 48,686,312
LIABILITIES AND SHAREHOLDERS EQUITY		
Current Liabilities		
Current Maturities of Long-Term Debt	782,912	732,835
Accounts Payable	8,823,104	9,008,426
Accrued Payroll and Commissions	2,881,469	2,896,557
Other Accrued Liabilities	781,566	732,012
Total Current Liabilities	13,269,051	13,369,830
Long-Term Liabilities		
Line of Credit	8,942,345	7,998,184
Long-Term Debt, Net of Current Maturities	4,206,221	4,072,506
Deferred Income Taxes	149,000	149,000
Other Long-Term Liabilities	145,497	268,400
Total Long-Term Liabilities	13,443,063	12,488,090
Total Liabilities	26,712,114	25,857,920
Shareholders Equity		
Preferred Stock, $1 par value; 1,000,000 Shares Authorized: 250,000 Shares Issued and Outstanding	250,000	250,000
Common Stock - $0.01 par value; 9,000,000 Shares Authorized: 2,742,992 Shares Issued and Outstanding	27,430	27,430
Additional Paid-In Capital	15,754,829	15,751,160
Accumulated Other Comprehensive Loss	(62,936)	(62,936)
Retained Earnings	6,669,951	6,862,738
Total Shareholders Equity	22,639,274	22,828,392

Total Liabilities and Shareholders Equity	$	49,351,388	$	48,686,312

See Accompanying Condensed Notes to Consolidated Financial Statements

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NORTECH SYSTEMS INCORPORATED AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF OPERATIONS

(UNAUDITED)

	THREE MONTHS ENDED MARCH 31			
	2015		**2014**	
Net Sales	$	26,539,622	$	26,149,142
Cost of Goods Sold		23,673,467		23,075,207
Gross Profit		2,866,155		3,073,935
Operating Expenses				
Selling Expenses		1,363,442		1,120,901
General and Administrative Expenses		1,704,314		1,716,813
Total Operating Expenses		3,067,756		2,837,714
Income (Loss) From Operations		(201,601)		236,221
Other Expense				
Interest Expense		(95,186)		(89,980)
Miscellaneous Income (Expense), net				(10,084)
Total Other Expense		(95,186)		(100,064)
Income (Loss) Before Income Taxes		(296,787)		136,157
Income Tax Expense (Benefit)		(104,000)		50,000
Net Income (Loss)	$	(192,787)	$	86,157
Earnings (Loss) Per Common Share:				
Basic	$	(0.07)	$	0.03
Weighted Average Number of Common Shares Outstanding - Basic		2,742,992		2,742,992
Diluted	$	(0.07)	$	0.03
Weighted Average Number of Common Shares Outstanding - Diluted		2,742,992		2,747,858

See Accompanying Condensed Notes to Consolidated Financial Statements

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NORTECH SYSTEMS INCORPORATED AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF CASH FLOWS

(UNAUDITED)

	THREE MONTHS ENDED MARCH 31	
	2015	**2014**
Cash Flows From Operating Activities		
Net Income (Loss)	$ (192,787)	$ 86,157
Adjustments to Reconcile Net Income (Loss) to Net Cash Provided by (Used in) Operating Activities		
Depreciation	516,666	497,350
Amortization	1,323	1,323
Compensation on Stock-Based Awards	3,669	7,482
Compensation on Equity Appreciation Rights	(11,683)	
(Gain) Loss on Disposal of Property and Equipment	1,129	1,150
Changes in Operating Assets and Liabilities:		
Changes in Current Operating Items		
Accounts Receivable	957,527	621,401
Inventories	(988,799)	(1,366,793)
Prepaid Expenses	(151,898)	(165,938)
Income Taxes Receivable	(138,740)	53,367
Income Taxes Payable		
Accounts Payable	(168,158)	640,234
Accrued Payroll and Commissions	(15,088)	76,156
Other Accrued Liabilities	(52,762)	71,528
Net Cash Provided by (Used in) Operating Activities	(239,601)	523,417
Cash Flows from Investing Activities		
Purchases of Property and Equipment	(907,260)	(669,663)
Net Cash Used in Investing Activities	(907,260)	(669,663)
Cash Flows from Financing Activities		
Borrowings on Line of Credit	29,068,236	27,046,075
Repayments on Line of Credit	(28,124,075)	(26,655,590)
Proceeds from Long-Term Debt	347,000	230,000
Principal Payments on Long-Term Debt	(163,209)	(138,044)
Net Cash Provided by Financing Activities	1,127,952	482,441
Net Increase (Decrease) in Cash	(18,909)	336,195
Cash - Beginning	66,371	
Cash - Ending	$ 47,462	$ 336,195
Supplemental Disclosure of Cash Flow Information		
Cash Paid During the Period for Interest	$ 92,265	$ 87,159
Cash Paid During the Period for Income Taxes		100
Supplemental Noncash Investing and Financing Activities		
Capital Expenditures in Accounts Payable	2,440	124,749

See Accompanying Condensed Notes to Consolidated Financial Statements

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CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The accompanying unaudited consolidated financial statements for the interim periods have been prepared in accordance with Generally Accepted Accounting Principles in the United States of America (GAAP) for interim financial information and pursuant to the rules and regulations of the Securities and Exchange Commission. Accordingly, they do not include all of the financial information and footnotes required by GAAP for complete financial statements, although we believe the disclosures are adequate to make the information presented not misleading. It is suggested that these consolidated financial statements be read in conjunction with the consolidated financial statements and the notes thereto included in our latest shareholders annual report on Form 10-K. The operating results for the interim periods presented are not necessarily indicative of the results expected for the full year or for any other interim period. In our opinion, all adjustments (consisting of normal recurring adjustments) considered necessary for a fair presentation have been included.

The preparation of financial statements in conformity with GAAP requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. In preparing these consolidated financial statements, we have made our best estimates and judgments of certain amounts included in the consolidated financial statements, giving due consideration to materiality. Changes in the estimates and assumptions used by us could have a significant impact on our financial results, since actual results could differ from those estimates.

Principles of Consolidation

The consolidated financial statements include the accounts of Nortech Systems Incorporated and its wholly owned subsidiary, Manufacturing Assembly Solutions of Monterrey, Inc. All significant intercompany accounts and transactions have been eliminated.

Revenue Recognition

We recognize manufacturing revenue when we ship goods or the goods are received by our customer, when title has passed, all contractual obligations have been satisfied, the price is fixed or determinable and collection of the resulting receivable is reasonably assured. Generally, there are no formal substantive customer acceptance requirements or further obligations related to manufacturing services. If such requirements or obligations exist, then we recognize the related revenues at the time when such requirements are completed and the obligations are fulfilled. We also provide engineering services separate from the manufacture of a product. Revenue for engineering services is generally recognized upon completion of the engineering process. In addition, we have another separate source of revenue that comes from short-term repair services, which are recognized when the repairs are completed and the repaired products are shipped back to the customer. Our net sales for services were less than 5% of our total sales for all periods presented, and accordingly, are included in net sales in the consolidated statement of operations. Shipping and handling costs charged to our customers are included in net sales, while the corresponding shipping expenses are included in cost of goods sold.

Stock Options

Following is the status of all stock options outstanding as of March 31, 2015:

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	Shares	Weighted-Average Exercise Price Per Share	Weighted-Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value
Outstanding - January 1, 2015	181,000	$ 6.36		
Granted				
Cancelled	(5,250)	7.64		
Outstanding - March 31, 2015	175,750	$ 6.32	2.72	$ 46,278
Exercisable - March 31, 2015	166,836	$ 6.49	2.44	$ 30,856

There were no options exercised during the three months ended March 31, 2015 and 2014. There were no stock options granted during the three months ended March 31, 2015 and 2014.

Total compensation expense related to stock options for the three months ended March, 2015 and 2014 was $3,669 and $7,482, respectively. As of March 31, 2015, there was approximately $13,000 of unrecognized compensation related to unvested option awards that we expect to recognize over a weighted-average period of 0.87 years.

Equity Appreciation Rights Plan

In November 2010, the Board of Directors approved the adoption of the Nortech Systems Incorporated Equity Appreciation Rights Plan (the 2010 Plan). The total number of Equity Appreciation Right Units (Units) the Plan can issue shall not exceed an aggregate of 750,000. The 2010 Plan provides that Units issued shall fully vest three years from the base date as defined in the agreement unless terminated earlier. Units give the holder a right to receive a cash payment equal to the appreciation in book value per share of common stock from the base date, as defined, to the redemption date. Unit redemption payments under this plan shall be paid in cash within 90 days after we determine the value as of the redemption date.

During the three months ended March 31, 2015, 100,000 Units were issued with a vesting date of December 31, 2018. On March 7, 2012, we granted an additional 250,000 Units with vesting dates ranging from December 31, 2014 through December 31, 2016. On February 13, 2013, we granted an additional 350,000 Units with vesting dates ranging from December 31, 2015 through December 31, 2019. On January 1, 2014, we granted an additional 50,000 Units with vesting dates ranging from December 31, 2016 through December 31, 2017.

Total compensation expense (income) related to the vested outstanding Units based on the estimated appreciation over their remaining terms was approximately ($11,700) and $43,000 for the three months ended March 31, 2015 and 2014, respectively. The income for the first three months of 2015 was the result of a change in the assumption of the appreciation of book value per share of common stock.

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As of March 31, 2015 and December 31, 2014, approximately $201,000 and $259,000 is accrued under this plan, respectively. As of March 31, 2015, approximately $111,000 of this balance is included in Other Accrued Liabilities and the remaining $90,000 balance was included in Other Long-term Liabilities. As of December 31, 2014, approximately $47,000 of this balance is included in Other Accrued Liabilites and the remaining $212,000 was included in Other Long-term Liabilities.

Earnings per Common Share

For the three months ended March 31, 2015 the company reported a net loss and all diluted features were excluded. For the three months ended March 31, 2014 26,750 stock options were included in the computation of diluted per share amounts as their impact is dilutive. For the three months ended March 31, 2014 stock options of 189,250 were excluded because their inclusion would be antidilutive.

Segment Reporting Information

All of our operations fall under the Contract Manufacturing segment within the Electronic Manufacturing Services industry. We strategically direct production between our various manufacturing facilities based on a number of considerations to best meet our customers requirements. We share resources for sales, marketing, engineering, supply chain, information services, human resources, payroll, and all corporate accounting functions. Consolidated financial information is available that is evaluated regularly by the chief operating decision maker in assessing performance and allocating resources.

Accounts Receivable and Allowance for Doubtful Accounts

We grant credit to customers in the normal course of business. Accounts receivable are unsecured and are presented net of an allowance for doubtful accounts. The allowance for doubtful accounts was $135,000 and $137,000 at March 31, 2015 and December 31, 2014, respectively. We determine our allowance by considering a number of factors, including the length of time accounts receivable are past due, our previous loss history, the customers current ability to pay their obligations to us, and the condition of the general economy and the industry as a whole. We write-off accounts receivable when they become uncollectible, and payments subsequently received on such receivables are credited to the allowance for uncollectible accounts.

Inventories

Inventories are stated at the lower of cost (first-in, first-out method) or market (based on the lower of replacement cost or net realizable value). Costs include material, labor, and overhead required in the warehousing and production of our products. Inventory reserves are maintained for the estimated value of the inventories that may have a lower value than stated or quantities in excess of future production needs.

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Inventories are as follows:

	March 31 2015	December 31 2014
Raw Materials	$ 13,621,218	$ 12,745,623
Work in Process	3,485,111	3,653,670
Finished Goods	3,147,012	2,861,373
Reserve	(736,124)	(732,248)
Total	$ 19,517,217	$ 18,528,418

Impairment Analysis

We evaluate long-lived assets, primarily property and equipment, as well as the related depreciation periods, whenever current events or changes in circumstances indicate that the carrying amount of an asset or asset group may not be recoverable. Recoverability for assets to be held and used is based on our projection of the undiscounted future operating cash flows of the underlying assets. To the extent such projections indicate that future undiscounted cash flows are not sufficient to recover the carrying amounts of related assets, a charge might be required to reduce the carrying amount to equal estimated fair value.

Recent Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board issued Accounting Standards Update (ASU) 2014-09, *Revenue from Contracts with Customers (Topic 606)*. This standard outlines a single comprehensive model for companies to use in accounting for revenue arising from contracts with customers and supersedes most current revenue recognition guidance, including industry-specific guidance. The core principle of the revenue model is that revenue is recognized when a customer obtains control of a good or service. A customer obtains control when it has the ability to direct the use of and obtain the benefits from the good or service. Transfer of control is not the same as transfer of risks and rewards, as it is considered in current guidance. In the first quarter of 2015, the FASB proposed a deferral of the effective date to January 1, 2018. The proposal is expected to be approved in the second quarter of 2015. If the proposal is approved, then upon adoption in 2018, the company will record an adjustment to retained earnings as of the beginning fo the year of initial application, which can be either the earliest comparative period presented, with all periods presented under the new rules, or January 1, 2018, without restating prior periods presented. Management has not yet determined which transition reporting option it will apply.

NOTE 2. CONCENTRATION OF CREDIT RISK AND MAJOR CUSTOMERS

Financial instruments that potentially subject us to concentrations of credit risk consist principally of cash and accounts receivable. With regard to cash, we maintain our excess cash balances in checking accounts at two high-credit quality financial institutions. These accounts may at times exceed federally insured limits. We grant credit to customers in the normal course of business and do not require collateral on our accounts receivable.

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Our largest customer, General Electric, has two divisions that collectively account for more than 10% of net sales for the three months ended March 31, 2015 and 2014, respectively. GE Healthcare accounted for 17% and 24% for the three months ended March 31, 2015 and 2014, respectively. GE Transportation accounted for 9% and 5% for the three months ended March 31, 2015 and 2014, respectively.

Combined accounts receivable from both divisions represented 18% and 19% of total accounts receivable at March 31, 2015 and December 31, 2014, respectively.

Export sales represented 7% and 13% of net sales for the three months ended March 31, 2015 and 2014, respectively.

NOTE 3. FINANCING ARRANGEMENTS

We have a credit agreement with Wells Fargo Bank (WFB) which was most recently amended on May 16, 2014 and provides for a line of credit arrangement of $13.5 million that expires, if not renewed, on May 31, 2018. The credit arrangement also has a $1.8 million real estate term note outstanding with a maturity date of March 31, 2027, an additional $1.7 million real estate term note outstanding that is due, if not renewed, on December 31, 2027, an equipment loan for $1.6 million and a new term loan facility of up to $1.0 million for capital expenditures, both with maturity dates of May 31, 2018. As of March 31, 2015, we have borrowed $0.7 million against the $1.0 million capital term note.

Long-term debt at March 31, 2015 and December 31, 2014 consisted of the following:

		March 31 2015		December 31 2014
Real Estate Term Loan 1, interest at three month LIBOR + 3.0%, due in installments through March 31, 2027	$	1,385,845	$	1,415,461
Real Estate Term Loan 2, interest at three month LIBOR + 3.0%, due in installments through December 31, 2027		1,432,200		1,460,100
Equipment loan, interest at three month LIBOR + 3.0%, due January 31, 2016		79,167		102,917
Equipment loan, interest at three month LIBOR + 3.0%, due May 31, 2018		1,053,372		1,117,863
Equipment loan, interest at three month LIBOR + 3.0%, due May 31, 2018		678,549		349,000
Blue Earth Bond, which bears a variable interest rate, due in installments through June 30, 2021		360,000		360,000
Total debt		4,989,133		4,805,341
Less current maturities		782,912		732,835
Long-term debt	$	4,206,221	$	4,072,506

Under the credit agreement, both the line of credit and real estate term notes are subject to variations in the LIBOR rate. Our line of credit bears interest at three-month LIBOR + 2.5% (approximately 2.75% at March 31, 2015) while our real estate term notes bear interest at three-

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month LIBOR + 3.0% (approximately 3.25% at March 31, 2015). The weighted-average interest rate on our line of credit was 2.9% and 3.0% for the three months ended March 31, 2015 and 2014, respectively. We had borrowing on our line of credit of $8,942,345 and $7,998,184 outstanding as of March 31, 2015 and December 31, 2014, respectively. The line of credit requires a lock box arrangement; however there are no acceleration clauses that would accelerate the maturity of our outstanding borrowings.

The credit agreement contains certain covenants which, among other things, require us to adhere to regular reporting requirements, abide by annual shareholder dividend limitations, maintain certain financial performance, and limit the amount of annual capital expenditures.

The availability under the line is subject to borrowing base requirements, and advances are at the discretion of the lender. At March 31, 2015, we have net unused availability under our line of credit of approximately $3.2 million. The line is secured by substantially all of our assets.

NOTE 4. INCOME TAXES

On a quarterly basis, we estimate what our effective tax rate will be for the full fiscal year and record a quarterly income tax provision based on the anticipated rate. As the year progresses, we refine our estimate based on the facts and circumstances, including discrete events, by each tax jurisdiction. Our effective tax rate for the three months ended March 31, 2015 was 35%, compared with 37% for the three months ended March 31, 2014.

The differences between federal income taxes computed at the federal statutory rate and reported income taxes for the three months ended March 31, 2015 and 2014 are as follows:

	Three Months Ended March 31			
		2015		**2014**
Statutory federal tax provision (benefit)	$	(82,000)	$	51,000
State income taxes (benefits)		(10,000)		7,000
Income tax credits		(13,000)		(8,000)
Other		1,000		
Income tax expense (benefit)	$	(104,000)	$	50,000

At March 31, 2015, we had $54,000 of net uncertain tax benefit positions remaining in other long-term liabilities related to research and development credits that would increase our effective income tax rate if recognized. At December 31, 2014, we had $56,000 of net uncertain tax benefit positions recorded in other long-term liabilities that would reduce our effective income tax rate if recognized.

NOTE 5. SUBSEQUENT EVENT

On April 1, 2015, we entered into an 89 month lease for approximately 19,000 square feet of space in Maple Grove, Minnesota for our new corporate headquarters. Annual rent payments during the lease term will increase from approximately $139,000 to $165,000. In addition to this rent obligation, we will also be responsible for certain costs, among other things, operating expenses, taxes, and insurance costs.

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

Overview:

We are a Wayzata, Minnesota based full-service electronics manufacturing services (EMS) contract manufacturer of wire and cable assemblies, printed circuit board assemblies, higher-level assemblies and box builds for a wide range of industries. We provide value added engineering services and technical support including design, testing, prototyping and supply chain management to customers mainly in the aerospace and defense, medical, and industrial equipment markets. We maintain manufacturing facilities in Baxter, Bemidji, Blue Earth, Mankato, Merrifield, and Milaca, Minnesota; Augusta, Wisconsin; and Monterrey, Mexico. All of our facilities are certified to one or more of the ISO standards, including 9001 and 13485, with most having additional certifications based on the needs of the customers they serve.

Summary of Results:

Revenue in the first quarter of 2015 was up 1.5% compared to the first quarter of 2014 with operating profits impacted by our larger global customers demand being down as they work through market and economic issues related to the strong US dollar, oil and gas industry conditions and challenging global economies in China, Asia Pacific and Europe.

For the quarter ended March 31, 2015, we reported net sales of $26.5 million compared to $26.1 million reported in the same quarter of 2014.

Our gross profit percentage for the three months ended March 31, 2015 was 10.8% compared to 11.8% for the three months ended March 31, 2014. Due to product mix and softness in our largest global customers demand in the first quarter our operations were under utilized.

First quarter 2015 loss from operations was $202,000 compared to income from operations of $236,000 for the three months ended March 31, 2014. The gross margin impact and the increase in business development spending accounted for the majority of the loss in the first quarter. General and administrative spending was in line with 2014 levels.

Net loss for the first quarter of 2015 was approximately $193,000 or $0.07 per diluted common share, compared to net income of approximately $86,000 or $0.03 per diluted common share for the same period in 2014.

Cash used in operating activities for the first quarter was approximately 240,000. Cash used in the quarter resulted from the operating loss and increased inventories that were partially offset by the noncash addback of depreciation and the timing of accounts receivable collections.

Results of Operations:

The following table presents statements of operations data as percentages of total net sales for the periods indicated:

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	Three Months Ended March 31 2015	2014
Net Sales	100.0%	100.0%
Cost of Goods Sold	89.2	88.2
Gross Profit	10.8	11.8
Selling Expenses	5.1	4.3
General and Administrative Expenses	6.4	6.6
Income (Loss) from Operations	(0.7)	0.9
Other Expenses, Net	(0.4)	(0.4)
Income (Loss)Before Income Taxes	(1.1)	0.5
Income Tax Expense (Benefit)	(0.4)	0.2
Net Income (Loss)	(0.7)%	0.3%

Net Sales:

We reported net sales of $26.5 million and $26.1 million for the three months ended March 31, 2015 and 2014, respectively. Revenue increases to our industrial customers were offset by decreases to our medical and defense customers

Net sales by our major EMS industry markets for the three month periods ended March 31, 2015 and 2014 were as follows:

(in thousands)	Three Months Ended March 31 2015 $	2014 $	% Change
Aerospace and Defense	3,096	4,241	(27)
Medical	8,952	9,568	(6)
Industrial	14,492	12,340	17
Total Sales	26,540	26,149	1

Backlog:

Our 90-day order backlog as of March 31, 2015 increased 6% to approximately $18.3 million, compared to approximately $17.3 million at the beginning of the quarter. Our industrial customers backlog has continued to improve and Aerospace and defense backlog increased sequentially and over prior year as we continue to see signs of stability as the defense industry has adjusted to the new Department of Defense budget levels. Our medical customers are being impacted globally as previously mentioned by the strong U. S. dollar and weak global economy. Our backlog consists of firm purchase orders and we expect a major portion of the current 90 day backlog to be realized as revenue during the following quarter.

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90 Day backlog by our major EMS industry markets are as follows:

	Backlog as of the Quarter Ended		
(in thousands)	March 31 2015	December 31 2014	March 31 2014
Aerospace and Defense	$ 3,834	$ 3,237	$ 2,921
Medical	6,129	6,306	8,014
Industrial	8,316	7,717	6,084
Total Backlog	$ 18,279	$ 17,260	$ 17,019

Our 90 day backlog varies due to order size, manufacturing delays, contract terms and conditions and timing from customer delivery schedules and releases. These variables cause inconsistencies in comparing the backlog from one period to the next.

Gross Profit:

Gross profit as a percent of net sales for the three months ended March 31, 2015 and 2014 was 10.8% and 11.8%, respectively. Due to product mix and softness in our largest global customers demand in the first quarter our operations were under utilized.

Selling Expense:

Our selling expenses were $1.4 million or 5.1% of net sales and $1.1 million or 4.3% of net sales for the three months ended March 31, 2015 and 2014, respectively. The increase in selling expense is related to increased business development activities needed to support growth initiatives and our expansion into the Asian markets.

General and Administrative Expense:

Our general and administrative expenses were $1.7 million or 6.4% of net sales and $1.7 million or 6.6% of net sales for the three months ended March 31, 2015 and 2014, respectively.

Income Taxes:

Our effective tax rate for the three months ended March 31, 2015 was 35% compared with 37% for the three months ended March 31, 2014.

The differences between federal income taxes computed at the federal statutory rate and reported income taxes for the three months ended March 31, 2015 and 2014 are as follows:

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	Three Months Ended March 31	
	2015	**2014**
Statutory federal tax provision	$ (82,000)	$ 51,000
State income taxes	(10,000)	7,000
Income tax credits	(13,000)	(8,000)
Other	1,000	
Income tax expense (benefit)	$ (104,000)	$ 50,000

Liquidity and Capital Resources:

We have satisfied our liquidity needs over the past several years with cash flows generated from operations and an operating line of credit through WFB. We also have real estate and equipment term loans. Both the line of credit and real estate term notes are subject to fluctuations in the LIBOR rates. The line of credit, real estate term notes, and equipment loans with WFB contain certain covenants which, among other things, require us to adhere to regular reporting requirements, abide by annual shareholder dividend limitations, maintain certain financial performance, and limit the amount of annual capital expenditures. The availability under our line is subject to borrowing base requirements, and advances are at the discretion of the lender. The line of credit is secured by substantially all of our assets.

On March 31, 2015, we had outstanding advances of $8.9 million under the line of credit and unused availability of $3.2 million supported by our borrowing base. We believe our financing arrangements and cash flows to be provided by operations will be sufficient to satisfy our future working capital needs. Our working capital was $24.7 million and $24.3 million as of March 31, 2015 and December 31, 2014, respectively.

Net cash used in operating activities for the three months ended March 31, 2015 was $0.2 million. Cash used was the result of the first quarter loss and increased inventories partially offset by the noncash addback of depreciation and the timing of accounts receivable collections.

Net cash used in investing activities of $0.9 million for the nine months ended March 31, 2015 is comprised of property and equipment purchases to support the business.

Critical Accounting Policies and Estimates:

Our significant accounting policies and estimates are summarized in Management s Discussion and Analysis of Financial Condition and Results of Operations in our Annual Report on Form 10-K for the year ended December 31, 2014. There have been no significant changes in these critical accounting policies since December 31, 2014. Some of our accounting policies require

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us to exercise significant judgment in selecting the appropriate assumptions for calculating financial estimates. Such judgments are subject to an inherent degree of uncertainty. These judgments are based on our historical experience, known trends in our industry, terms of existing contracts and other information from outside sources, as appropriate. Actual results could differ from these estimates.

Recent Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board issued Accounting Standards Update (ASU) 2014-09, *Revenue from Contracts with Customers (Topic 606)*. This standard outlines a single comprehensive model for companies to use in accounting for revenue arising from contracts with customers and supersedes most current revenue recognition guidance, including industry-specific guidance. The core principle of the revenue model is that revenue is recognized when a customer obtains control of a good or service. A customer obtains control when it has the ability to direct the use of and obtain the benefits from the good or service. Transfer of control is not the same as transfer of risks and rewards, as it is considered in current guidance. In the first quarter of 2015, the FASB proposed a deferral of the effective date to January 1, 2018. The proposal is expected to be approved in the second quarter of 2015. If the proposal is approved, then upon adoption in 2018, the company will record an adjustment to retained earnings as of the beginning fo the year of initial application, which can be either the earliest comparative period presented, with all periods presented under the new rules, or January 1, 2018, without restating prior periods presented. Management has not yet determined which transition reporting option it will apply.

Forward-Looking Statements:

Those statements in the foregoing report that are not historical facts are forward-looking statements made pursuant to the safe-harbor provisions of the Private Securities Litigation Reform Act of 1995. Such statements generally will be accompanied by words such as anticipate, believe, estimate, expect, forecast, intend, possible, potential, predict, project, or other similar words that convey the uncertainty of future e outcomes. Although we believe these forward-looking statements are reasonable, they are based upon a number of assumptions concerning future conditions, any or all of which may ultimately prove to be inaccurate. Forward-looking statements involve a number of risks and uncertainties. Important factors that could cause actual results to differ materially from the forward-looking statements include, without limitation:

- Volatility in the marketplace which may affect market supply and demand for our products;
- Increased competition;
- Changes in the reliability and efficiency of operating facilities or those of third parties;
- Risks related to availability of labor;
- Increase in certain raw material costs such as copper;
- Commodity and energy cost instability;

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- General economic, financial and business conditions that could affect our financial condition and results of operations; and
- Availability of raw material components.

The factors identified above are believed to be important factors (but not necessarily all of the important factors) that could cause actual results to differ materially from those expressed in any forward-looking statement made by us. Unpredictable or unknown factors not discussed herein could also have material adverse effects on forward-looking statements. All forward-looking statements included in this Form 10-Q are expressly qualified in their entirety by the forgoing cautionary statements. We undertake no obligations to update publicly any forward-looking statement (or its associated cautionary language) whether as a result of new information or future events.

Please refer to forward-looking statements and risks as previously disclosed in our report on Form 10-K for the fiscal year ended December 31, 2014.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures:

In accordance with Rule 13a-15(b) of the Securities Exchange Act of 1934 (the Exchange Act), as of the end of the period covered by this Quarterly Report on Form 10-Q, our management evaluated, with the participation of our Chief Executive Officer and Chief Financial Officer, the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rule 13a-15(e) and Rule 15d-15(e) under the Exchange Act). Based upon their evaluation of these disclosure controls and procedures, the Chief Executive Officer and Chief Financial Officer have concluded that the disclosure controls and procedures were effective as of the date of such evaluation in ensuring that information required to be disclosed in our Exchange Act reports is (1) recorded, processed, summarized and reported in a timely manner, and (2) accumulated and communicated to management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

Changes in Internal Control Over Financial Reporting:

There was no change in our internal control over financial reporting that occurred during the period covered by this Quarterly Report on Form 10-Q that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

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PART II

ITEM 1. LEGAL PROCEEDINGS

We are subject to various legal proceedings and claims that arise in the ordinary course of business.

ITEM 6. EXHIBITS

Exhibits

31.1	Certification of the Chief Executive Officer pursuant to Rule 13a-14(a) and Rule 15d-14(a), promulgated under the Securities Exchange Act of 1934, as amended.
31.2	Certification of the Chief Financial Officer pursuant to Rule 13a-14(a) and Rule 15d-14(a), promulgated under the Securities Exchange Act of 1934, as amended.
32	Certification of the Chief Executive Officer and Chief Financial Officer, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101	Financial statements from the quarterly report on Form 10-Q for the quarter ended September 30, 2014, formatted in XBRL: (i) Consolidated Balance Sheets, (ii) Consolidated Statements of Income, (iii) Consolidated Statements of Cash Flows, and (iv) the Condensed Notes to Consolidated Financial Statements.

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.

Nortech Systems Incorporated and Subsidiary

Date: May 6, 2015	by	/s/ Richard G. Wasielewski
	Richard G. Wasielewski Chief Executive Officer and President Nortech Systems Inc.	
Date: May 6, 2015	by	/s/ Paula M. Graff

Paula M. Graff
Vice President and Chief Financial Officer
Nortech Systems Inc.