

RELIABILITY INC  
Form 10QSB  
May 14, 2008

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-QSB**

**QUARTERLY REPORT UNDER SECTION 13 or 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended March 31, 2008

**TRANSITION REPORT UNDER SECTION 13 or 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from \_\_\_\_\_ to \_\_\_\_\_.

Commission File Number 0-7092

**RELIABILITY INCORPORATED**

(Name of small business issuer in its charter)

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**TEXAS**  
(State or other jurisdiction of  
incorporation or organization)

**75-0868913**  
(I.R.S. Employer  
Identification Number)

**Post Office Box 218670 Houston, Texas**  
(Address of principal executive offices)

**(281) 492-0550**

**77218-8670**  
(Zip Code)

(Issuer's telephone number, including area code)

Check whether the issuer (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 twelve 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 ninety days. YES  NO

State the number of shares outstanding of each of the issuer's classes of common equity, as of the latest practicable date: 6,335,965 shares of Common Stock, no par value as of May 1, 2008.

Transitional Small Business Disclosure Format (check one): Yes  No

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

**RELIABILITY INCORPORATED**

**FORM 10-QSB**

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## PART I FINANCIAL INFORMATION

## Item 1. Financial Statements

## RELIABILITY INCORPORATED

## UNAUDITED CONSOLIDATED BALANCE SHEET (In thousands)

	March 31, 2008
<b>ASSETS</b>	
Current assets:	
Cash and cash equivalents	\$ 14
Prepaid expenses	18
Assets of discontinued operations	104
Total current assets	136
Asset held for sale	225
	\$ 361
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>	
Current liabilities:	
Accrued liabilities	\$ 20
Note payable- insurance	12
Accrued liabilities of discontinued operations	120
Total current liabilities	152
Stockholders equity:	
Common stock, without par value; 20,000,000 shares authorized; 6,690,265 issued	9,767
Accumulated deficit	(8,464)
Less treasury stock at cost, 354,300 shares	(1,094)
Total stockholders equity	209
	\$ 361

See accompanying notes.

RELIABILITY INCORPORATED

UNAUDITED CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except per share data)

	Three Months 2008	Ended March 31, 2007
General and administrative	\$ 24	\$ 221
Total cost and expenses	24	221
Operating (loss) from continuing operations	(24)	(221)
Other income (expense):		
Interest income		16
Other income		1
Total other income (expense)		17
(Loss) from continuing operations, before income taxes	(24)	(204)
Provision for income taxes		
(Loss) from continuing operations	(24)	(204)
(Loss) from discontinued operations, net of income tax provisions of nil	(2)	(70)
Net (loss)	\$ (26)	\$ (274)
Basic and diluted (loss) per share:		
Continuing operations	\$ (.00)	\$ (.03)
Discontinued operations	(.00)	(.01)
Net (loss)	\$ (.00)	\$ (.04)
Weighted average shares:		
Basic	6,336	6,336
Diluted	6,336	6,336

See accompanying notes.

## RELIABILITY INCORPORATED

## UNAUDITED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

	Three Months 2008	Ended March 31, 2007
Cash flows from operating activities:		
Net loss	\$ (26)	\$ (274)
Loss from discontinued operations	(2)	(70)
Loss from continuing operations	(24)	(204)
Changes in operating assets and liabilities:		
Accounts receivable	4	2
Prepaid expenses	13	10
Accounts payable		
Accrued liabilities	(2)	114
Total adjustments	15	126
Net cash (used) by continuing operations	(9)	(78)
Net cash (used) provided by discontinued operations	(2)	(20)
Net cash (used) by operating activities	(11)	(98)
Cash flows from investing activities:		
Deferred acquisition cost		(121)
Net cash (used) provided by investing activities		(121)
Cash flows from financing activities:		
Repayments on notes payable	(7)	
Net cash (used) by financing activities	(7)	
Net (decrease) increase in cash	(18)	(219)
Cash and cash equivalents:		
Beginning of period	32	1,258
End of period	\$ 14	\$ 1,039

See accompanying notes.

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RELIABILITY INCORPORATED

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

March 31, 2008

**1. DISCONTINUANCE OF ALL OPERATIONS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

***Discontinuance of all Operations and Liquidity***

The Company has sustained significant negative financial results, including substantial decreases in revenues, net income, and cash flows from operating activities. The deterioration in the Company's financial condition and liquidity are generally attributable to operating losses sustained in each of the last seven years.

Due to the deterioration in its financial position, the Company undertook significant steps to reduce its expenses and improve the Company's liquidity, including the sale and discontinuance of all operations. Based upon its current financial position, the Company concluded that it should pursue the following course of action: sell its remaining real estate holding and invest in another line of business through a purchase or merger.

On April 1, 2007, Reliability completed the merger of its wholly owned subsidiary, Reliability-Medallion, Inc., a Florida corporation, into Medallion Electric Acquisition Corporation and the indirect acquisition, through Medallion Electric Acquisition Corporation, of Medallion Electric, Inc. Medallion Electric Acquisition Corporation was incorporated under the laws of the State of Florida on December 8, 2006 to facilitate a merger between business entities and was considered to be a development stage company with no operations at March 31, 2007. On June 21, 2007, the Company changed the name of Medallion Electric Acquisition Corporation ( *MEAC* ) to Reliability Contractors of Florida, Inc. Reliability Contractors of Florida, Inc. is a wholly-owned subsidiary of Reliability.

Medallion Electric, Inc. ( *Medallion Electric* or *Medallion* ) was incorporated in the State of Florida in 1980. Medallion Electric is an electrical contracting company, located in Coral Springs, Florida, specializing in electrical contracting services to residential homebuilders, with its major assets consisting of contracts for services to be performed and accounts receivable. Medallion Electric is a wholly-owned subsidiary of Reliability Contractors of Florida, Inc. (collectively referred to as *Reliability Florida* or *Electrical Contracting Services* ).

All of the funds used for the initial acquisition payment and the Company's transaction costs related to the merger and acquisition were paid out of the Company's cash on hand. The Company funded \$750,000 to finance the acquisition. \$100,000 of such funds was made available to Medallion Electric as working capital; \$150,000 was used by MEAC to pay its transaction related expenses. The remaining \$500,000 was used to make the initial payment to the sole shareholder of Medallion Electric for 100% of the stock of Medallion Electric. The remainder of the purchase price consisted of two notes- one for \$500,000 due in six months and one for \$1.4 million due in six months. The Company secured the \$500,000 note with the pledge of its real property in North Carolina; the \$1.4 million note was secured with the assets of Medallion Electric.

The Company planned to pay the notes from the Company's working capital, funds generated by Electrical Contracting Services, additional debt and/or equity financing, and the sale of a part of its real estate located in North Carolina. However, in early September, 2007 it became apparent, the Company was not generating enough funds and had not been successful in raising debt or equity funds to meet all of the obligations which would be due on October 1, 2007. Therefore, the Reliability Board of Directors passed a resolution on September 25, 2007 that instructed management to enter into an agreement to sell Medallion Electric, Inc. back to the previous owner.

On October 12, 2007, the Company and its subsidiaries Reliability Contractors of Florida, Inc. and Medallion Electric, Inc. entered into a Settlement, Sale of Stock and Release Agreement ( *Agreement* ) with Mr. Ronald Masaracchio, the previous owner, pursuant to which Reliability Contractors sold back the stock of Medallion effective October 1, 2007. The Company agreed to pay \$325,000 upon the closing of the sale of part of the Company's North Carolina real estate, which was under a purchase and sale contract, and transfer 100% of the Medallion stock to the previous owner, who agreed to release all the liens against the Company's assets, cancel all the notes, and release the Company from any and all of its

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RELIABILITY INCORPORATED

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

March 31, 2008

obligations to him. In addition to the \$325,000, Reliability transferred all the stock of Medallion which held assets that were valued at approximately \$1.7 million on Reliability's balance sheet and liabilities which were generated in the normal course of business at Medallion valued at approximately \$529,000.

Upon the closing of the sale of a portion of Reliability's North Carolina real estate on October 26, 2007, the previous owner received the \$325,000, and the sale of Medallion Electric, the release of the liens, and cancellation of all the obligations was consummated. At the time of the sale, the previous owner held two notes totaling \$1.9 million, which were due October 1, 2007, and an earnout agreement which called for a minimum payment of \$750,000 over three years. The notes were secured by the assets of Medallion and the North Carolina property owned by Reliability. The sale of Medallion back to previous owner included a release of all liability on the notes and the earnout agreement, assumption of all Medallion ordinary course of business debts and obligations, mutual releases between Reliability and previous owner, including a release of the security for the notes. The net proceeds from the sale of a part of the North Carolina real estate to Reliability, after the \$325,000 payment and all other expenses of the sale, were \$292,000. The Company retained the ownership of 10 acres of land in North Carolina.

The accompanying financial statements have been prepared assuming the Company will continue as a going concern. However, upon the completion of the sale of Medallion Electric, the Company has no further operating activities. There can be no assurances that the Company will be able to successfully complete a merger or acquisition or be able to maintain sufficient liquidity to continue to seek a merger or acquisition, in which case the Company might be forced to liquidate or seek protection under the Federal bankruptcy statutes, or both.

The accompanying financial statements do not include any adjustments to reflect the possible future effects on the recoverability and classification of assets or the amounts and classifications of liabilities that may result from the possible inability of the Company to continue as a going concern.

***Basis of presentation***

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and with instructions to Form 10-QSB and Item 10 of Regulation S-B. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements. In the opinion of management, all adjustments considered necessary for a fair presentation have been included. Operating results for the interim period ended March 31, 2008 are not necessarily indicative of the results that may be expected for the year ending December 31, 2008.

The consolidated financial statements include the financial transactions and accounts of the Company and its wholly-owned subsidiary. All significant intercompany balances and transactions have been eliminated in consolidation. For further information, refer to the financial statements and footnotes thereto included in the Company's annual report on Form 10-KSB for the year ended December 31, 2007.

Certain expenses on the consolidated statement of operations for the three months ended March 31, 2007, related primarily to discontinued operations, have been reclassified to be consistent with the classifications adapted for the three months ended March 31, 2008. These reclassifications had no effect on net income.

RELIABILITY INCORPORATED

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

March 31, 2008

***Accounting Estimates***

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires that management make estimates and assumptions that affect the reported amounts of assets and liabilities and 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. Actual results may differ from those estimates.

***Stock Options***

January 1, 2006, the Company adopted the fair value recognition provisions of Statement of Financial Accounting Standards 123(R), *Share-Based Payment* ( SFAS 123(R) ). SFAS 123(R) requires that the compensation cost relating to stock-based payments, including grants of employee stock options, be recognized in financial statements. That cost is measured based on the fair value of the equity instruments issued. SFAS 123(R) allows two methods for determining the effects of the transition: the modified-prospective transition method and the modified-retrospective method of transition. The Company adopted the modified-prospective method. Under this transition method, the Company recognizes the fair value of stock-based compensation awards as compensation expense in its statement of operations on a straight line basis, over the vesting period, for awards granted after January 1, 2006 and for unvested awards outstanding as of December 31, 2005.

***Cash Equivalents***

For the purposes of the statements of cash flows, the Company considers all highly liquid cash investments that mature in three months or less when purchased, to be cash equivalents. Cash equivalents are stated at cost, which approximates fair value.

***Property, Plant and Equipment***

The Company has approximately 10 acres of land held for sale and is reflected at cost net of an allowance for impairment. See Note 4.

## RELIABILITY INCORPORATED

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

March 31, 2008

**2. INCOME TAXES**

Deferred income taxes are provided under the liability method and reflect the net tax effects of temporary differences between the tax basis of assets and liabilities and their reported amounts in the consolidated financial statements. The Company establishes valuation allowances when the realization of specific deferred tax assets are subject to significant uncertainty. The Company recorded no tax benefits on its operating losses, as the losses will have to be carried forward and realization of any benefit is uncertain.

At December 31, 2007, the Company had U.S. net operating loss carryforwards of \$15.3 million that will expire commencing in 2023 through 2027. These carryforwards may be subject to certain limitations on annual utilization in the event of a change in ownership, as defined by tax law. See Note 5 in the Company's 10-KSB dated December 31, 2007.

**3. ACCRUED LIABILITIES**

Accrued liabilities as of March 31, 2008 consists of the following (in thousands):

	<b>March 31, 2008</b>
Property taxes	\$ 1
Professional fees	17
Payroll related	
Telephone	1
Other	1
	\$ 20

**4. ASSETS HELD FOR SALE AND IMPAIRMENT LOSS**

The Company shut down a Services facility in North Carolina in April 1998. On October 26, 2007, seven and one half acres of the land and a building previously occupied by the Services operation were sold for \$675,000 cash. The Company still retains 10 acres of land adjacent to the property that was sold. The previous owner of Medallion Electric held a lien on the property in the form of a note. \$325,000 of the proceeds were paid and the lien has been released. The value of the land is presented as assets held for sale in the accompanying consolidated balance sheet. An impairment loss of \$159,000 was recorded in the third quarter of 2007 to reduce the carrying value of the real estate held for sale. The property has been actively marketed since 1998, although no assurances can be given the remaining acreage will be sold during 2008.

## RELIABILITY INCORPORATED

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

March 31, 2008

**5. STOCK OPTION PLAN**

Under the Company's Amended and Restated 1997 Stock Option Plan (Option Plan), stock option grants are available for officers, directors, and key employees. The objectives of the Option Plan are to promote the interest of the Company by providing an ownership incentive to officers, directors, and key employees, to reward outstanding performance, and to encourage continued employment. The Board of Directors, which acts as the Plan Administrator, determines to whom options are granted, the type of options, the number of shares covered by such options and the option vesting schedule. The Option Plan provides for the grant of stock options to purchase an aggregate of up to 1,500,000 shares of the Company's Common Stock. All options are issued at market value on the date of the grant and generally have a ten-year contractual term with graded vesting.

On January 1, 2006, the Company adopted the fair value recognition provisions of Statement of Financial Accounting Standards 123(R), *Share-Based Payment* (SFAS 123(R)). SFAS 123(R) requires that the compensation cost relating to stock-based payments, including grants of employee stock options, be recognized in financial statements. The Company recognizes the fair value of stock-based compensation awards as compensation expense in its statement of operations on a straight line basis, over the vesting period, for awards granted after January 1, 2006 and for unvested awards outstanding as of December 31, 2005.

The fair value of each option is estimated on the date of grant using a Black-Scholes option-pricing model. Expected volatilities are based on a number of factors, including historical volatility of the Company's stock. The Company uses the shortcut method described in SAB Topic 14D.2 for determining the expected life used in the valuation model. The risk-free rate for periods within the contractual life of the option is based on the U.S. Treasury yield curve in effect at the time of the grant. As the Company has not declared dividends since it became a public entity, no dividend yield is used in the calculation. No options were granted during the three months ended March 31, 2008.

At March 31, 2008, there were no unvested option grants, thus no further stock option expense will be recorded until such time that additional grants are made. The weighted-average remaining contractual term, as of March 31, 2008, was 8.6 years for outstanding and exercisable options. The following table summarizes option activity for the three months ended March 31, 2008:

	Number of Options	Weighted Average Price
Balance as of December 31, 2007	370,000	\$ .21
Expired or canceled		
Exercised		
Granted		
Balance as of March 31, 2008	370,000	\$ .21

In addition to the options outstanding under The Company's Stock Option Plan, 100,000 options were issued in connection with a business combination were and were outstanding and exercisable at December 31, 2007. These options were canceled as of January, 2008.

## RELIABILITY INCORPORATED

## NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

March 31, 2008

**6. DISCONTINUED OPERATIONS**

On March 14, 2006, the Company sold its Power Sources Division to Reliability Power, Inc., an unaffiliated third party. Proceeds from the sale were \$300,000.

On April 18, 2006, the Company announced plans to close down its Services division located in Singapore. During the wind down of operations, the division has maintained a small number of employees to complete unfinished jobs, provide limited services for its customers while they seek alternative service providers, prepare equipment for sale and vacate the division's leased facility. The liquidation of the Company's former Services division was substantially complete as of June 30, 2007.

In April of 2007, following the acquisition of Medallion Electric, the Company concluded that it should abandon its Testing Products business in favor of concentrating all available resources on its newly acquired business line, Electrical Contracting Services.

On September 25, 2007, the Company's Board of Directors passed a resolution to sell Medallion Electric to the previous owner. Therefore, all operations, including Electrical Contracting Services (Medallion Electric, Inc.) will be included as a discontinued operation.

Results for all operations for the Company's former Power Sources, Services, Testing Products, and Electrical Contracting Services are reported as discontinued operations in the accompanying Statement of Operations for each period presented. Net sales and the loss from discontinued operations are as follows (in thousands):

	<b>Three Months Ended</b>	
	<b>March 31,</b>	
	<b>2008</b>	<b>2007</b>
<b>Revenues:</b>		
Power Sources	\$	\$
Services		36
Testing Products		6
Electrical Contracting Services		
	\$	\$ 42
<b>Income (loss) from discontinued operations:</b>		
Power Sources		
Services	(2)	(74)
Testing Products		4
Electrical Contracting Services		
	\$ (2)	\$ (70)

RELIABILITY INCORPORATED

NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

March 31, 2008

The assets and liabilities of the Company's former Services segment are reported as assets of discontinued operations and accrued liabilities of discontinued operations in the accompanying Consolidated Balance Sheet for each period presented. There are no remaining assets or liabilities of the Company's former Power Sources or Testing Products segment. The assets and accrued liabilities from discontinued operations of the Company's former Services segment are as follows (in thousands):

	<b>Ended March 31, 2008</b>
<b>Assets:</b>	
Cash	\$ 92
Accounts receivable	12
	\$ 104
<b>Accrued liabilities:</b>	
Accrued payroll and termination benefits	\$ 113
Other accrued liabilities	7
	\$ 120

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RELIABILITY INCORPORATED

MANAGEMENT'S DISCUSSION AND ANALYSIS

March 31, 2008

*Item 2. Management's Discussion and Analysis or Plan of Operations*  
**FORWARD-LOOKING STATEMENTS**

This Management's Discussion and Analysis and other parts of this report contain forward-looking statements that involve risks and uncertainties, as well as current expectations and assumptions. From time to time, the Company may publish forward-looking statements, including those that are contained in this report, relating to such matters as anticipated financial performance, business prospects, technological developments, new products, research and development activities and similar matters. The Private Securities Litigation Reform Act of 1995 provides a safe harbor for forward-looking statements. In order to comply with the terms of the safe harbor, the Company notes that a variety of factors could cause the Company's actual results and experience to differ materially from the anticipated results or other expectations expressed in the Company's forward-looking statements. The risks and uncertainties that may affect the operations, performance, development and results of the Company's business include, but are not limited to, its ability maintain sufficient working capital, adverse changes in the economy, the ability to attract and maintain key personnel, the ability to sell its remaining real estate holdings or business line, its ability to identify and complete mergers or acquisitions, and future results related to acquisitions, mergers or investment activities. The Company's actual results could differ materially from those anticipated in these forward-looking statements, including those set forth elsewhere in this report. The Company assumes no obligation to update any such forward-looking statements.

**CRITICAL ACCOUNTING POLICIES AND COMMENTS RELATED TO OPERATIONS**

The Company has defined a critical accounting policy as one that is both important to the portrayal of the Company's financial condition and results of operations and requires the management of the Company to make difficult, subjective or complex judgments. Estimates and assumptions about future events and their effects cannot be perceived with certainty. The Company bases its estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments. These estimates may change as new events occur, as more experience is acquired, as additional information is obtained and as the Company's operating environment changes. There have been no material changes or developments in the Company's evaluation of the accounting estimates and the underlying assumptions or methodologies that it believes to be Critical Accounting Policies and Estimates as disclosed in its Form 10-KSB for the year ended December 31, 2007.

Management's Discussion included in the Form 10-KSB for the year ended December 31, 2007 includes discussion of various factors related to the decline in the Company's revenues and items related to the Company's results of operations, liquidity, merger and acquisition. There have been no other significant changes in most of the factors discussed in the Form 10-KSB and many of the items discussed in the Form 10-KSB are relevant to 2008 operations; thus the reader of this report should read Management's Discussion included in Form 10-KSB for the year ended December 31, 2007 and Form 8-K filed on April 6, 2007.

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RELIABILITY INCORPORATED

MANAGEMENT'S DISCUSSION AND ANALYSIS

March 31, 2008

**LIQUIDITY AND CAPITAL RESOURCES**

Due to the deterioration in its financial position, the Company undertook significant steps to reduce its expenses and improve the Company's liquidity, including the sale and discontinuance of all operations. Based upon its current financial position, the Company concluded that it should pursue the following course of action: sell its remaining real estate holding and invest in another line of business through a purchase or merger.

On April 1, 2007, the Company consummated a merger of its wholly owned subsidiary, Reliability-Medallion, Inc., a Florida corporation, into Medallion Electric Acquisition Corporation, a Florida corporation ( "MEAC" ), and the indirect acquisition, through MEAC, of Medallion Electric, Inc., a Florida corporation ( "Medallion Electric" ). All of the funds used for the initial payment to Medallion Electric were paid out of the Company's cash on hand. Additional payments were to come from the Company's working capital, funds generated by the private placements, and funds generated by Medallion Electric's operations. However, the Company was not successful in raising funds or increasing its liquidity from Medallion's operation over a period of time that would allow it to continue to service the related acquisition commitments.

The Company passed a resolution on September 25, 2007 to sell Medallion Electric back to its previous owners and the operation was sold effective October 1, 2007. See the Company's Form 10-KSB Note 1 filed for the year ended December 31, 2007, and Note 1 of this document for more information. The Company is now reporting all the operations as discontinued operations.

The accompanying financial statements have been prepared assuming the Company will continue as a going concern. However, upon the completion of the sale of Medallion Electric, the Company has no further operating activities. There can be no assurances that the Company will be able to successfully complete a merger or acquisition or be able to maintain sufficient liquidity to continue to seek a merger or acquisition, in which case the Company might be forced to liquidate or seek protection under the Federal bankruptcy statutes, or both.

Net cash used by operating activities during the three months ended March 31, 2008 was \$11,000 compared to \$98,000 used by operations in the comparable period of 2007. The principal items contributing to the difference was a lower loss from continuing operations of \$204,000 in 2007 as compared to \$24,000 in 2008.

Cash flow from investing activities also consumed \$121,000 in 2007 compared to zero in the same three months of 2008 ending on March 31. The \$121,000 relates to the deferred acquisition cost from the Company's April 1, 2007 merger and acquisition.

The Company consumed \$7,000 in financing activities, during the three months ended March 31, 2008, as compared to zero during the same period of 2007.

**RESULTS OF OPERATIONS**

**Three months ended March 31, 2008 compared to three months ended March 31, 2007.**

*Revenues and Gross Profit.*

Revenues and gross profit for the three months ended March 31, 2008, and March 31, 2007 were both reported as zero, since all operations are reported as discontinued operations.

RELIABILITY INCORPORATED

MANAGEMENT'S DISCUSSION AND ANALYSIS

March 31, 2008

***General and Administrative***

Marketing, general and administrative expenses decreased from \$221,000 for the three months ended March 31, 2007 to \$24,000 for the first quarter of 2008. The expense reductions were primarily the result of a \$168,000 decrease in payroll and payroll related cost due to staff reductions and pay decreases, a \$2,000 decrease in corporate compliance and professional fees, and a \$9,000 reduction in rent and utility expenses.

***Interest and Other Income***

Interest and other income was \$17,000 for the three months ended March 31, 2007 compared with zero for the same period of 2008. The Company generated approximately \$16,000 in interest in the three months ended in 2007 from its cash investments vs zero in the same period of 2008.

**Item 3. Controls and Procedures.**

As of the end of the period covered by this report, the Company carried out an evaluation, under the supervision and with the participation of the Company's management, including the Company's Chief Executive Officer and Acting Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures pursuant to Rule 13a-5 under the Securities Exchange Act. Based on that evaluation, the Company's Chief Executive Officer and Acting Chief Financial Officer had concluded that the Company's disclosure controls and procedures provide reasonable assurance of their effectiveness.

There have been no significant changes in the Company's internal controls or in other factors that could significantly affect these controls subsequent to the date of the evaluation described in the preceding paragraph.

RELIABILITY INCORPORATED

OTHER INFORMATION

**PART II - OTHER INFORMATION**

March 31, 2008

*Items 1 through 5 are not applicable and have been omitted.*

**Item 6. Exhibits:**

The following exhibits are filed as part of this report:

- 31.1 Certification Pursuant to Rule 13a-14(a)/15d-14(a) of the Securities Exchange Act of 1934, as Amended
- 32 Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

RELIABILITY INCORPORATED

SIGNATURES

March 31, 2008

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.

RELIABILITY INCORPORATED

(Registrant)

May 14, 2008

/s/ Larry Edwards  
Larry Edwards

President and Chief Executive Officer