NORTECH SYSTEMS INC
Form 10-Q
August 10, 2007

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 June 30, 2007

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 if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes o No x

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Act. Yes o No x

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 is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act.

Large Accelerated Filer o Accelerated Filer o Non-accelerated Filer 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 August 10, 2007 - 2,714,812

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PART 1

ITEM 1. FINANCIAL STATEMENTS

NORTECH SYSTEMS INCORPORATED AND SUBSIDIARY

CONSOLIDATED BALANCE SHEETS

JUNE 30, 2007 AND DECEMBER 31, 2006

	JUNE 30 2007 (Unaudited)	DECEMBER 31 2006
ASSETS		
Current Assets		
Cash and Cash Equivalents	$ 946,308	$ 725,891
Accounts Receivable, Less Allowance for Uncollectible Accounts of $238,000 and $220,000, respectively	16,804,900	14,493,339
Inventories:		
Raw Materials	13,989,999	11,161,883
Work In Process	4,160,840	3,339,325
Finished Goods	2,855,297	2,770,670
Reserves	(1,624,088)	(1,295,656)
Total Inventories	19,382,048	15,976,222
Prepaid Expenses	362,694	492,177
Income Taxes Receivable		209,025
Deferred Income Tax Assets	1,092,000	856,000
Total Current Assets	38,587,950	32,752,654
Property and Equipment		
Land	300,000	300,000
Building and Leasehold Improvements	6,120,696	6,063,385
Manufacturing Equipment	9,723,059	9,092,455
Office and Other Equipment	3,581,556	3,532,038
Construction in Progress	266,397	90,945
Total Property and Equipment	19,991,708	19,078,823
Accumulated Depreciation	(11,350,073)	(10,823,655)
Net Property and Equipment	8,641,635	8,255,168
Other Assets		
Restricted Cash	427,500	427,500
Finite Life Intangibles	1,135,329	82,890
Goodwill	75,006	75,006
Deferred Income Tax Assets	288,000	277,000
Deposits	7,726	7,726
Total Other Assets	1,933,561	870,122
Total Assets	$ 49,163,146	$ 41,877,944

See Accompanying Notes to Condensed Consolidated Financial Statements

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NORTECH SYSTEMS INCORPORATED AND SUBSIDIARY

CONSOLIDATED BALANCE SHEETS

JUNE 30, 2007 AND DECEMBER 31, 2006

	JUNE 30 2007 (Unaudited)	DECEMBER 31 2006
LIABILITIES AND SHAREHOLDERS EQUITY		
Current Liabilities		
Bank Note Payable	$ 8,631,496	$ 4,694,027
Current Maturities of Long-Term Debt	970,449	1,524,743
Accounts Payable	11,537,851	10,018,263
Accrued Payroll and Commissions	3,112,256	3,094,092
Accrued Health and Dental Claims	343,000	325,000
Other Accrued Liabilities	598,321	385,251
Income Taxes Payable	116,226	
Total Current Liabilities	25,309,599	20,041,376
Long-Term Liabilities		
Long-Term Debt (Net of Current Maturities)	4,586,244	3,509,039
Other Long-Term Liabilities	14,386	25,670
Total Long-Term Liabilities	4,600,630	3,534,709
Total Liabilities	29,910,229	23,576,085
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: 2,714,754 and 2,674,729 Shares Issued and Outstanding at June 30, 2007 and December 31, 2006, respectively	27,148	26,747
Additional Paid-In Capital	14,972,180	14,644,901
Accumulated Other Comprehensive Loss	(22,195)	(23,179)
Retained Earnings	4,025,784	3,403,390
Total Shareholders Equity	19,252,917	18,301,859
Total Liabilities and Shareholders Equity	$ 49,163,146	$ 41,877,944

See Accompanying Notes to Condensed Consolidated Financial Statements

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NORTECH SYSTEMS INCORPORATED AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF INCOME

JUNE 30, 2007 AND 2006

(UNAUDITED)

	THREE MONTHS ENDED JUNE 30 2007	**2006**
Net Sales	$ 31,136,314	$ 26,173,559
Cost of Goods Sold	26,883,177	22,759,919
Gross Profit	4,253,137	3,413,640
Operating Expenses:		
Selling Expenses	1,375,314	1,127,525
General and Administrative Expenses	2,037,669	1,658,616
Total Operating Expenses	3,412,983	2,786,141
Income From Operations	840,154	627,499
Other Income (Expense)		
Interest Income	6,162	669
Miscellaneous Income (Expense), net	(33,590)	9,283
Interest Expense	(260,226)	(190,786)
Total Other Expense	(287,654)	(180,834)
Income Before Income Taxes	552,500	446,665
Income Tax Expense	185,000	138,000
Net Income	$ 367,500	$ 308,665
Earnings Per Common Share:		
Basic	$ 0.14	$ 0.12
Weighted Average Number of Common Shares Outstanding Used for Basic Earnings Per Common Share	2,695,754	2,619,281
Diluted	$ 0.13	$ 0.11
Weighted Average Number of Common Shares Outstanding Plus Effect of Dilutive Common Stock Options	2,735,654	2,682,244

See Accompanying Notes to Condensed Consolidated Financial Statements

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NORTECH SYSTEMS INCORPORATED AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF INCOME

JUNE 30, 2007 AND 2006

(UNAUDITED)

	SIX MONTHS ENDED JUNE 30 2007	**2006**
Net Sales	$ 59,130,776	$ 52,191,178
Cost of Goods Sold	51,240,292	45,618,787
Gross Profit	7,890,484	6,572,391
Operating Expenses:		
Selling Expenses	2,569,676	2,248,176
General and Administrative Expenses	3,829,275	3,095,746
Total Operating Expenses	6,398,951	5,343,922
Income From Operations	1,491,533	1,228,469
Other Income (Expense)		
Interest Income	13,715	1,002
Miscellaneous Income (Expense), net	(39,167)	14,346
Interest Expense	(487,687)	(366,204)
Total Other Expense	(513,139)	(350,856)
Income Before Income Taxes	978,394	877,613
Income Tax Expense	324,000	305,000
Net Income	$ 654,394	$ 572,613
Earnings Per Common Share:		
Basic	$ 0.24	$ 0.22
Weighted Average Number of Common Shares Outstanding Used for Basic Earnings Per Common Share	2,685,469	2,618,742
Diluted	$ 0.24	$ 0.21
Weighted Average Number of Common Shares Outstanding Plus Effect of Dilutive Common Stock Options	2,724,808	2,683,587

See Accompanying Notes to Condensed Consolidated Financial Statements

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NORTECH SYSTEMS INCORPORATED AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF CASH FLOWS

JUNE 30, 2007 AND 2006

(UNAUDITED)

	SIX MONTHS ENDED JUNE 30 2007	**2006**
Cash Flows From Operating Activities		
Net Income	$ 654,394	$ 572,613
Adjustments to Reconcile Net Income to Net Cash		
Provided by Operating Activities:		
Depreciation	772,007	662,953
Amortization	91,159	196,964
Compensation on Restricted Stock and Stock Option Grants	127,506	66,207
Other	(11,284)	
Deferred Taxes	(247,000)	(264,000)
Loss on Disposal of Assets	10,492	867
Foreign Currency Transaction Loss (Gain)	1,188	(6,210)
Changes in Current Operating Items, net of effect of business acquisition:		
Accounts Receivable	(327,902)	314,227
Inventories	(1,123,100)	(1,304,787)
Prepaid Expenses and Other Assets	217,883	39,127
Income Taxes Payable	293,017	(204,017)
Accounts Payable	700,741	(130,674)
Accrued Payroll and Commissions	(64,880)	255,826
Accrued Health and Dental Claims	18,000	128,896
Other Accrued Liabilities	12,632	(95,088)
Net Cash Provided by Operating Activities	1,124,853	232,904
Cash Flows from Investing Activities:		
Proceeds from Sale of Assets	1,161	275
Business Acquisition (Note 9)	(4,807,699)	
Restricted Cash		(427,500)
Purchase of Property and Equipment	(758,607)	(2,421,637)
Net Cash Used in Investing Activities	(5,565,145)	(2,848,862)
Cash Flows from Financing Activities:		
Net Change in Line of Credit	3,937,469	1,875,750
Proceeds from Long-Term Debt	1,668,195	2,540,926
Payments of Long-Term Debt	(1,145,284)	(751,394)
Issuance of Stock Upon Exercise of Options	200,173	8,228
Checks in Excess of Bank Balance		(1,200,000)
Net Cash Provided by Financing Activities	4,660,553	2,473,510
Effect of Exchange Rate Changes on Cash	156	(1,562)
Net Increase (Decrease) in Cash and Cash Equivalents	220,417	(144,010)
Cash and Cash Equivalents - Beginning	725,891	840,123
Cash and Cash Equivalents - Ending	$ 946,308	$ 696,113
Supplemental disclosure of cash flow information:		
Cash paid during the period for interest	$ 493,533	$ 363,153
Cash paid during the period for income taxes	282,929	771,000

Supplemental schedule of noncash operating activity:				
Cumulative effect of FIN 48 adoption	$	32,000	$	
Supplemental schedule of noncash investing activity:				
Accrual for estimated earnout payment on business acquisition	$	200,000	$	
Supplemental schedule of noncash financing activity:				
Issuance of Common Stock on a restricted basis	$		$	212,040

See Accompanying Notes to Condensed Consolidated Financial Statements

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NORTECH SYSTEMS INCORPORATED AND SUBSIDIARY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The accompanying condensed unaudited consolidated financial statements for the interim periods have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) for interim financial information and in accordance with 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. These statements should be read in conjunction with our Annual Report on Form 10-K for the year ended December 31, 2006. 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.

Summary of Significant Accounting Policies

In preparing the consolidated financial statements in conformity with accounting principles generally accepted in the United States, we must make decisions, which impact the reported amounts and related disclosures. Such decisions include the selection of the appropriate principles to be applied and the assumptions on which to base accounting estimates. In reaching such decisions, we apply judgment based on our understanding and analysis of the relevant circumstances.

The accounting principles followed in the preparation of the condensed consolidated financial information contained on Form 10-Q are the same as those described in our Annual Report on Form 10-K for the year ended December 31, 2006, some of which have been included herein.

Cash and Cash Equivalents

For purposes of reporting cash flows, we consider cash equivalents to be short-term, highly liquid interest-bearing accounts readily convertible to cash. The carrying amount approximates fair value.

Restricted Cash

As of both June 30, 2007 and December 31, 2006, restricted cash of $427,500 is to be used for the purchase of equipment and facility upgrades at our Blue Earth, Minnesota facility as required by the Industrial Revenue Bond agreement into which we entered on June 28, 2006 to purchase the Blue Earth, Minnesota facility, see Note 4.

Stock Based Compensation

We have two types of stock-based compensation awards consisting of restricted stock and stock options. Following is a summary of the key terms and methods of valuation for our stock-based compensation awards.

Restricted Stock

On March 7, 2006, 28,500 shares of restricted common stock were granted to our management and directors. This benefit was valued at the market price of the stock on the date of grant. These awards vest over a three-year term and are expensed ratably over the same period. We recorded compensation expense of $17,475 and $22,075 for the three months ended June 30, 2007 and 2006, respectively. Total compensation expense related to restricted stock included in the statements of income for the six months ended June 30, 2007 and 2006 was $34,950 and $25,754, respectively. The following is the status of our restricted shares as of June 30, 2007, including changes during the six months then ended:

	Restricted Shares	**Weighted-Average Grant Date Fair Value**
Outstanding - January 1, 2007	28,500	$ 7.44
Granted		
Outstanding - June 30, 2007	28,500	$ 7.44
Exercisable on June 30, 2007	9,500	$ 7.44

As of June 30, 2007 and 2006, there was approximately $105,000 and $186,000 of unrecognized compensation expense related to unvested restricted stock awards being recognized over a weighted average period of 1.50 years and 2.50 years, respectively.

Stock Options

To calculate the option-based compensation under SFAS 123R, we used the Black-Scholes option-pricing model, which we had previously used for the valuation of option-based awards for our pro forma information required under SFAS 123 for periods prior to fiscal 2006. Our determination of fair value of option-based awards on the date of grant using the Black-Scholes model is affected by our stock price as well as assumptions regarding a number of subjective variables. These variables include, but are not limited to, our expected stock price volatility over the term of the awards, risk-free interest rate, and the expected life of the options. The risk-free interest rate is based on a treasury instrument whose term is consistent with the expected life of our stock options. The expected volatility, holding period, and forfeitures of options are based on our historical experience.

Total compensation expense related to stock options included in our statements of income for the three months ended June 30, 2007 and 2006 were $46,278 and $32,276, respectively. Total compensation expense related to stock options included in our statements of income for the six months ended June 30, 2007 and 2006 was $92,556 and $40,453, respectively. For all grants, the amount of compensation expense to be recognized is adjusted for an estimated forfeiture rate, which is based on historical data.

Following is the status of our stock option plan as of June 30, 2007, including changes during the six-month period then ended:

	Options	Weighted-Average Exercise Price Per Share	Weighted-Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value
Outstanding January 1, 2007	391,500	$ 6.84		
Granted		$		
Exercised	(40,000)	$ 5.00		
Forfeited	(2,000)	$ 8.00		
Outstanding June 30, 2007	349,500	$ 7.05	$ 7.19	$ 196,750
Exercisable on June 30, 2007	233,500	$ 6.75	$ 6.25	$ 196,750

As of June 30, 2007 and 2006, there was approximately $384,000 and $275,000, respectively, of unrecognized compensation expense related to unvested option awards that we expect to recognize over a weighted average period of 1.98 years and 2.50 years, respectively. For the six months ended June 30, 2007, there were no options that became vested.

Segment Reporting Information

Our results of operations for the three months and six months ended June 30, 2007 and 2006 represent a single segment referred to as Contract Manufacturing. Export sales represented 1% and 2% of consolidated net sales for the three-month and six-month periods ended June 30, 2007, respectively. Export sales represented 5% of consolidated net sales for the three-month and six-month periods ended June 30, 2006.

Long-lived assets by country are as follows:

	United States	Mexico	Total
June 30, 2007			
Net Property and Equipment	$ 8,126,352	$ 515,283	$ 8,641,635
Other Assets	1,925,835	7,726	1,933,561
December 31, 2006			
Net Property and Equipment	$ 7,700,481	$ 554,687	$ 8,255,168
Other Assets	862,396	7,726	870,122

Finite Life Intangible Assets

Finite life intangible assets at June 30, 2007 and December 31, 2006 are as follows:

	June 30, 2007 Estimated Lives (Years)	**Gross Carrying Amount**	**Accumulated Amortization**	**Net Book Value**
Deferred Bond Issue Costs	15	$ 79,373	$ 5,291	$ 74,082
Preliminary Estimated Intangible				
Value from Acquisition (Note 9)	5	1,143,597	82,350	1,061,247
Other Intangibles	3	37,059	37,059	
Totals		$ 1,260,029	$ 124,700	$ 1,135,329

	December 31, 2006 Estimated Lives (Years)	**Gross Carrying Amount**	**Accumulated Amortization**	**Net Book Value**
Deferred Bond Issue Costs	15	$ 79,373	$ 2,649	$ 76,724
Non-Compete	4	1,526,384	1,526,384	
Other Intangibles	3	37,059	30,893	6,166
Totals		$ 1,642,816	$ 1,559,926	$ 82,890

Amortization expense related to these assets is as follows:

Quarter ended June 30, 2007	$59,246
Quarter ended June 30, 2006	$98,474
Six months ended June 30, 2007	$91,159
Six months ended June 30, 2006	$196,964

Estimated future amortization expense related to these assets is as follows:

Remainder of 2007	$ 117,000
2008	234,000
2009	234,000
2010	234,000
2011	234,000
Thereafter	82,000
Total	$ 1,135,000

As discussed in Note 9, the estimated future amortization expense presented above may change once the final purchase price allocation of the acquisition is completed.

NOTE 2. PRINCIPLES OF CONSOLIDATION

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

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NOTE 3. MAJOR CUSTOMERS AND CONCENTRATION OF CREDIT RISK

Financial instruments that potentially subject us to concentrations of credit risk consist principally of cash and trade accounts receivable. With regard to cash, we maintain our excess cash balances in checking accounts at three financial institutions. We do not require collateral on our receivables. Historically, we have not suffered significant losses with respect to trade accounts receivable.

Two customers accounted for 10% or more of our net sales for the three-month and six-month periods ended June 30, 2007 and 2006. For the three-month and six-month periods ended June 30, 2007 and 2006, G.E. s Medical and Transportation Divisions together accounted for 18% and 14% of net sales respectively. Accounts receivable from G.E. s Medical and Transportation Divisions at June 30, 2007 and 2006, represented 12% and 13% of total accounts receivable, respectively. Additionally, Northrop Grumman Corp. accounted for 14% and 15% of net sales for the three-month periods ended June 30, 2007 and 2006, respectively. For the six-month periods ended June 30, 2007 and 2006, Northrop Grumman Corp. accounted for 14% and 12% of net sales, respectively. Accounts receivable from Northrop Grumman Corp. at June 30, 2007 and 2006 represented 11% and 16% of total accounts receivable, respectively.

NOTE 4. LONG TERM DEBT

On June 28, 2006, we received $1,440,000 million in exchange for an industrial revenue bond with our trustee, Wells Fargo Bank (WFB), where the City of Blue Earth, Minnesota is issuer of the bond. The bond, which matures on June 1, 2021, bears a variable interest rate. In connection with the bond, we have a standby letter of credit of $1,458,000 with WFB of which none has been drawn upon. The bond agreement contains certain covenants, which, among other things, require us to furnish reports, records, etc. upon request of the trustee and/or issuer as described in the agreement. With WFB, we entered into an interest rate swap agreement with a notional amount of $1,440,000 million to effectively convert our industrial revenue bond debt from a variable rate to a fixed rate of 4.07% for five years, maturing on June 28, 2011. The fair value of the swap at June 30, 2007 was recorded as a long-term liability of $14,386. The bond is payable in annual installments per the agreement with WFB. Our first bond principal payment on June 1, 2007 was $130,000. The proceeds of the bond were used to purchase the facility in Blue Earth, Minnesota as well as facility upgrades and equipment to support the Blue Earth operations.

On February 2, 2007, in connection with the acquisition of Suntron s Midwest Operations located in Garner, Iowa, we entered into a 7th amendment to our credit agreement with WFB, increasing our line of credit arrangement from $10 million to $15 million and extending the maturity date of the line of credit to April 30, 2009. Additionally, the 7th amendment increased our real estate term note balance of $1,680,555 to $3,348,750 and extended the maturity date to May 31, 2012. Per the 7th amendment, both the line of credit and real estate term note are subject to variations in LIBOR rates. The line of credit and other installment debt 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 ratios, and limit the amount of annual capital expenditures. On June 30, 2007, we had an outstanding balance of $8.6 million under the line of credit and unused availability of $6.0 million supported by the borrowing base level. The line of credit is secured by substantially all of our assets.

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NOTE 5. NET INCOME PER COMMON SHARE

The following is a reconciliation of the numerators and the denominators of the basic and diluted per common share computations.

	Three Months Ended June 30, 2007	2006	Six Months Ended June 30, 2007	2006
Basic Earnings Per Common Share				
Net income, as reported	$ 367,500	$ 308,665	$ 654.394	$ 572,613
Weighted average common shares outstanding	2,695,754	2,619,281	2,685,469	2,618,742
Basis earnings per common share	$ 0.14	$ 0.12	$ 0.24	$ 0.22
Diluted Earnings Per Common Share				
Net income, as reported	$ 367,500	$ 308,665	$ 654,394	$ 572,613
Weighted average common shares outstanding	2,695,754	2,619,281	2,685,469	2,618,742
Effect of Stock options	34,209	58,895	33,769	52,265
Effect of Restricted stock	5,691	4,068	5,570	12,580
Weighted average common shares for diluted earnings per common share	2,735,654	2,682,244	2,724,808	2,683,587
Diluted earnings per common share	$ 0.13	$ 0.11	$ 0.24	$ 0.21

For the six-month periods ended June 30, 2007 and 2006, 51,373 and 26,159 shares, respectively, were excluded from the computation of diluted earnings per share because to include them would be antidilutive.

NOTE 6. FOREIGN CURRENCY TRANSLATION

Local currency is considered the functional currency for operations outside the United States. Assets and liabilities are translated at period-end exchange rates. Income and expense items are translated at average rates of exchange prevailing during the period. Translation adjustments are recorded as a component of accumulated other comprehensive loss in shareholders equity. Foreign currency exchange transaction gains and losses attributable to exchange rate movements on intercompany receivables and payables not deemed to be of a long-term investment nature are recorded in miscellaneous income (expense). The Mexican peso is the only foreign currency being translated.

NOTE 7. COMPREHENSIVE INCOME

Comprehensive income is comprised of net income and other comprehensive income (loss). Other comprehensive income (loss) includes gains and losses resulting from foreign currency translations. The details of comprehensive income are as follows:

	Three Months Ended June 30, 2007	June 30, 2006	Six Months Ended June 30, 2007	June 30, 2006
Net Income, as reported	$ 367,500	$ 308,665	$ 654,394	$ 572,613
Other Comprehensive Income (Loss):				
Currency Translation Adjustment	11,083	(10,746)	984	(20,001)
Comprehensive Income	$ 378,583	$ 297,919	$ 655,378	$ 552,612

NOTE 8. RECENTLY ISSUED ACCOUNTING STANDARDS

We adopted the provisions of FASB Interpretation No. 48 (FIN 48), *Accounting for Uncertainty in Income Taxes an Interpretation of FASB Statement 109*, on January 1, 2007. As required by FIN 48, we recognize the financial statement benefit of a tax position only after determining that the relevant tax authority would more likely than not sustain the position following an audit. For tax positions meeting the more-likely-than-not threshold, the amount recognized in the financial statements is the largest benefit that has a greater than 50 percent likelihood of being realized upon ultimate settlement with the relevant tax authority. At the adoption date, we applied FIN 48 to all tax positions for which the statute of limitations remained open. As a result of the implementation of FIN 48, we recognized $32,000 in the liability for unrecognized income tax benefits, which is included in income taxes payable, as a cumulative change to opening retained earnings as prescribed. We have also recorded an additional $5,000 of income taxes payable and expense for unrecognized 2007 income tax benefits.

The $32,000 of unrecognized tax benefits as of January 1, 2007 and the additional $5,000 as of June 30, 2007, includes unrecognized tax benefits, which, if ultimately recognized, will reduce our annual effective tax rate.

We are subject to income taxes in the U.S. federal jurisdiction and various state jurisdictions. Tax regulations within each jurisdiction are subject to the interpretation of the related tax laws and regulations and require significant judgment to apply. With few exceptions, we are no longer subject to U.S. federal, state or local income tax examinations by tax authorities for the years before 2003. We are not currently under examination by any taxing jurisdiction.

In September 2006, the FASB issued SFAS No. 157 (SFAS 157), *Fair Value Measurements*. SFAS 157 establishes a common definition for fair value to be applied to U.S. GAAP guidance requiring use of fair value, establishes a framework for measuring fair value, and expands disclosure about such fair value measurements. SFAS 157 is effective for fiscal years beginning after November 15, 2007. We are currently assessing the impact of SFAS 157 on its consolidated financial position and results of operations.

In February 2007, the FASB issued SFAS No. 159 (SFAS 159), *The Fair Value Option for Financial Assets and Financial Liabilities Including an amendment of FASB Statement No. 115*. SFAS 159 allows organizations to measure and report the fair market value of many financial instruments and certain other items. SFAS 159 is effective for fiscal years beginning after November 15, 2007. We are currently evaluating the impact of adopting SFAS 159 on our consolidated financial statements.

NOTE 9. ACQUISITION

On February 4, 2007, we purchased substantially all of the assets and assumed certain liabilities of Suntron s Midwest Operations located in Garner, Iowa. This operation is an Electronics Manufacturer Service (EMS) provider of printed circuit board assemblies, box build assemblies and repair services. This acquisition will strengthen our capabilities in printed circuit board assemblies and high level complete box build assemblies while opening new market segments in the agriculture and oil and gas industries.

The following table presents further information on the aforementioned business acquisition and the preliminary estimate of the allocation of the purchase price. Because the acquisition was recently completed the estimated allocation of purchase is preliminary in nature. The purchase agreement calls for a contingent earn-out of up to $600,000 if certain revenue levels are achieved. Based on our review of both actual and projected revenue levels of the acquired business, we believe it is probable that $200,000 of the possible earn-out payment will be earned. Accordingly, at June 30, 2007, such amount has been recorded in other accrued liabilities and accounted for as additional consideration. At the conclusion of the earn-out period on December 31, 2007, we will reassess this contingency and adjust the accrued earn-out accordingly.

Assets acquired and liabilities assumed:

Accounts receivable	$ 1,981,000	
Inventories	2,283,000	
Other current assets	88,000	
Property, plant and equipment	412,000	
Finite lived intangibles	944,000	
Accounts payable assumed	(819,000	)
Accrued compensation and other liabilities assumed	(81,000	)
Cash consideration paid	4,808,000	
Accrual for estimated earnout payment	200,000	
Net assets acquired and liabilities assumed	$ 5,008,000	

The finite life intangibles have been estimated to include non-competition agreements and a customer base, which are being amortized over an estimated life of five years.

The table below reflects our unaudited pro forma combined results of operations as if the acquisition had taken place as of January 1, 2006:

	Pro Forma Three Months Ended June 30, 2007 (unaudited)	June 30, 2006	Pro Forma Six Months Ended June 30, 2007 (unaudited)	June 30, 2006
Net Sales	$ 31,136,000	$ 29,584,000	$ 60,289,000	$ 58,861,000
Net Income	$ 368,000	$ 399,000	$ 631,000	$ 732,000
Basic earnings per common share	$ 0.14	$ 0.15	$ 0.23	$ 0.28
Diluted earnings per common share	$ 0.13	$ 0.15	$ 0.23	$ 0.27

The pro forma unaudited results do not purport to be indicative of the results which would have been obtained had the acquisition been completed as of the beginning of the earliest period presented. Furthermore, the purchase price allocation is preliminary and subject to change. Once the final purchase price allocation is determined, the unaudited pro forma combined results of operations presented above may change.

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. Major markets served include industrial equipment and transportation, medical and military/defense. We have operating facilities in Baxter, Bemidji, Blue Earth, Fairmont and Merrifield, Minnesota, Garner, Iowa, Augusta, Wisconsin, and Monterrey, Mexico.

Summary:

For the quarter ended June 30, 2007, we reported net sales of $31.1 million, up 19% over the $26.2 million we reported in the same quarter of 2006. For the six months ended June 30, 2007, we reported net sales of $59.1 million, up 13% over the $52.2 million we reported for the first six months of 2006. Our sales increase was primarily attributed to our acquisition during the year, with the new Garner, Iowa facility accounting for $6.1 million of the increase in the first six months. The gross profit percentage was 14% and 13% for the second quarters of 2007 and 2006, respectively. For the first six months of 2007 and 2006, the gross profit percentage was 13%. Income from operations for the second quarter of 2007 totaled $840,154, an increase of 34% above the $627,499 reported in the second quarter of 2006. Income from operations for the first six months of 2007 totaled $1,491,533, an increase of 21% above the $1,228,469 reported in the first six months of 2006. Net income for the second quarter of 2007 totaled $367,500, or $0.13 per diluted common share, is up 19% compared to $308,665, or $0.11 per diluted common share, reported in the second quarter of 2006. Net income for the first six months of 2007 totaled $654,394, or $0.24 per diluted common share, and was above the $572,613, or $0.21 per diluted common share, reported in the first six months of 2006.

(1.) Results of Operations:

The following table presents statement of operations data as percentages of total revenues for the periods indicated:

	Three Months Ended June 30, 2007		2006		Six Months Ended June 30, 2007		2006	
Net Sales	100	%	100	%	100	%	100	%
Cost of Good Sold	86	%	87	%	87	%	87	%
Gross Profit	14	%	13	%	13	%	13	%
Selling Expenses	4	%	5	%	4	%	4	%
General and Administrative Expenses	7	%	6	%	6	%	6	%
Income from Operations	3	%	2	%	3	%	3	%
Other Expenses, Net	1	%	1	%	1	%	1	%
Income Tax Expense	1	%	0	%	1	%	1	%
Net Income	1	%	1	%	1	%	1	%

Net Sales:

We reported net sales of $31.1 million and $26.2 million for the second quarter ended June 30, 2007 and 2006, respectively, a 19% increase year over year. The increase in net sales of $4.9 million for the second quarter is attributable to the acquisition of the Garner, Iowa Electronic Circuit Board Assemblies facility accounting for $4.1 million of the increase, our Merrifield, Minnesota Electronic Circuit Board Assemblies facility accounting for $0.8 million of the increase, and our Aerospace Systems sales was up $0.3 million and these increases were offset by a slight decline in our Cable and Wire sales of $0.3 million. We reported net sales of $59.1 million and $52.2 million for the six months ended June 30, 2007 and 2006, respectively. The increase in net sales of $6.9 million for the first six months is due to the acquisition of the Garner, Iowa Electronic Circuit Board Assemblies facility of $6.1 million and our Merrifield, Minnesota Electronic Circuit Board Assemblies facility of $1.1 million, while our Cable and Wire, and Aerospace Systems sales remained relatively flat to last year. Our 90-day order backlog as of June 30, 2007 was approximately $22.6 million, compared to approximately $26.7 million at the beginning of the quarter. Our Garner, Iowa facility accounts for approximately $2.7 million of the backlog at both the end and the beginning of the quarter or about 12% and 10% of the backlog, respectively.

Gross Profit:

Our gross profit for the second quarter of 2007 was $4.3 million or 14% of net sales compared to gross profit of $3.4 million or 13% of net sales for the second quarter of 2006. A favorable mix of product and manufacturing cost improvements account for the gross profit percentage improvement. Our gross profit for the first six months of 2007 was $7.9 million compared to gross profit of $6.6 million for the first six months of 2006, both representing 13% of net sales.

Selling Expense:

We had selling expenses of $1.4 million or 4% of net sales for the second quarter of 2007 compared to $1.1 million or 5% of net sales for the second quarter of 2006. For the first six months ended June 30, 2007 and 2006, we had selling expenses of $2.6 million and $2.2 million, respectively, representing 4% of net sales. The selling expenses for the quarter and first six months were relatively flat as we spend at the rate of growth and continue to invest in sales infrastructure and expand marketing initiatives in order to maintain a high level of customer service and support.

General and Administrative Expense:

Our general and administrative expenses were $2.0 million or 7% of net sales for the second quarter of 2007 and $1.7 million or 6% of net sales reported for the second quarter of 2006. The increase in general and administrative expenses for the quarter of $0.3 million was a result of $0.2 million for the support of our new Garner, Iowa facility and $0.1 million in personnel and related costs to support the business. For the first six months ended June 30, 2007 and 2006, we had general and administrative expenses of $ 3.8 million and $3.1 million, respectively, representing 6% of net sales. The increase in general and administrative expenses for the first six months of $0.7 million was a result of $0.3 million for the support of our new Garner, Iowa facility, $0.3 million in personnel and related costs to support the business and $0.1 million due to increased compliance costs and higher share based compensation expenses over the prior year.

Other Expense:

Other expenses, net were $287,654 for the quarter ended June 30, 2007 compared to $180,834 for the second quarter of 2006. Other expenses, net were $513,139 for the six months ended June 30, 2007 compared to $350,856 for the first six months of 2006. The increase in interest expense for the quarter and the first six months of $69,440 and $121,483 resulted from increased debt levels related to the acquisition above as well as the Blue Earth, Minnesota expansion that occurred in June 2006. Higher interest rates have also impacted overall interest charges compared to prior year. For the quarter and the first six months, interest income was positively impacted by $5,493 and $12,713, respectively, as the result of carrying the $427,500 of restricted cash related to the Blue Earth, Minnesota expansion. The remaining miscellaneous expense increase from 2006 resulted from experiencing less favorable currency exchange rates.

Income Tax:

Income tax expense for the three months ended June 30, 2007 was $185,000, compared to an income tax expense of $138,000 for the three months ended June 30, 2006. Income tax expense for the six months ended June 30, 2007 was $324,000 compared to an income tax expense of $305,000 for the six months ended June 30, 2006. The effective tax rate for 2007 is expected to approximate 33%, and the effective rate for 2006 was 30% due to the recognition of tax credits and other tax adjustments that occurred during 2006.

(2.) Liquidity and Capital Resources:

We have satisfied our liquidity needs over the past several years through revenue generated from operations and an operating line of credit through Wells Fargo Bank, N.A. (WFB). On February 2, 2007, we entered into a 7th amendment to our credit agreement with WFB increasing our line of credit arrangement from $10 million to $15 million and extending the maturity date of the line of credit to April 30, 2009. Additionally, the 7th amendment increased our real estate term note balance of $1,680,555 at February 2, 2007 to $3,348,750 and extended the maturity date to May 31, 2012. Per the 7th amendment, both the line of credit and real estate term note are subject to variations in the LIBOR rates. The 7th amendment funded the Iowa acquisition on February 4, 2007.

The line of credit and other installment debt 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 ratios, 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. The line is secured by substantially all of our assets. On June 30, 2007, we had an outstanding balance of $8.6 million under the line of credit and unused availability of $6.0 million supported by our borrowing base level.

The following unaudited ratios are not required under the SEC guidelines or accounting principles generally accepted in the United States of America, however, we believe they are meaningful measures and are useful to readers of our financial statements.

	June 30, 2007	**December 31, 2006**	**December 31, 2005**	**December 31, 2004**
Current Ratio (Current Assets / Current Liabilities)	1.52	1.63	1.60	1.65
Working Capital (Current Assets Current Liabilities)	$ 13,278,351	$ 12,711,278	$ 12,214,328	$ 11,749,991
Quick Ratio (Cash + Accounts Receivable / Current Liabilities)	0.70	0.76	0.75	0.77
Accounts Receivable to Working Capital (Average Accounts Receivable/ Working Capital)	1.18	1.14	1.14	1.03
Inventory to Working Capital (Average Inventory/ Working Capital)	1.33	1.25	1.23	1.10

Our working capital of $13.3 million as of June 30, 2007 increased from $12.7 million at December 31, 2006. The majority of our working capital changes were a direct result of $4.7 million of working capital generated from our new the Garner, Iowa operation. This increase was offset primarily due to $3.4 million in current financing activities to help fund the transaction, along with $0.7 million in other changes to working capital. We continue to focus our efforts on lowering inventory levels and collecting accounts receivable within terms in order to improve our working capital position.

Net cash provided by operating activities for the six months ended June 30, 2007 was $1.1 million, which is up from the $0.2 million of net cash provided by operating activities for the six months ended June 30, 2006. The cash flow from operations for the six months ended June 30, 2007 is the result of net income of $0.7 million, adjusted for noncash depreciation, amortization, loss on the disposal of assets, stock-based compensation expense, foreign currency transaction loss, and the change in deferred taxes, which combined totaled $0.7 million in net positive adjustments, less the net change in operating assets and liabilities of $0.3 million. Increases in Accounts Receivable of $0.3 million, Inventories of $1.1 million offset by increases in Accounts Payable of $0.7 million account for the majority of net use of working capital cash in the first six months of 2007.

Net cash used in investing activities of $5.6 million for the six months ended June 30, 2007 is primarily due to the acquisition of Garner, Iowa of $4.8 million (See Note 9) as well as $0.8 million in property and equipment and is up from $2.8 million net cash used in investing activities for the six months ended June 30, 2006, where the majority of the use was for purchase of the Blue Earth, Minnesota facility. (See Note 9)

Net cash provided by financing activities for the six months ended June 30, 2007 was $4.7 million, consisting primarily of drawing on the line of credit by $3.9 million and proceeds from the $1.7 million equipment note, offset by principal payments on notes payable.

We believe that our future financing requirements can be met with funds generated from our operating activities and our operating line of credit. Set forth below is information about our long-term contractual obligations outstanding as of June 30, 2007, excluding interest. Refer to the Annual Report on Form 10-K for detailed information on our long-term contractual obligations and commitments.

	Payments Due by Period Remainder of 2007	2 - 3 Yrs	4 - 5 Yrs	Thereafter
Bank Note Payable	$ 8,631,496	$	$	$
Notes and Bonds Payable	431,817	1,372,557	2,952,319	800,000
Operating Leases	175,193	375,251	60,368	
Equipment Purchase Commitments	550,000			
Total Contractual Obligations and Commitments	$ 9,788,506	$ 1,747,808	$ 3,012,687	$ 800,000

As result of the purchase of the Blue Earth facility on June 28, 2006, we are leasing 45,000 square feet of the building to the previous owner until September 2007 for approximately $17,000 per month. Included in the equipment purchase commitments is $427,500 that will be used for the purchase of equipment for the Blue Earth facility as specified in the Industrial Revenue Bond Agreement.

From time to time we enter into purchase commitments with our suppliers under customer purchase order forms. Any significant losses implicit in these contracts would be recognized in accordance with generally accepted accounting principles. At June 30, 2007, no such losses existed.

(3.) Critical Accounting Policies:

Our significant accounting policies and estimates are summarized in the footnotes to the annual consolidated financial statements. Some of the most critical accounting policies and estimates that require us to exercise significant judgment are listed below.

Revenue Recognition:

We recognize revenue upon shipment of products to customers, when title has passed, all contractual obligations have been satisfied and collection of the resulting receivables are reasonably assured. In the normal course of business, we enter into a number of contracts with customers under which we provide engineering services on a per project basis. Revenue for these services is recognized upon completion of the engineering process, usually upon initial shipment of the product. Revenues from repair services are recognized upon shipment of related equipment to customers.

Allowance for Uncollectible Accounts:

We evaluate our allowance for uncollectible accounts on a quarterly basis and review any significant customers with delinquent balances to determine future collectibility. We base our determinations on legal issues (such as bankruptcy status), past history, current financial and credit agency reports, and experience. We reserve accounts deemed to be uncollectible in the quarter in which we make the determination. We maintain additional reserves based on our historical bad debt experience. We believe these estimates may differ from actual results. We believe that, based on past history and credit policies, the net accounts receivable are of good quality.

Inventory Valuation and Reserves:

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 inventory that may have a lower value than stated or in excess of production needs. These estimates may differ from actual results. We have an evaluation process that is used to assess the value of the inventory by part and customer that is slow moving, excess or obsolete. This process is reviewed and evaluated quarterly.

Deferred Income Tax Valuation:

At June 30, 2007 and December 31, 2006, we have recorded U.S. and state deferred tax assets pertaining to the recognition of future deductible temporary differences. We have not provided any valuation allowance with respect to these assets, as we believe their realization is more likely than not. This determination is primarily based upon our expectation that future U.S. operations will be sufficiently profitable, as well as various tax, business and other planning strategies available to us. We cannot assure you that we will be able to realize this asset or that future valuation allowances will not be required. The failure to utilize this asset would adversely affect our results of operations and financial position.

Valuation of Long-Lived Assets Including Intangible Assets with Finite Lives:

We evaluate long-lived assets and intangible assets with finite lives for impairment, as well as the related amortization periods, to determine whether adjustments to these amounts or useful lives are required based on current events and circumstances. The evaluation 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 is recorded to reduce the carrying amount to its estimated fair value.

The test for impairment requires us to make several estimates about fair value, most of which are based on projected future cash flows. The estimates associated with the asset impairment tests are considered critical due to the judgments required in determining fair value amounts, including projected future cash flows. Changes in these estimates may result in the recognition of an impairment loss.

Allocation of Purchase Price Paid for the Garner, Iowa Acquisition:

As a result of our Garner, Iowa acquisition, as described in Note 9 to the condensed notes to the consolidated financial statements, we were required to allocate the consideration paid between tangible assets, identifiable intangible assets, and goodwill. We engaged an independent valuation firm to assist in the determination of the fair values of the intangible assets. The amount of the purchase price allocated to intangible assets is being determined by estimating the future cash flows of each asset and discounting the net cash flows back to their present values. The discount rate being used in calculating the present value of the various intangibles is in accordance with accepted valuation methods. Preliminary estimates indicate that there is no goodwill. However, because the acquisition was recently completed the estimated allocation of purchase price is preliminary in nature.

Stock-Based Compensation:

We adopted the provisions of SFAS 123R, Share-Based Payment on January 1, 2006. SFAS 123R requires us to measure and recognize in our consolidated statements of operations the expense associated with all share-based payment awards made to employees and directors based on estimated fair values. We have two types of stock-based compensation awards consisting of restricted stock and stock options.

Restricted stock is valued at the market price of the stock on the date of grant. These awards vest over a three-year term and are expensed ratably over the same period.

We utilize the Black-Scholes option valuation model to measure the amount of compensation expense to be recognized for each stock option award. There are several assumptions that must be made when using the Black-Scholes model such as the expected term of each option, the expected volatility of the stock price during the expected term of the option, the expected dividends to be paid and the risk free interest rate expected during the option term. We have reviewed each of these assumptions carefully and we determined our best estimate for these variables. Of these assumptions, the expected term of the option and expected volatility of our common stock are the most difficult to estimate since they are based on the exercise behavior of employees and the expected performance of our stock. An increase in the volatility of our stock will increase the amount of compensation expense on new awards. An increase in the holding period of options will also cause an increase in compensation expense. Dividend yields and risk-free interest rates are less difficult to estimate, but an increase in the dividend yield will cause a decrease in expense and an increase in the risk-free interest rate will increase compensation expense.

Based on a critical assessment of our accounting policies and the underlying judgments and uncertainties affecting the application of those policies, we believe that our consolidated financial statements provide a meaningful and fair perspective of our financial position as of June 30, 2007 and results of operations for the three-month and six-month periods ended. This is not to suggest that other general risk factors, such as changes in worldwide economic conditions, fluctuations in foreign currency exchange rates, changes in materials costs, performance of acquired businesses and others, could not adversely impact our consolidated financial position, results of operations and cash flows in future periods.

(4.) 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;
- General economic, financial and business conditions that could affect our financial condition and results of operations.

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.

The factors identified above are believed to be important factors (but not necessarily all of the important factors) tha

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We are exposed to changes in interest rates primarily as a result of our borrowing activities used to maintain liquidity. Our earnings have been affected by recent changes in interest rates on our floating interest rate debt because interest rates have risen over the past year while our utilization on our line of credit has remained stable. Based on our current borrowings, an increase of 100 basis points in prevailing interest rates would increase our annual interest expense by less than $100,000,which may be offset in part by the interest rate swap agreement entered into in connection with the issuance of bonds at the end of the second quarter.

We are exposed to currency exchange fluctuations related to our Mexico subsidiary; however, the Mexican peso continues to remain fairly stable.

ITEM 4. CONTROLS AND PROCEDURES

We evaluated, with the participation of our Chief Executive Officer and Chief Financial Officer, the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934) as of June 30, 2007. Based on such evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that, as of such date, our disclosure controls and procedures are designed to ensure that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC s rules and regulations and are operating in an effective manner.

We are currently in the process of reviewing and formalizing our internal controls and procedures for financial reporting in accordance with the Securities and Exchange Commission s rules implementing the internal control reporting requirements included in Section 404 of the Sarbanes-Oxley Act of 2002 (Section 404). Changes have been and will be made to our internal controls over financial reporting as a result of these efforts. We are dedicating significant resources, including senior management time and effort, and incurring substantial costs in connection with its ongoing Section 404 assessment. We are currently documenting and testing internal controls and considering whether any improvements are necessary for maintaining an effective control environment. The evaluation of internal controls is being conducted under the direction of senior management in consultation with an independent third party consulting firm. In addition, senior management is regularly discussing proposed improvements to the control environment with the Audit Committee. We expect to assess controls and procedures on a regular basis and will continue to work to improve controls and procedures and educate and train employees on the existing controls and procedures in connection with the efforts to maintain an effective controls infrastructure.

PART II

ITEM 1. LEGAL PROCEEDINGS

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

ITEM 1A. RISK FACTORS

We are affected by risks specific to us as well as factors that affect all businesses operating in a global market. The significant factors known to us that could materially adversely affect our business, financial condition, or operating results are described in our most recently filed Annual Report on Form 10-K (Item 1A). There has been no material change in those risk factors.

ITEM 6. EXHIBITS

(a) 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.

32.1 Certification of the Chief Executive Officer and Chief Financial Officer, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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

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Date: August 10, 2007	by	/s/ Michael J. Degen
		Michael J. Degen President and Chief Executive Officer
Date: August 10, 2007	by	/s/ Richard G. Wasielewski
		Richard G. Wasielewski Chief Financial Officer