TEL INSTRUMENT ELECTRONICS CORP
Form 10-Q
August 13, 2014

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

FORM 10-Q

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

For the quarterly period ended: June 30, 2014

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

Commission File Number: 001-31990

TEL-INSTRUMENT ELECTRONICS CORP
(Exact name of registrant as specified in its charter)

New Jersey (State or other jurisdiction of incorporation or organization)	22-1441806 (I.R.S. Employer Identification No.)

One Branca Road
East Rutherford, NJ 07073
(Address of principal executive offices)

(201) 933-1600
(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 past 12 months, and (2) has been subject to such filing requirements for the past 90 days. Yes ý No ¨

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or 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	¨	Accelerated filer	¨
Non-accelerated filer	¨	Smaller reporting company	ý

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

As of August 12, 2014, there were 3,251,387 shares outstanding of the registrant’s common stock.

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PART I – FINANCIAL INFORMATION

Item 1. Financial Statements.

TEL-INSTRUMENT ELECTRONICS CORP
CONDENSED CONSOLIDATED BALANCE SHEETS

		June 30, 2014 (unaudited)	March 31, 2014
ASSETS			
Current assets:			
Cash and cash equivalents	$	202,458	232,118
Accounts receivable, net		844,712	2,095,640
Inventories, net		4,568,538	4,025,391
Prepaid expenses and other current assets		580,220	263,592
Deferred financing costs		108,321	108,321
Deferred income tax asset		1,089,538	1,089,538
Total current assets		7,393,787	7,814,600
Equipment and leasehold improvements, net		392,945	450,873
Deferred financing costs – long-term		21,062	48,142
Deferred income tax asset – non-current		2,386,250	2,273,068
Other long-term assets		47,670	47,670
Total assets		10,241,714	10,634,353
LIABILITIES & STOCKHOLDERS' EQUITY			
Current liabilities:			
Current portion of long-term debt		745,090	718,848
Capital lease obligations – current portion		37,183	53,608
Accounts payable and accrued liabilities		3,329,588	3,332,181
Progress billings		775,475	775,475
Deferred revenues – current portion		4,226	37,452
Accrued payroll, vacation pay and payroll taxes		473,174	444,238
Total current liabilities		5,364,736	5,361,802
Subordinated notes payable - related parties		250,000	250,000
Capital lease obligations – long-term		17,345	21,320
Long-term debt, net of debt discount		445,089	596,526
Deferred revenues – long-term		133,650	133,650
Warrant liability		488,190	354,309
Other long-term liabilities		54,000	56,100
Total liabilities		6,753,010	6,773,707
Commitments			
Stockholders' equity:			

Common stock, par value $0.10 per share, 3,251,387 shares issued and outstanding as of June 30, 2014 and March 31, 2014	325,136	325,136
Additional paid-in capital	7,999,163	7,987,100
Accumulated deficit	(4,835,595)	(4,451,590)
Total stockholders' equity	3,488,704	3,860,646
Total liabilities and stockholders' equity	$ 10,241,714	$ 10,634,353

See accompanying notes to condensed consolidated financial statements.

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TEL-INSTRUMENT ELECTRONICS CORP
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)

	Three Months Ended June 30, 2014	Three Months Ended June 30, 2013
Net sales	$ 3,129,076	$ 3,199,975
Cost of sales	2,008,859	2,013,817
Gross margin	1,120,217	1,186,158
Operating expenses:		
Selling, general and administrative	879,193	653,250
Engineering, research and development	483,896	480,377
Total operating expenses	1,363,089	1,133,627
Income (loss) from operations	(242,872)	52,531
Other income (expense):		
Amortization of debt discount	(30,874)	(22,987)
Amortization of deferred financing costs	(27,080)	(27,080)
Change in fair value of common stock warrants	(133,881)	24,572
Loss on extinguishment of debt	-	(26,600)
Interest expense	(62,480)	(104,077)
Total other income (expense)	(254,315)	(156,172)
Loss before income taxes	(497,187)	(103,641)
Income tax benefit	(113,182)	(17,869)
Net loss	$ (384,005)	$ (85,772)
Net loss per share:		
Basic loss per common share	$ (0.12)	$ (0.03)
Diluted loss per common share	$ (0.12)	$ (0.03)
Weighted average shares outstanding:		
Basic	3,251,387	3,079,871
Diluted	3,251,387	3,079,871

See accompanying notes to condensed consolidated financial statements.

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TEL-INSTRUMENT ELECTRONICS CORP
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)

	Three months ended June 30, 2014	Three months ended June 30, 2013
Cash flows from operating activities:		
Net loss	$ (384,005)	$ (85,772)
Adjustments to reconcile net loss to net cash used in operating activities:		
Deferred income taxes	(113,182)	(17,869)
Depreciation and amortization	45,062	53,351
Provision for inventory obsolescence	5,000	-
Amortization of debt discount	30,874	22,987
Amortization of deferred financing costs	27,080	27,080
Loss on extinguishment of debt	-	26,600
Change in fair value of common stock warrant	133,881	(24,572)
Non-cash stock-based compensation	12,063	16,358
Changes in assets and liabilities:		
Decrease (increase) in accounts receivable	1,250,928	(412,173)
(Increase) decrease in inventories, net	(534,136)	763,938
(Increase) decrease in prepaid expenses & other	(316,628)	28,810
Decrease in accounts payable and other accrued liabilities	(2,593)	(1,301,001)
Increase (decrease) in accrued payroll, vacation pay & withholdings	28,936	(10,618)
Decrease in deferred revenues	(33,226)	(7,339)
Increase in progress billings	-	858,050
Decrease in other long-term liabilities	(2,100)	-
Net cash provided by (used in) operating activities	147,954	(62,170)
Cash flows from investing activities:		
Purchases of equipment	(1,145)	-
Net cash used in investing activities	(1,145)	-
Cash flows from financing activities:		
Proceeds from note payable – related party	-	100,000
Repayment of long-term debt	(156,069)	(136,540)
Repayment of capitalized lease obligations	(20,400)	(17,637)
Net cash used in financing activities	(176,469)	(54,177)
Net decrease in cash and cash equivalents	(29,660)	(116,347)
Cash and cash equivalents at beginning of period	232,118	310,297
Cash and cash equivalents at end of period	$ 202,458	$ 193,950
Supplemental cash flow information:		
Taxes paid	$ 20,500	$ -
Interest paid	$ 53,556	$ 101,554

Supplemental non-cash information:				
Converted debt to equity	$	-	$	600,000
Converted accrued interest to equity	$	-	$	37,400

See accompanying notes to condensed consolidated financial statements.

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TEL-INSTRUMENT ELECTRONICS CORP
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Note 1 – Basis of Presentation

In the opinion of management, the accompanying unaudited condensed consolidated financial statements contain all adjustments necessary to present fairly the financial position of Tel-Instrument Electronics Corp (the "Company" or "TIC") as of June 30, 2014, the results of operations for the three months ended June 30, 2014 and June 30, 2013, and statements of cash flows for the three months ended June 30, 2014 and June 30, 2013. These results are not necessarily indicative of the results to be expected for the full year. The financial statements have been prepared in accordance with the requirements of Form 10-Q and consequently do not include disclosures normally made in an Annual Report on Form 10-K. The March 31, 2014 balance sheet included herein was derived from the audited financial statements included in the Company's Annual Report on Form 10-K as of that date. Accordingly, the financial statements included herein should be reviewed in conjunction with the financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the fiscal year ended March 31, 2014 , as filed with the United States Securities and Exchange Commission (the "SEC") on June 30, 2014.

Note 2 – Summary of Significant Accounting Policies

During the three months ended June 30, 2014, there have been no material changes in the Company's significant accounting policies to those previously disclosed in the Company's Annual Report on Form 10-K for the year ended March 31, 2014, as filed with the SEC on June 30, 2014.

Note 3 – Accounts Receivable, net

The following table sets forth the components of accounts receivable:

	June 30, 2014	March 31, 2014
Government	$ 552,100	$ 1,982,215
Commercial	319,894	140,707
Less: Allowance for doubtful accounts	(27,282)	(27,282)
	$ 844,712	$ 2,095,640

Note 4 – Inventories, net

Inventories consist of:

	June 30, 2014	March 31, 2014
Purchased parts	$ 3,169,621	$ 3,085,070
Work-in-process	1,597,284	1,134,714
Finished goods	11,633	10,607
Less: Inventory reserve	(210,000)	(205,000)
	$ 4,568,538	$ 4,025,391

Note 5 – Loss Per Share

Net loss per share has been computed according to FASB ASC 260, “Earnings per Share,” which requires a dual presentation of basic and diluted loss per share (“EPS”). Basic EPS represents net loss divided by the weighted average number of common shares outstanding during a reporting period. Diluted EPS reflects the potential dilution that could occur if securities, including warrants and options, were converted into common stock. The dilutive effect of outstanding warrants and options is reflected in earnings per share by use of the treasury stock method. In applying the treasury stock method for stock-based compensation arrangements, the assumed proceeds are computed as the sum of the amount the employee must pay upon exercise and the amounts of average unrecognized compensation costs attributed to future services.

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TEL-INSTRUMENT ELECTRONICS CORP
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Note 5 – Loss Per Share (continued)

Diluted loss per share for the three months ended June 30, 2014 and 2013 does not include common stock equivalents, as these stock equivalents would be anti-dilutive.

	Three Months Ended June 30, 2014	Three Months Ended June 30, 2013
Basic net loss per share computation:		
Net loss	$ (384,005)	$ (85,772)
Weighted-average common shares outstanding	3,251,387	3,079,871
Basic net loss per share	$ (0.12)	$ (0.03)
Diluted net loss per share computation:		
Net loss	$ (384,005)	$ (85,772)
Weighted-average common shares outstanding	3,251,387	3,079,871
Incremental shares attributable to the assumed exercise of outstanding stock options	-	-
Total adjusted weighted-average shares	3,251,387	3,079,871
Diluted net loss per share	$ (0.12)	$ (0.03)

For the three months ended June 30, 2014 and 2013, all outstanding warrants and options were excluded from the computation of diluted loss per share because their effect would be anti-dilutive.

Note 6 – Long-Term Debt

In September 2010, the Company entered into an agreement with BCA Mezzanine Fund LLP ("BCA") to loan the Company $2,500,000 in the form of a Promissory Note (the "Note"). The Note contains a number of affirmative and negative covenants which restrict our operations. For the quarter ended June 30, 2014, the Company was not in compliance with two of the four covenants related to maintaining agreed upon financial ratios for fixed charges and debt service. On August 11, 2014 the Company received a waiver from BCA on each of the above mentioned covenants.

Note 7 – Segment Information

In accordance with FASB ASC 280, "Disclosures about Segments of an Enterprise and related information," the Company determined it has two reportable segments - avionics government and avionics commercial. There are no inter-segment revenues.

The Company is organized primarily on the basis of its avionics products. The avionics government segment consists primarily of the design, manufacture, and sale of test equipment to the U.S. and foreign governments and militaries either directly or through distributors. The avionics commercial segment consists of design, manufacture, and sale of test equipment to domestic and foreign airlines, directly or through commercial distributors, and to general aviation repair and maintenance shops. The Company develops and designs test equipment for the avionics industry and as such, the Company’s products and designs cross segments.

Management evaluates the performance of its segments and allocates resources to them based on gross margin. The Company’s general and administrative costs and sales and marketing expenses, and engineering costs are not segment specific. As a result, all operating expenses are not managed on a segment basis. Net interest includes expenses on debt and income earned on cash balances, both maintained at the corporate level.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Note 7 – Segment Information (continued)
The table below presents information about reportable segments within the avionics business for the three month periods ending June 30, 2014 and 2013:

Three Months Ended June 30, 2014	Avionics Government	Avionics Commercial	Avionics Total	Corporate Items	Total
Net sales	$ 2,520,723	$ 608,353	$ 3,129,076	-	$ 3,129,076
Cost of sales	1,514,415	494,444	2,008,859	-	2,008,859
Gross margin	1,006,308	113,909	1,120,217	-	1,120,217
Engineering, research, and development			483,896	-	483,896
Selling, general and administrative			292,383	586,810	879,193
Amortization of debt discount			-	30,874	30,874
Amortization of deferred financing costs			-	27,080	27,080
Change in fair value of common stock warrants			-	133,881	133,881
Interest expense, net			-	62,480	62,480
Total expenses			776,279	841,125	1,617,404
Income (loss) before income taxes			$ 343,938	$ (841,125)	$ (497,187)

Three Months Ended June 30, 2013	Avionics Government	Avionics Commercial	Avionics Total	Corporate Items	Total
Net sales	$ 2,802,842	$ 397,133	$ 3,199,975	-	$ 3,199,975
Cost of sales	1,662,246	351,571	2,013,817	-	2,013,817
Gross margin	1,140,596	45,562	1,186,158	-	1,186,158
Engineering, research, and development			480,377		480,377
Selling, general, and administrative			264,145	389,105	653,250
Amortization of debt discount			-	22,987	22,987
Amortization of deferred financing costs			-	27,080	27,080
Loss on extinguishment of debt			-	26,600	26,600
Change in fair value of common stock warrants			-	(24,572)	(24,572)
Interest (income) expense, net			-	104,077	104,077
Total expenses			744,522	545,277	1,289,799
Income (loss) before income taxes			$ 441,636	$ (545,277)	$ (103,641)

Note 8 – Income Taxes

The Company adopted FASB ASC 740-10, Accounting for Uncertainty in Income Taxes, effective April 1, 2007 ("ASC 740-10"). ASC 740-10 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. The Company has analyzed filing positions in all of the federal and state jurisdictions where it is required to file income tax returns, as well as all open tax years in these jurisdictions. The Company does not have any unrecognized tax benefits.

The tax effect of temporary differences, primarily net operating loss carryforwards, asset reserves and accrued liabilities, gave rise to the Company's deferred tax asset in the accompanying June 30, 2014 and March 31, 2014 condensed consolidated balance sheets. Deferred income taxes are recognized for the tax consequence of such temporary differences at the enacted tax rate expected to be in effect when the differences reverse.

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Note 9 – Fair Value Measurements

FASB ASC 820-10, Fair Value Measurements and Disclosures ("ASC 820-10") defines fair value, establishes a framework for measuring fair value under generally accepted accounting principles and expands disclosures about fair value measurements.

As defined in ASC 820-10, fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (exit price). The Company utilizes market data or assumptions that market participants would use in pricing the asset or liability, including assumptions about risk and the risks inherent in the inputs to the valuation technique. These inputs can be readily observable, market corroborated, or generally unobservable. The Company classifies fair value balances based on the observation of those inputs. ASC 820-10 establishes a fair value hierarchy that prioritizes the inputs used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (level 1 measurement) and the lowest priority to unobservable inputs (level 3 measurement).

The three levels of the fair value hierarchy defined by ASC 820-10 are as follows:

· Level 1 – Quoted prices are available in active markets for identical assets or liabilities as of the reporting date. Active markets are those in which transactions for the asset or liability occur in sufficient frequency and volume to provide pricing information on an ongoing basis. Level 1 primarily consists of financial instruments such as exchange-traded derivatives, marketable securities and listed equities.

· Level 2 – Pricing inputs are other than quoted prices in active markets included in Level 1, which are either directly or indirectly observable as of the reported date. Level 2 includes those financial instruments that are valued using models or other valuation methodologies. These models are primarily industry-standard models that consider various assumptions, including quoted forward prices for commodities, time value, volatility factors, and current market and contractual prices for the underlying instruments, as well as other relevant economic measures. Substantially all of these assumptions are observable in the marketplace throughout the full term of the instrument, can be derived from observable data or are supported by observable levels at which transactions are executed in the marketplace. Instruments in this category generally include non-exchange-traded derivatives such as commodity swaps, interest rate swaps, options and collars.

· Level 3 – Pricing inputs include significant inputs that are generally less observable from objective sources. These inputs may be used with internally developed methodologies that result in management's best estimate of fair value.

The valuation techniques that may be used to measure fair value are as follows:

· Market approach — Uses prices and other relevant information generated by market transactions involving identical or comparable assets or liabilities.

· Income approach — Uses valuation techniques to convert future amounts to a single present amount based on current market expectations about those future amounts, including present value techniques, option-pricing models and excess earnings method.

·

Cost approach — Based on the amount that currently would be required to replace the service capacity of an asset (replacement cost).

The carrying value of the Company's borrowings is a reasonable estimate of its fair value as borrowings under the Company's credit facility reflect currently available terms and conditions for similar debt.

The following table sets forth by level within the fair value hierarchy the Company's financial assets and liabilities that were accounted for at fair value as of June 30, 2014 and March 31, 2014. As required by ASC 820-10, financial assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement.

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Note 9 – Fair Value Measurements (continued)

The Company's assessment of the significance of a particular input to the fair value measurement requires judgment, and may affect the valuation of fair value assets and liabilities and their placement within the fair value hierarchy levels.

June 30, 2014	Level I	Level II	Level III	Total
Total Assets	$ -	$ -	$ -	$ -
Warrant liability	-	-	488,190	488,190
Total Liabilities	$ -	$ -	$ 488,190	$ 488,190

March 31, 2014	Level I	Level II	Level III	Total
Total Assets	$ -	$ -	$ -	$ -
Warrant liability	-	-	354,309	354,309
Total Liabilities	$ -	$ -	$ 354,309	$ 354,309

The Company adopted the guidance of ASC 815 "Derivative and Hedging", which requires that we mark the value of our warrant liability (see Note 6) to market and recognize the change in valuation in our statement of operations each reporting period. Determining the warrant liability to be recorded requires us to develop estimates to be used in calculating the fair value of the warrant. The fair value of the warrants is calculated using the Black-Scholes valuation model.

The following table provides a summary of the changes in fair value of our Level 3 financial liabilities from March 31, 2014 through June 30, 2014, as well as the portion of gains or losses included in income attributable to unrealized gains or losses related to the liability held at June 30, 2014:

Level 3 Reconciliation	Beginning at beginning of period	Gains and losses for the period (realized and unrealized)	Purchases, issuances, sales and settlements, net	Transfers in or out of Level 3	Balance at the end of period
Warrant liability	354,309	133,881	-	-	488,190
Total Liabilities	$ 354,309	$ 133,881	$ -	$ -	$ 488,190

The common stock warrants were not issued with the intent of effectively hedging any future cash flow, fair value of any asset, liability or any net investment in a foreign corporation. The warrants do not qualify for hedge accounting, and, as such, all changes in the fair value of these warrants are recognized as other income/expense in the statement of operations until such time as the warrants are exercised or expire. Since these common stock warrants do not trade in an active securities market, the Company recognizes a warrant liability and estimates the fair value of these warrants using the Black-Scholes options model using the following assumptions:

Values at Inception

Date of Warrant	Expiration Date	Number of Warrants	Exercise Price	Fair Market Value Per Share	Expected Volatility	Remaining Life in Years	Risk Free Interest Rate	Warrant Liability
09-10-2010	09-10-2019	136,920	$ 6.70	$ 6.70	28.51%	9	2.81%	$ 267,848
09-10-2010	09-10-2015	10,416	$ 6.70	$ 6.70	28.51%	5	1.59%	$ 13,808
07-26-2012	09-10-2019	50,000	$ 3.35	$ 3.90	42.04%	7	0.94%	$ 66,193
07-26-2012	09-10-2019	20,000	$ 3.35	$ 3.90	42.04%	7	0.94%	$ 26,477
11-20-2012	09-10-2019	20,000	$ 3.56	$ 3.50	42.45%	6.83	1.09%	$ 21,441
02-14-2013	09-10-2019	20,000	$ 3.58	$ 3.80	41.25%	6.58	1.43%	$ 23,714
07-12-2013	09-10-2019	20,000	$ 3.33	$ 3.32	40.26%	6.17	2.00%	$ 19,523
08-12-2013	09-10-2019	20,000	$ 3.69	$ 3.69	40.20%	6.08	2.01%	$ 21,587

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TEL-INSTRUMENT ELECTRONICS CORP
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
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Note 9 – Fair Value Measurements (continued)

Values at March 31, 2014

Date of Warrant	Expiration Date	Number of Warrants	Exercise Price	Fair Market Value Per Share	Expected Volatility	Remaining Life in Years	Risk Free Interest Rate	Warrant Liability
09-10-2010	09-10-2019	136,920	$ 6.70	$ 4.42	43.35%	5.45	1.73%	$ 123,564
09-10-2010	09-10-2015	10,416	$ 6.70	$ 4.42	43.35%	1.45	0.44%	$ 2,498
07-26-2012	09-10-2019	50,000	$ 3.35	$ 4.42	43.35%	5.45	1.73%	$ 77,626
07-26-2012	09-10-2019	20,000	$ 3.35	$ 4.42	43.35%	5.45	1.73%	$ 31,050
11-20-2012	09-10-2019	20,000	$ 3.56	$ 4.42	43.35%	5.45	1.73%	$ 29,892
02-14-2013	09-10-2019	20,000	$ 3.58	$ 4.42	43.35%	5.45	1.73%	$ 29,310
07-12-2013	09-10-2019	20,000	$ 3.33	$ 4.42	43.35%	5.45	1.73%	$ 31,163
08-12-2013	09-10-2019	20,000	$ 3.69	$ 4.42	43.35%	5.45	1.73%	$ 29,206

Values at June 30, 2014

Date of Warrant	Expiration Date	Number of Warrants	Exercise Price	Fair Market Value Per Share	Expected Volatility	Remaining Life in Years	Risk Free Interest Rate	Warrant Liability
09-10-2010	09-10-2019	136,920	$ 6.70	$ 5.44	42.56%	5.20	1.62%	$ 174,114
09-10-2010	09-10-2015	10,416	$ 6.70	$ 5.44	42.56%	1.20	0.47%	$ 4,415
07-26-2012	09-10-2019	50,000	$ 3.35	$ 5.44	42.56%	5.20	1.62%	$ 105,124
07-26-2012	09-10-2019	20,000	$ 3.35	$ 5.44	42.56%	5.20	1.62%	$ 42,049
11-20-2012	09-10-2019	20,000	$ 3.56	$ 5.44	42.56%	5.20	1.62%	$ 40,624
02-14-2013	09-10-2019	20,000	$ 3.58	$ 5.44	42.56%	5.20	1.62%	$ 39,902
07-12-2013	09-10-2019	20,000	$ 3.33	$ 5.44	42.56%	5.20	1.62%	$ 42,189
08-12-2013	09-10-2019	20,000	$ 3.69	$ 5.44	42.56%	5.20	1.62%	$ 39,773

The volatility calculation was based on the 54 months for the Company’s stock price prior to the measurement date, utilizing January 1, 2010 as the initial period, as the Company believes that this is the best indicator of future performance, and the source of the risk free interest rate is the US Treasury rate. The exercise price is per the agreement, the fair market value is the closing price of our stock on the date of measurement, and the expected life is based on management’s current estimate of when the warrants will be exercised. All inputs to the Black-Scholes options model are evaluated each reporting period.

Note 10 – Reclassifications

Certain prior year and period amounts have been reclassified to conform to the current period presentation.

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(Unaudited)

Note 11 – Litigation

On March 24, 2009, Aeroflex Wichita, Inc. ("Aeroflex") filed a petition against the Company and two of its employees in the District Court, Sedgwick County, Kansas, Case No. 09 CV 1141 (the "Aeroflex Action"), alleging that the Company and its two employees misappropriated Aeroflex's proprietary technology in connection with the Company winning a substantial contract from the U.S. Army (the "Award"), to develop new Mode-5 radar test sets and kits to upgrade the existing TS-4530 radar test sets to Mode 5. Aeroflex's petition alleges that in connection with the Award, the Company and its named employees misappropriated Aeroflex's trade secrets; tortiously interfered with its business relationship; conspired to harm Aeroflex and tortiously interfered with its contract and seeks injunctive relief and damages. The central basis of all the claims in the Aeroflex Action is that the Company misappropriated and used Aeroflex proprietary technology and confidential information in winning the Award. In February 2009, subsequent to the Award to the Company, Aeroflex filed a protest of the Award with the Government Accounting Office ("GAO"). In its protest, Aeroflex alleged, inter alia, that the Company used Aeroflex's proprietary technology in order to win the Award, the same material allegations as were later alleged in the Aeroflex Action. On or about March 17, 2009, the U.S. Army Contracts Attorney and the U.S. Army Contracting Officer each filed a statement with the GAO, expressly rejecting Aeroflex's allegations that the Company used or infringed Aeroflex proprietary technology in winning the Award, and concluding that the Company had used only its own proprietary technology. On April 6, 2009, Aeroflex withdrew its protest.

In December 2009, the Kansas District Court dismissed on jurisdiction grounds the Aeroflex Action. Aeroflex appealed this decision. In May 2012, the Kansas Supreme Court reversed the decision and remanded the Aeroflex Action to the District Court for further proceedings. The Company has been in engaged in discovery and depositions for the last two quarters, which has resulted in substantially higher legal expense. The case is currently set for trial on May 19, 2015, but this date may continue to slip. Tel is optimistic as to the outcome of this litigation. However, the outcome of any litigation is unpredictable and an adverse decision in this matter could have a material adverse effect on our financial condition, results of operations or liquidity.

On October 9, 2013, the SEC notified the Company that it may be in violation of Section 16(a) for failure to accurately and timely file beneficial ownership reports (the "Filings") for certain officers and directors. The Company accepted responsibility for filing all such reports on behalf of each officer and director.

The Company apparently made certain coding errors with respect to certain of the Filings, in addition to, not filing within two business days of a reportable transaction as reported by an officer or director. Based on the above, the SEC notified the Company that it may be in violation of Section 16(a). Currently, all transactions by the Holders have been disclosed with the SEC and the Company believes that the transactions which required timely Section 16(a) reports did not involve a material amount of equity securities. Additionally, no sales were made by any officer or director and the violation is related to disclosure only.

The Company has made an Offer to Settle to the Commission and is finalizing such Offer. The Company has also revised its procedures for Section 16(a) reports to ensure complete compliance.

Other than the matters outlined above, we are currently not involved in any litigation that we believe could have a material adverse effect on our financial condition or results of operations. There is no action, suit, proceeding, inquiry or investigation before any court, public board, government agency, self-regulatory organization or body pending or, to the knowledge of executive officers of our Company, threatened against or affecting our Company, or our common stock in which an adverse decision could have a material effect.

Note 12 – New Accounting Pronouncements

In May 2014, the FASB issued Accounting Standard Update No. 2014-09, “Revenue from Contracts with Customers (Topic 606),” (“ASU 2014-09”). ASU 2014-09 outlines a new, single comprehensive model for entities to use in accounting for revenue arising from contracts with customers and supersedes most current revenue recognition guidance, including industry-specific guidance. This new revenue recognition model provides a five-step analysis in determining when and how revenue is recognized. The new model will require revenue recognition to depict the transfer of promised goods or services to customers in an amount that reflects the consideration a company expects to receive in exchange for those goods or services. This ASU is effective for annual reporting periods beginning after December 15, 2016 and early adoption is not permitted. Accordingly, the Company will adopt this ASU on April 1, 2017. Companies may use either a full retrospective or modified retrospective approach to adopt this ASU and management is currently evaluating which transition approach to use. The Company is currently assessing the impact that adopting this new accounting guidance will have on its condensed consolidated financial statements and footnote disclosures.

No other recently issued accounting pronouncements had or are expected to have a material impact on the Company’s condensed consolidated financial statements.

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Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Forward Looking Statements

This quarterly report on Form 10-Q and other reports filed by the Company from time to time with the SEC contain or may contain forward-looking statements (collectively the "Filings") and information that are based upon beliefs of, and information currently available to, the Company's management as well as estimates and assumptions made by Company's management. Readers are cautioned not to place undue reliance on these forward-looking statements, which are only predictions and speak only as of the date hereof. When used in the Filings, the words "anticipate", "believe", "estimate", "expect", "future", "intend", "plan", or the negative of these terms and similar expressions as they rela the Company or the Company's management identify forward-looking statements. Such statements reflect the current view of the Company with respect to future events and are subject to risks, uncertainties, assumptions, and other factors, including the risks contained in the "Risk Factors" section of the Company's Annual Report on Form 10-K for the year ended March 31, 2014, filed with the SEC on June 30, 2014, relating to the Company's industry, the Company's operations and results of operations, and any businesses that the Company may acquire. Should one or more of these risks or uncertainties materialize, or should the underlying assumptions prove incorrect, actual results may differ significantly from those anticipated, believed, estimated, expected, intended, or planned.

Although the Company believes that the expectations reflected in the forward-looking statements are reasonable, the Company cannot guarantee future results, levels of activity, performance, or achievements. Except as required by applicable law, including the securities laws of the United States, the Company does not intend to update any of the forward-looking statements to conform these statements to actual results.

Our financial statements are prepared in accordance with accounting principles generally accepted in the United States ("GAAP"). These accounting principles require us to make certain estimates, judgments and assumptions. We believe that the estimates, judgments and assumptions upon which we rely are reasonable based upon information available to us at the time that these estimates, judgments and assumptions are made. These estimates, judgments and assumptions can affect the reported amounts of assets and liabilities as of the date of the financial statements as well as the reported amounts of revenues and expenses during the periods presented. Our financial statements would be affected to the extent there are material differences between these estimates and actual results. In many cases, the accounting treatment of a particular transaction is specifically dictated by GAAP and does not require management's judgment in its application. There are also areas in which management's judgment in selecting any available alternative would not produce a materially different result. The following discussion should be read in conjunction with our financial statements and notes thereto appearing elsewhere in this report.

Overview

As previously announced, revenues for the first quarter of fiscal year 2015 were comparable to revenues for the first quarter of fiscal year 2014.

The Company had also announced the receipt of full rate production approval for the U.S. Army TS-4530A KITS with expected deliveries of about $450k per month, which commenced in July 2014. The U.S. Army is still working to secure production approval for the complete SETS, but this could take several additional months. As of June 30, 2014, the Company has open orders for 2,350 kits and 687 sets, totaling $19.5 million. The Company also began shipping the first U.S. Navy ITATS production units in July 2014. As of June 30, 2014, the Company has open orders for the AN/ARM-206 (ITATS) for 102 units at a contract value of $5.7 million, including additional enhancements. The Company continues to ship the AN/USM-708 CRAFT test sets and should complete the shipment of all of the Ship in Place units by August 2014. In October 2013, the Company received an additional contract for the CRAFT program with a maximum value of $9.5 million. The order is a not-to-exceed $9.5 million fixed-price, indefinite-delivery/indefinite-quantity (“IDIQ”) contract for the manufacture and delivery of communications/navigation radio frequency avionics flight line tester CRAFT AN/USM-708 and/or AN/USM-719. This contract is in support of the U.S. Navy, U.S. Marine Corps, U.S. Army and various Foreign Military Sales customers under the Foreign Military Sales program. This follow-on contract further strengthens our position in the industry as the predominant supplier of Mode 5 test equipment. The CRAFT unit has been well received by the end users and we look forward to working with the U.S. Navy on this program, and we believe our CRAFT unit will be the Mode 5 test set of choice for a number of years. The Company has received delivery orders against this new contract for the additional test sets at a total value of $4.1 million. The Company currently has open orders for the AN/USM-708 and AN/USM-719 for 331 units, totaling $8.5million, and an option to purchase up to $5.4 million of additional units.

As such, we anticipate improvement in revenues and profitability for the remainder of fiscal year 2015. The revenue increase from the TS-4530A and ITATS shipments will also enhance the Company’s liquidity position.

For the three months ended June 30, 2014, the Company recorded an operating loss of $242,872 as compared to an operating profit of $52,531 for the three months ended June 30, 2013. For the three months ended June 30, 2014, the Company recorded a loss before taxes of $497,187 as compared to a loss before taxes of $103,641 for the three months ended June 30, 2013.

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Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations (continued)

Overview (continued)

As a result of the substantial operating losses incurred in fiscal year 2013, the Company was not in compliance with the NYSE-MKT's (the "Exchange") continued listing standards. The Company also received a letter from the staff of the Exchange that, based on the Company's financial statements at March 31, 2013, the Company was no longer in compliance with the minimum stockholders' equity requirement of $4.0 million, and had also reported net losses in three of its last four fiscal years, as set forth in Section 1003(a)(ii) of the NYSE MKT Company Guide. On July 17, 2014, based on the review of publicly available and Section 1009(f) of the NYSE MKT Company Guide, the Exchange has indicated that the Company had resolved the continued listing deficiencies with respect to both Sections 1003(a)(ii) and 1003(4)(iv) of the Company Guide, since it has reported net income for the fiscal year ended March 31, 2014 and demonstrated that it has remedied its financial impairment. As is the case with all listed issuers on the NYSE-MKT, the Company's continued listing eligibility will be assessed on an ongoing basis.

At June 30, 2014, the Company's backlog was approximately $36.0 million as compared to approximately $34.2 million at June 30, 2013.

Based on existing and expected production releases, the Company believes that it will have adequate liquidity, and backlog to fund operating plans for at least the next twelve months. Currently, the Company has no material future capital expenditure requirements. However, there can be no assurances that the Company will achieve profitability or will not require additional financing.

Results of Operations

Sales

For the three months ended June 30, 2014, sales decreased $70,899 (2.2%) to $3,129,076 as compared to $3,199,975 for the three months ended June 30, 2013.

Avionics government sales decreased $282,119 (10.1%) to $2,520,723 for the three months ended June 30, 2014 as compared to $2,802,842 for the three months ended June 30, 2013. This decrease is mostly attributed to the lower shipments for the TS-4530A program, as well as lower sales for the Company's legacy products. These reductions were partially offset by the increased revenues associated with the CRAFT program. In the prior year, the Company was able to ship against a partial release from the U.S. Army. The Company did not receive a full production release from the U.S. Army for kits until June 29, 2014. The Company resumed shipment of the kits for the U.S. Army TS-4530A program in July 2014, and, as such, believes that sales will increase over the remainder of the fiscal year.

Commercial sales increased $211,220 (53.2%) to $608,353 for the three months ended June 30, 2014 as compared to $397,133 for the three months ended June 3, 2013. The increase in sales is primarily attributed to parts availability as the Company was able to reduce its backlog for its commercial products as well as increased sales from the overhaul and repairs business. The economic conditions in the commercial market remain depressed and, therefore, this increase in commercial sales cannot be considered a trend.

Gross Margin

Gross margin decreased $65,941 (5.6%) to $1,120,217 for the three months ended June 30, 2014 as compared to $1,186,158 for the three months ended June 30, 2013. Gross profit was affected by higher labor and overhead variances due in part to additional staffing associated with the startup of the TS-4530A and ITATS programs. The gross margin percentage for the three months ended June 30, 2014 was 35.8%, as compared to 37.1% for the three months ended June 30, 2013.

Operating Expenses

Selling, general and administrative expenses increased $225,943 (34.6%) to $879,193 for the three months ended June 30, 2013 as compared to $653,250 for the three months ended June 30, 2013. This increase was primarily attributed to an increase in professional fees, mostly higher legal costs associated with the Aeroflex litigation.

Engineering, research and development expenses increased $3,519 (0.7%) to $483,896 for the three months ended June 30, 2014 as compared to $480,377 for the three months ended June 30, 2013. While the Company has completed development on its major programs, research and development resources have now been focused on new product development and enhancements to existing products.

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Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations (continued)

Income (Loss) From Operations

As a result of the above, the Company recorded an operating loss of $242,872 for the three months ended June 30, 2014, as compared to operating income of $52,531 for the three months ended June 30, 2013.

Other Income (Expense), Net

For the three months ended June 30, 2014, total other expense was $254,315 as compared to other expense of $156,172 for the three months ended June 30, 2013. This change is primarily due to the higher non-cash loss on the change in the valuation of common stock warrants as compared to the prior period last year offset partially by lower interest expense.

Loss before Income Taxes

As a result of the above, the Company recorded a loss before income taxes of $497,187 for the three months ended June 30, 2014 as compared to a loss before taxes of $103,641 for the three months ended June 30, 2013.

Income Tax Benefit

For the three months ended June 30, 2014, the Company recorded an income tax benefit of $113,182 as compared to an income tax benefit of $17,869 for the three months ended June 30, 2013. These amounts represent the statutory federal and state tax rate on the Company's loss before taxes.

Net Loss

As a result of the above, the Company recorded a net loss of $384,005 for the three months ended June 30, 2014, as compared to a net loss of $85,772 for the three months ended June 30, 2013.

Liquidity and Capital Resources

At June 30, 2014, the Company had net working capital of $2,029,051 as compared to $2,452,798 at March 31, 2014. This change is primarily the result of the decrease in accounts receivable offset partially by an increase in inventories.

During the three months ended June 30, 2014, the Company's cash balance decreased by $29,660 to $202,458. The Company's principal sources and uses of funds were as follows:

Cash provided by (used in) operating activities. For the three months ended June 30, 2014, the Company provided $147,954 in cash for operations as compared to using $62,170 in cash for operations for the three months ended June 30, 2013. This improvement is the result of the reduction in accounts receivable offset partially by the increase in inventories and the lower change in accounts payable and accrued liabilities.

Cash used in investing activities. For the three months ended June 30, 2014, the Company used $1,145 of its cash for investing activities, as compared to $-0- for the three months ended June 31, 2013 as result of lower purchases of equipment.

Cash used in financing activities. For the three months ended June 30, 2014, the Company used $176,469 in financing activities as compared to using $54,177 for the three months ended June 30, 2013. This is the result of lower proceeds from notes payable. For the three months ended June 30, 2013, the Company received net proceeds from a related party note payable in the amount of $100,000.

Based on existing and expected production releases, the Company believes that it will have adequate liquidity, and backlog to fund operating plans for at least the next twelve months. Currently, the Company has no material future capital expenditure requirements. However, there can be no assurances that the Company will achieve profitability or will not require additional financing.

There was no significant impact on the Company's operations as a result of inflation for the three months ended June 30, 2014.

These financial statements should be read in conjunction with the Company's Annual Report on Form 10-K for the fiscal year ended March 31, 2014, filed with the SEC on June 30, 2014.

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Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations (continued)

Off-Balance Sheet Arrangements

As of June 30, 2014, the Company had no off-balance sheet arrangements.

Critical Accounting Policies

Our critical accounting policies are described in Management's Discussion and Analysis of Financial Condition and Results of Operations included in our Annual Report on Form 10-K for the year ended March 31, 2014, as filed with the SEC on June 30, 2014. There have been no changes in our critical accounting policies. Our significant accounting policies are described in our notes to the 2014 consolidated financial statements included in our Annual Report on Form 10-K for the year ended March 31, 2014, as filed with the SEC on June 30, 2014.

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Item 3. Quantitative and Qualitative Disclosures about Market Risk.

We do not hold any derivative instruments and do not engage in any hedging activities.

Item 4. Controls and Procedures.

(a) Evaluation of Disclosure Controls and Procedures

The Company, including its principal executive officer and principal financial officer, conducted an evaluation of the effectiveness of the design and operation of its disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934 (the “Exchange Act”) as of the end of the period covered by this report (the “Evaluation Date”). Based upon the evaluation, our principal executive officer and principal financial officer concluded as of the Evaluation Date that our disclosure controls and procedures were effective. Disclosure controls are controls and procedures designed to reasonably ensure that information required to be disclosed in our reports filed under the Exchange Act, such as this report, is recorded, processed, summarized and reported within the time periods specified in the SEC’s rules and forms. Disclosure controls include controls and procedures designed to reasonably ensure that such information is accumulated and communicated to our 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

The Company, including its principal executive officer and principal accounting officer, reviewed the Company’s internal control over financial reporting, pursuant to Rule 13(a)-15(e) under the Exchange Act and concluded that there was no change in the Company’s internal control over financial reporting during the Company’s most recently completed fiscal quarter that has materially affected, or is reasonably likely to materially affect, the Company’s internal control over financial reporting.

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PART II – OTHER INFORMATION

Item 1. Legal Proceedings.

On March 24, 2009, Aeroflex Wichita, Inc. ("Aeroflex") filed a petition against the Company and two of its employees in the District Court, Sedgwick County, Kansas, Case No. 09 CV 1141 (the "Aeroflex Action"), alleging that the Company and its two employees misappropriated Aeroflex's proprietary technology in connection with the Company winning a substantial contract from the U.S. Army (the "Award"), to develop new Mode-5 radar test sets and kits to upgrade the existing TS-4530 radar test sets to Mode 5. Aeroflex's petition alleges that in connection with the Award, the Company and its named employees misappropriated Aeroflex's trade secrets; tortiously interfered with its business relationship; conspired to harm Aeroflex and tortiously interfered with its contract and seeks injunctive relief and damages. The central basis of all the claims in the Aeroflex Action is that the Company misappropriated and used Aeroflex proprietary technology and confidential information in winning the Award. In February 2009, subsequent to the Award to the Company, Aeroflex filed a protest of the Award with the Government Accounting Office ("GAO"). In its protest, Aeroflex alleged, inter alia, that the Company used Aeroflex's proprietary technology in order to win the Award, the same material allegations as were later alleged in the Aeroflex Action. On or about March 17, 2009, the U.S. Army Contracts Attorney and the U.S. Army Contracting Officer each filed a statement with the GAO, expressly rejecting Aeroflex's allegations that the Company used or infringed Aeroflex proprietary technology in winning the Award, and concluding that the Company had used only its own proprietary technology. On April 6, 2009, Aeroflex withdrew its protest.

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The Company has made an Offer to Settle to the Commission and is finalizing such Offer. The Company has also revised its procedures for Section 16(a) reports to ensure complete compliance.

Other than the matters outlined above, we are currently not involved in any litigation that we believe could have a material adverse effect on our financial condition or results of operations. There is no action, suit, proceeding, inquiry or investigation before any court, public board, government agency, self-regulatory organization or body pending or, to the knowledge of executive officers of our Company, threatened against or affecting our Company, or our common stock in which an adverse decision could have a material effect.

Item 1A. Risk Factors.

We believe there are no changes that constitute material changes from the risk factors previously disclosed in the Company's Annual Report on Form 10-K for the fiscal year ended March 31, 2014, filed with the SEC on June 30, 2014.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.

There were no unregistered sales of the Company's equity securities during the quarter ended June 30, 2014, other than those previously reported in a Current Report on Form 8-K.

Item 3. Defaults Upon Senior Securities.

There has been no default in the payment of principal, interest, sinking or purchase fund installment, or any other material default, with respect to any indebtedness of the Company.

Item 4. Mine Safety Disclosures.

Not applicable.

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Item 5. Other Information.

There is no other information required to be disclosed under this item which was not previously disclosed.

Item 6. Exhibits.

Exhibit No.	Description
31.1	Certification of Principal Executive Officer, pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 302 of 2002*
31.2	Certification of Principal Financial Officer, pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 302 of 2002*
32.1	Certification of Principal Executive Officer, pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002*
32.2	Certification of Principal Financial Officer, pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002*
101.INS	XBRL Instance Document*
101.SCH	Taxonomy Extension Schema Document*
101.CAL	Taxonomy Extension Calculation Linkbase Document*
101.DEF	Taxonomy Extension Definition Linkbase Document*
101.LAB	Taxonomy Extension Label Linkbase Document*
101.PRE	Taxonomy Extension Presentation Linkbase Document*

* Filed herewith

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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.

TEL-INSTRUMENT ELECTRONICS CORP.

Date: August 13, 2014

By: /s/ Jeffrey C. O'Hara
Name: Jeffrey C. O'Hara
Title: Chief Executive Officer
Principal Executive Officer

Date: August 13, 2014

By: /s/ Joseph P. Macaluso
Name: Joseph P. Macaluso
Title: Principal Financial Officer
Principal Accounting Officer