

WINLAND ELECTRONICS INC

Form 10QSB

November 06, 2002

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**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**
Washington, D.C. 20549

FORM 10-QSB

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

For the Quarter Ended September 30,
2002

Commission File Number:
0-18393

WINLAND ELECTRONICS, INC.
(Name of small business issuer in its charter)

Minnesota
(state or other jurisdiction of
incorporation or organization)

41-0992135
(I.R.S. Employer
Identification Number)

1950 Excel Drive, Mankato, Minnesota 56001
(Address of principal executive offices)

(507) 625-7231
(Issuer's telephone number)

Securities registered pursuant to Section 12(b) of the Exchange Act:

| Title of Each Class | Name of Exchange |
|-------------------------------|-------------------------|
| Common Stock, \$.01 par value | American Stock Exchange |

Securities registered pursuant to Section 12(g) of the Exchange Act: None

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 preceding 12 months (or for such shorter period that the Issuer was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes No

There were 2,972,692 shares of Common Stock, \$.01 par value, outstanding as of October 30, 2002.

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

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BALANCE SHEETS**

| ASSETS | September 30, 2002 | December 31, 2001 |
|--|-----------------------|----------------------|
| | (UNAUDITED) | |
| Current Assets | | |
| Cash | \$ 263,304 | \$ 399,749 |
| Accounts and notes receivable, net | 2,244,913 | 1,993,983 |
| Income tax receivable | 23,003 | 177,000 |
| Inventories | 2,126,899 | 2,439,727 |
| Prepaid expenses | 168,656 | 100,191 |
| Total current assets | 4,826,775 | 5,110,650 |
| Other Assets | | |
| Patent and trademarks, net of amortization | 699 | 1,027 |
| Property and Equipment, at cost: | | |
| Land and land improvements | 272,901 | 272,901 |
| Building | 2,983,586 | 2,983,586 |
| Machinery and equipment | 3,735,486 | 3,675,897 |
| Data processing equipment | 1,303,961 | 1,301,598 |
| Office furniture and equipment | 352,834 | 353,932 |
| Total property and equipment | 8,648,768 | 8,587,914 |
| Less accumulated depreciation | (4,430,962) | (3,884,440) |
| Net property and equipment | 4,217,806 | 4,703,474 |
| Total assets | \$ 9,045,280 | \$ 9,815,151 |

See Notes to the Interim Financial Statements

Table of Contents**BALANCE SHEETS**

| LIABILITIES AND STOCKHOLDERS' EQUITY | September 30, 2002 | December 31, 2001 |
|---|-------------------------------|------------------------------|
| | <u>(UNAUDITED)</u> | |
| Current Liabilities | | |
| Note payable to bank | \$ 566,000 | \$ 1,981,501 |
| Current maturities of long-term debt | 424,750 | 472,325 |
| Accounts payable | 977,278 | 931,385 |
| Accrued expenses: | | |
| Compensation | 407,004 | 289,749 |
| Other | 192,352 | 68,024 |
| | <u>2,567,384</u> | <u>3,742,984</u> |
| Deferred Revenue | 180,993 | 187,098 |
| Long-Term Debt, less current maturities | 2,194,810 | 2,453,909 |
| | <u>2,375,803</u> | <u>2,641,007</u> |
| Total long-term liabilities | 2,375,803 | 2,641,007 |
| | <u>4,943,187</u> | <u>6,383,991</u> |
| Total liabilities | 4,943,187 | 6,383,991 |
| Stockholders' Equity | | |
| Common stock | 29,727 | 29,598 |
| Additional paid-in capital | 2,258,258 | 2,249,702 |
| Retained earnings | 1,814,108 | 1,151,860 |
| | <u>4,102,093</u> | <u>3,431,160</u> |
| Total stockholders' equity | 4,102,093 | 3,431,160 |
| | <u>\$ 9,045,280</u> | <u>\$ 9,815,151</u> |
| Total liabilities and stockholders' equity | \$ 9,045,280 | \$ 9,815,151 |

See Notes to the Interim Financial Statements

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WINLAND ELECTRONICS, INC.
STATEMENTS OF INCOME
For the Three Months Ended September 30, 2002 and 2001
(UNAUDITED)

| | <u>2002</u> | <u>2001</u> |
|---|------------------|--------------|
| Net sales | \$ 4,038,930 | \$ 3,195,580 |
| Cost of sales | 3,191,279 | 2,678,026 |
| Gross profit | 847,651 | 517,554 |
| Operating expenses: | | |
| General and administrative | 323,881 | 453,837 |
| Research and development | 174,570 | 213,051 |
| Sales and marketing | 236,504 | 189,363 |
| | 734,955 | 856,251 |
| Operating income (loss) | 112,696 | (338,697) |
| Other income (expenses): | | |
| Interest expense | (61,188) | (109,520) |
| Other, net | 658 | 14,056 |
| | (60,530) | (95,464) |
| Income (loss) before income taxes | 52,166 | (434,161) |
| Income tax (expense) benefit | (22,000) | 46,738 |
| Net income (loss) | \$ 30,166 | \$ (387,423) |
| Earnings (loss) per share data: | | |
| Basic | \$ 0.01 | \$ (0.13) |
| Diluted | 0.01 | (0.13) |
| Weighted-average number of common shares outstanding: | | |
| Basic | 2,970,627 | 2,955,872 |
| Diluted | 3,045,642 | 2,955,872 |

See Notes to the Interim Financial Statements

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WINLAND ELECTRONICS, INC.
STATEMENTS OF INCOME
For the Nine Months Ended September 30, 2002 and 2001
(UNAUDITED)

| | <u>2002</u> | <u>2001</u> |
|---|--------------------------|----------------------------|
| Net sales | \$ 13,435,655 | \$ 11,551,162 |
| Cost of sales | <u>10,306,797</u> | <u>9,691,157</u> |
| Gross profit | <u>3,128,858</u> | <u>1,860,005</u> |
| Operating expenses: | | |
| General and administrative | 948,875 | 1,301,829 |
| Research and development | 489,038 | 675,328 |
| Sales and marketing | <u>682,446</u> | <u>540,911</u> |
| | <u>2,120,359</u> | <u>2,518,068</u> |
| Operating income (loss) | <u>1,008,499</u> | <u>(658,063)</u> |
| Other income (expenses): | | |
| Interest expense | (204,320) | (391,920) |
| Other, net | <u>4,070</u> | <u>26,312</u> |
| | <u>(200,250)</u> | <u>(365,608)</u> |
| Income (loss) before income taxes | <u>808,249</u> | <u>(1,023,671)</u> |
| Income tax (expense) benefit | <u>(146,000)</u> | <u>252,738</u> |
| Net income (loss) | <u>\$ 662,249</u> | <u>\$ (770,933)</u> |
| Earnings (loss) per share data: | | |
| Basic | \$ 0.22 | \$ (0.26) |
| Diluted | 0.22 | (0.26) |
| Weighted-average number of common shares outstanding: | | |
| Basic | 2,963,871 | 2,953,525 |
| Diluted | 3,013,365 | 2,953,525 |

See Notes to the Interim Financial Statements

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WINLAND ELECTRONICS, INC.
STATEMENTS OF CASH FLOWS
For the Nine Months Ended September, 2002 and 2001
(UNAUDITED)

| | <u>2002</u> | <u>2001</u> |
|--|--------------------|--------------------|
| Cash Flows From Operating Activities | | |
| Net income (loss) | \$ 662,249 | \$ (770,933) |
| Adjustments to reconcile net income (loss) to net cash provided by operating activities: | | |
| Depreciation and amortization | 569,427 | 599,374 |
| Loss on disposal of equipment | 3,232 | 10,954 |
| Changes in assets and liabilities: | | |
| Accounts and notes receivable | (250,930) | 1,292,846 |
| Income taxes receivable | 153,997 | (121,923) |
| Inventories | 312,828 | 2,389,072 |
| Prepaid expenses | (68,465) | (60,743) |
| Accounts payable | 45,893 | (1,337,041) |
| Accrued expenses, including deferred revenue | 235,478 | 7,070 |
| Net cash provided by operating activities | 1,663,709 | 2,008,676 |
| Cash Flows From Investing Activities | | |
| Purchases of property and equipment | (86,664) | (49,576) |
| Proceeds from sale of equipment | | 18,150 |
| Net cash used in investing activities | (86,664) | (31,426) |
| Cash flows From Financing Activities | | |
| Net payments on revolving credit agreement | (1,415,501) | (1,305,000) |
| Payments on long-term borrowings, including capital lease obligations | (306,674) | (567,026) |
| Proceeds from issuance of common stock | 8,685 | 3,782 |
| Net cash used in financing activities | (1,713,490) | (1,868,244) |
| Net increase (decrease) in cash | (136,445) | 109,006 |
| Cash | | |
| Beginning | 399,749 | 38,961 |
| End | \$ 263,304 | \$ 147,967 |
| Supplemental Disclosures of Cash Flow Information | | |
| Cash payments for: | | |
| Interest | \$ 204,091 | \$ 392,139 |
| Income tax (refund) | (17,084) | (130,815) |

See Notes to Interim Financial Statements

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NOTES TO THE INTERIM FINANCIAL STATEMENTS
(UNAUDITED)****Note 1. Basis of Presentation**

The accompanying unaudited financial statements have been prepared by the Company in accordance with generally accepted accounting principles in the United States of America, pursuant to the rules and regulations of the Securities and Exchange Commission. In management's opinion all adjustments necessary for a fair presentation of the results for the interim period have been reflected in the interim financial statements. The results of operations for any interim period are not necessarily indicative of the results for a full year. All adjustments to the financial statements are of a normal recurring nature. Certain information and footnote disclosures normally included in financial statements have been condensed or omitted. Such disclosures are those that would substantially duplicate information contained in the most recent audited financial statements of the Company, such as significant accounting policies, lease and license commitments and stock options. Management presumes that users of the interim statements have read or have access to the audited financial statements included in the Company's most recent annual report on Form 10-KSB.

Note 2. Inventories

Major components of inventory at September 30, 2002 and December 31, 2001 are as follows:

| | September 30, 2002 | December 31, 2001 |
|----------------------|-------------------------------|------------------------------|
| Raw Materials | \$ 1,633,595 | \$ 2,006,461 |
| Work In Process | 218,271 | 138,859 |
| Finished Goods | 430,406 | 429,407 |
| Obsolescence reserve | (155,373) | (135,000) |
| Total | \$ 2,126,899 | \$ 2,439,727 |

Note 3. Financing Arrangement

The Company had a \$3,500,000 revolving line-of-credit agreement through September 15, 2002. The bank extended the revolving line-of-credit agreement at a maximum of \$2,500,000 requested by the Company through March 31, 2003, with interest on advances set at two percentage points over the bank's reference rate (6.75 percent at September 30, 2002) and due monthly. Advances outstanding on the revolving line-of-credit agreement at September 30, 2002 and December 31, 2001, were \$566,000 and \$1,981,501, respectively.

Advances are due on demand, are secured by substantially all assets of the Company, and are subject to a defined borrowing base equal to 75 percent of qualified accounts receivable and 40 percent of eligible inventories. In addition, the agreement contains certain reporting and operating covenants. At September 30, 2002, the Company had additional borrowing capacity on the revolving line-of-credit of over \$1,934,000 according to the borrowing base formula. At September 30, 2002, the Company is in compliance with all covenants.

Table of Contents**Note 4. Stock Options**

As of September 30, 2002, options to purchase 339,000 shares of common stock were outstanding under the Company's 1997 Stock Option Plan, of which 214,000 shares were exercisable. At September 30, 2002, the exercise prices of all outstanding options range from \$.53 to \$2.938 per share.

Note 5. Paid Time Off Policy Change

Effective July 1, 2002 the Company changed its policy of accumulating separate vacation and sick hours by combining them into one pool called Paid Time Off (PTO). The PTO pool is now available to be used for either vacation or sick time. As a result, it was necessary to accrue a one-time expense of \$69,000, representing previously unaccrued sick time. This one-time expense is reflected in the results of the third quarter of 2002. The expense was distributed among the departments according to the sick leave balances at July 1, 2002.

Note 6. Major Customers and Enterprisewide Disclosures

Major Customers: The Company has customers that accounted for more than 10 percent of net sales for the three and nine months ended September 30, 2002 and 2001, as follows:

| | Three Months Ended September 30, 2002 | Three Months Ended September 30, 2001 |
|-------------------|--|--|
| Sales percentage: | | |
| Customer A | 46% | 35% |
| Customer B | 19% | 16% |

| | Nine Months Ended September 30, 2002 | Nine Months Ended September 30, 2001 |
|-------------------|---|---|
| Sales percentage: | | |
| Customer A | 49% | 31% |
| Customer B | 18% | 15% |

The net receivables at September 30, 2002 and December 31, 2001 for the above customers were as follows:

| | | |
|---------------------------------|-----|-----|
| Accounts receivable percentage: | | |
| Customer A | 46% | 38% |
| Customer B | 16% | 12% |

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Enterprisewide Disclosures: The following table presents three-month revenues from external customers for each of the Company's groups of products and services:

| | September 30, 2002 | September 30, 2001 |
|--|---|---|
| Proprietary microprocessors and mechanically controlled sensors and alarms | \$ 689,054 | \$ 753,585 |
| Electronic controls and assemblies for OEM customers | 3,349,876 | 2,441,995 |
| | \$ 4,038,930 | \$ 3,195,580 |
| | | |
| | Nine Months Ended September 30, 2002 | Nine Months Ended September 30, 2001 |
| Proprietary microprocessors and mechanically controlled sensors and alarms | \$ 1,991,511 | \$ 2,072,083 |
| Electronic controls and assemblies for OEM customers | 11,444,144 | 9,479,079 |
| | \$ 13,435,655 | \$ 11,551,162 |

Note 7. Earnings (Loss) Per Share

Basic per-share amounts are computed, generally, by dividing net income or loss by the weighted-average number of common shares outstanding. Diluted per-share amounts assume the conversion, exercise, or issuance of all potential common stock instruments unless the effect is antidilutive.

In 2001, options were not included in the computation of diluted earnings per share for the three and nine months ended September 30, 2001, because the Company incurred year-to-date losses. The inclusion of potential common shares in the calculation of diluted loss per share would have an antidilutive effect. Therefore, basic and diluted loss per share amounts are the same for the period presented for 2001.

Note 8. New Accounting Standards

In June 2002, the Financial Accounting Standards Board (FASB) issued SFAS 146, Accounting for Costs Associated with Exit or Disposal Activities. SFAS 146 addresses significant issues regarding the recognition, measurement, and reporting of costs that are associated with exit and disposal activities, including restructuring activities that are currently accounted for pursuant to the guidance that the Emerging Issues Task Force (EITF) has set forth in EITF Issue 94-3, Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring). The scope of SFAS 146 also includes (1) costs related to terminating a contract that is not a capital lease, (2) termination benefits that employees who are involuntarily terminated receive under the terms of a one-time benefit arrangement that is not an ongoing benefit arrangement or an individual deferred-compensation contract and (3) costs to consolidate facilities or relocate employees. SFAS 146 will be effective for exit or disposal activities that are initiated after December 31, 2002. Early application is encouraged. While management has not determined the impact of the new standard, it is not expected to be material to the Company.

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ITEM 2: MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATION

RESULTS OF OPERATIONS

**Three and nine months ended September 30 2002 v.
Three and nine months ended September 30, 2001**

Net Sales: The Company recorded net sales of \$4,038,930 for the three months ended September 30, 2002, an increase of \$843,350, or 26.4% from \$3,195,580 for the same period in 2001. For the first nine months of 2002 the Company recorded net sales of \$13,435,655, an increase of \$1,884,493, or 16.3 % from \$11,551,162 for the same period in 2001. The increase in sales for both the three and nine months ended September 30, 2002 are attributed to increased sales to original equipment manufacture (OEM) customers. Sales of Winland's proprietary products, which include the security/industrial sensors, DC motor controls and utility controls, declined for both the three and nine months ended September 30, 2002, compared to the same periods in 2001.

The Company currently has orders and forecasts from its major OEM customers for delivery during the remainder of 2002 and the first part of 2003 having an aggregate value of \$5.8 million. These are at various stages of completion. The Company also has several smaller customer commitments to be completed in 2002 and early 2003. The Company expects to receive additional orders from current OEM customers for 2002 and 2003 production. In addition, the Company signed a multi-year manufacturing agreement with Select Comfort Corporation, the Company's largest OEM customer.

The Company has continued to position itself as a full service designer and manufacturer of custom controls and assemblies for OEM customers. The Company continues to explore additional geographic regions to market its OEM services, primarily through networking with referral sources in the Chicago and Minneapolis areas. The loss of any significant OEM customer would likely have an adverse effect on the Company's short-term, and potentially long-term, results.

Gross Profits: Gross profit increased 63.8% to \$847,651 or 21.0% of net sales for the three months ended September 30, 2002, compared to \$517,554 or 16.2% of net sales for the same period in 2001. For the first nine months of 2002 gross profit was \$3,128,858 or 23.3% of net sales, an increase from \$1,860,005 or 16.1% of net sales for the same period in 2001. For the first nine months of 2002 gross profit increased \$1,268,853, a 68.2% increase over the same period in 2001. The increase in gross profits for the quarter ended September 30, 2002 is primarily attributed to a more profitable sales mix and the Company's ability to maintain lower direct and variable indirect expenses as sales increased from the latter part of 2001 into the first nine months of 2002. Reductions in cost of good sold, as a percentage of sales, for the first nine months of 2002 are primarily in salaries and employee related expenses, as well as lower information technology and facility expenses, offset in part by increased warranty and obsolescence reserves, commissions expense, accrued employee incentive plan expense and the administrative expenses related to the new Arrow Electronics, Inc. In Plant Store (IPS). Inventory in the IPS, although located on Company premises, is owned by Arrow Electronics, Inc. and is invoiced to the Company when utilized by the Company in manufacturing. The Company expects the use of the IPS to reduce shipping and carrying costs of inventory. The increase in gross profit was offset in part by the additional accrued Paid Time Off (PTO) that was necessary when the Company changed its policy and is now combining vacation and sick leave hours into one pool. (See Note 5 above)

Operating Expenses: General and administrative expense was \$323,881 or 8.0% of net sales for the three months ended September 30, 2002, compared to \$453,837 or 14.2% of net sales for the same period in 2001. For the first nine months of 2002 the general and administrative expense was \$948,875 or 7.1% of net sales, compared to \$1,301,829 or 11.3% of net sales for the same period in 2001. The decrease in general and administrative expenses for the three and nine months ended September 30, 2002 is attributed primarily to reductions in professional fees, executive severance expense for the former CEO of the Company and leased vehicle expense, offset in part by increased employee incentive plan accruals, PTO accruals, investor relations, and directors and officers insurance premium expenses.

Sales and marketing expense (including project management) was \$236,504 or 5.9% of net sales for the three months ended September 30, 2002, compared to \$189,363 or 5.9% of net sales for the same

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period in 2001. For the first nine months of 2002 sales and marketing expense was \$682,446 or 5.1% of net sales, compared to \$540,911 or 4.7% of net sales for the same period in 2001. The increase in sales and marketing expense for both the three and nine months ended September 30, 2002 is primarily attributable to increased salaries and employee related costs due to reassignment of certain personnel and the addition of a Vice President of Sales. In addition, the Company incurred increased expense related to employee incentive plan accruals, increased PTO accruals, offset in part by decreased leased vehicle expenses, information technology expenses and promotional expenses.

Winland's sales and marketing efforts continued to favor building direct personal contact with high-potential OEM customer prospects and developing an extensive referral network. Management believes that relationships built on networking, referrals and face-to-face contact will provide Winland an opportunity to build market share in the EMS (Electronic Manufacturing Services) market.

Research and development expense (including the development of new company products as well as design services and support to the OEM customer base) was \$174,570 or 4.3% of net sales for the three months ended September 30, 2002, compared to \$213,051 or 6.7% of net sales for the same period in 2001. The research and development expense for the first nine months of 2002 was \$489,038 or 3.6% of net sales, compared to \$675,328 or 5.8% of net sales for the same period in 2001. The decline in research and development expense for the three and nine months ended September 30, 2002 compared to 2001 is primarily attributable to employee attrition and reassignment without replacement. Accordingly, total salaries and related expenses decreased, as well as decreased facility, information technology and leased vehicle expenses, offset in part by increased employee incentive plan accruals and PTO accruals.

Interest Expense: Interest expense was \$61,188 or 1.5% of net sales and \$204,320 or 1.5% of net sales for the three and nine months ended September 30, 2002, compared to \$109,520 or 3.4% of net sales and \$391,920 or 3.4% of net sales for the same periods in 2001, respectively. The decrease in interest expense for the third quarter and first nine months of 2002 was due to a reduction in short-term and long-term debt as well as lower interest rates on short-term debt. During the first nine months of 2002, the Company paid down \$1,415,501 (71 %) on its line-of-credit and paid down \$306,674 of long-term debt. All of the cash used to reduce debt was generated from the Company's operating activities.

Net Earnings: The Company reported net income of \$30,166 or \$0.01 per basic and diluted share and \$662,249 or \$0.22 per basic and diluted share for the three and nine months ended September 30, 2002, compared to a net losses of \$387,423 or (\$0.13) per basic and diluted share and \$770,933 or (\$0.26) per basic and diluted share for the same periods in 2001. The net income for the first nine months of 2002 is primarily due to increased gross profit margins based on a more profitable sales mix and the Company's ability to maintain lower direct and variable indirect expenses as sales increased from the latter part of 2001 into the first nine months of 2002. Bottom line performance also benefited from overall reductions in operating expenses and interest expense.

The Company believes inflation has not significantly affected its results of operations.

The Company uses a 37% blended federal and state income tax rate, offset in part, by a tax benefit from the use of net operating losses and tax credits generated in previous years.

LIQUIDITY AND CAPITAL RESOURCES

Cash provided by operating activities was \$1,663,709 for the nine months ended September 30, 2002, compared to \$2,008,676 for the same period in 2001, a decrease of \$344,967. Cash provided by operations was used to pay down \$1,415,501 of the Company's revolving line-of-credit (a reduction of approximately 71%), reduce long-term debt and to a lesser degree, for the purchase of equipment. The Company has funded its current operations with working capital provided by operations.

The current ratio at September 30, 2002 and December 31, 2001 was 1.9 to 1 and 1.4 to 1, respectively. Working capital equaled \$2,259,391 on September 30, 2002, compared to \$1,367,666 on December 31, 2001. The increase in working capital is attributed to reductions in short-term and long-term debt, offset in part by increased accounts payable and accrued expenses, as well as, decreased inventory and income tax receivable.

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The Company has a \$2,500,000 revolving line-of-credit agreement with Wells Fargo Bank, through March 31, 2003. Interest on advances is at two percentage points over the bank's reference rate (6.75 percent at September 30, 2002) and is due monthly. Advances outstanding on the revolving line-of-credit at September 30, 2002 and December 31, 2001 were \$566,000 and \$1,981,501, respectively. Advances are due on demand, are secured by substantially all assets of the Company, and are subject to a defined borrowing base equal to 75% of qualified accounts receivable and 40% of eligible inventory. In addition, the line-of-credit agreement contains certain reporting and operating covenants.

In order to continue operations in the ordinary course, the Company will seek to renew or refinance its line of credit agreement, which currently expires March 31, 2003.

A summary of our contractual cash obligations at September 30, 2002 is as follows:

| <u>Contractual Obligations</u> | <u>Payments due by period</u> | | | | | <u>2006 and thereafter</u> |
|------------------------------------|-------------------------------|--------------------------|-------------|-------------|--------------|----------------------------|
| | <u>Total</u> | <u>Remainder Of 2002</u> | <u>2003</u> | <u>2004</u> | <u>2005</u> | |
| Long-term debt, including interest | \$ 2,966,000 | \$ 111,200 | \$ 578,900 | \$ 982,300 | \$ 1,129,700 | \$ 163,900 |
| Operating leases | 14,000 | 3,900 | 10,100 | 0 | 0 | 0 |
| Total contractual cash obligations | \$ 2,980,000 | \$ 115,100 | \$ 589,000 | \$ 982,300 | \$ 1,129,700 | \$ 163,900 |

We also have a commercial commitment as described below:

| <u>Other Commercial Commitment</u> | <u>Total Amount Committed</u> | <u>Outstanding at September 30, 2002</u> | <u>Date of Expiration</u> |
|------------------------------------|-------------------------------|--|---------------------------|
| Line of credit | \$ 2,500,000 | \$ 566,000 | March 31, 2003 |

CAUTIONARY STATEMENTS

Certain statements contained in this Quarterly Report on Form 10-QSB and other written and oral statements made from time to time by the Company do not relate strictly to historical or current facts. As such, they are considered forward-looking statements which provide current expectations or forecasts of future events. Such statements can be identified by the use of terminology such as anticipate, believe, estimate, expect, intend, may, could, possible, plan, project, should, will, forecast and similar words or expressions. The Company's forward-looking statements generally relate to the Company's growth strategies, financial results, product development and sales efforts. One must carefully consider forward-looking statements and understand that such statements involve a variety of risks and uncertainties, known and unknown, and may be affected by inaccurate assumptions, including, among others, those discussed below. Consequently, no forward-looking statement can be guaranteed and actual results may vary materially. As provided for under the Private Securities Litigation Reform Act of 1995, the Company wishes to caution investors that the following important factors, among others, in some cases have affected and in the future could affect the Company's actual results of operations and cause such results to differ materially from those anticipated in forward-looking statements made in this document and elsewhere by or on behalf of the Company.

The Company derives a significant portion of its revenues from a small number of major OEM customers. If any major customer should for any reason decrease the volume of their business or stop doing business with the Company, the Company's business would be adversely affected. Some of the Company's customers are not large, well-established companies, and the business of each customer is subject to various risks such as market acceptance of new products and continuing availability of financing. To the extent that the Company's customers encounter difficulties, or the

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Company is unable to meet the demands of its OEM customers, the Company could be adversely affected.

The Company's ability to increase revenues and profits is dependent upon its ability to retain valued existing customers and obtain new customers that fit its customer profile. The Company competes for new customers with numerous independent contract design and manufacturing firms in the United States and abroad, many of whom have greater financial resources and more established reputations. The Company's ability to compete successfully in this industry depends, in part, upon the price at which the Company is willing to manufacture a proposed product and the quality of the Company's design and manufacturing services. There is no assurance that the Company will be able to continue to obtain contracts from existing and new customers on financially advantageous terms, and the failure to do so could prevent the Company from achieving the growth it anticipates.

The Company's ability to execute its initiatives to increase sales and expand market share depends upon its ability to develop additional value added capabilities and/or proprietary products and technologies and on the availability of sufficient financing, both equity and debt, to meet fixed and variable costs associated with such growth. In the current economic environment, banks and other sources of financing are becoming increasingly conservative in their lending and investment policies. There is no assurance that the Company will be able to obtain the financing necessary to achieve its goals.

The Company's success in providing an improved mix of higher margin products and services depends on the effectiveness of its new product development and planning efforts as well as the timing of such and the availability and costs of any competing products or services on the market.

ITEM 3. CONTROLS AND PROCEDURES

(a) Evaluation of Disclosure Controls Procedures.

The Company's Chief Executive Officer, Lorin E. Krueger, and Chief Financial Officer, Jennifer A. Thompson, have reviewed the Company's disclosure controls and procedures within 90 days prior to filing this report. Based upon this review, these officers believe that the Company's disclosure controls and procedures are effective in ensuring that material information related to the Company that are required to be disclosed is made known to them.

(b) Changes in Internal Controls.

There were no significant changes in the Company's internal controls or in other factors that could significantly affect these controls subsequent to the date the Company carried out its evaluations, including any corrective actions with regards to significant deficiencies and material weaknesses.

PART II OTHER INFORMATION

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) **Exhibits.** See Exhibit Index immediately following the signature page.

(b) **Reports on Form 8-K.** None.

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SIGNATURES

Pursuant to the requirements of Section 13 of the Securities Exchange Act of 1934, the Company has caused this Report to be signed on its behalf by the undersigned, thereunto duly authorized.

Dated: November 1, 2002

WINLAND ELECTRONICS, INC.
(Company)

/s/ Lorin E. Krueger
Lorin E. Krueger, President and Chief Executive
Officer (Principal Executive Officer)

/s/ Jennifer A. Thompson
Jennifer A. Thompson, Chief Financial Officer
(Principal Financial and Accounting Officer)

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SARBANES-OXLEY SECTION 302 CERTIFICATION

I, Lorin E. Krueger, certify that:

1. I have reviewed this quarterly report on Form 10-QSB of Winland Electronics, Inc.;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:
 - a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
 - b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the "Evaluation Date"); and
 - c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):
 - a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
 - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
6. The registrant's other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: November 1, 2002

/s/ Lorin E. Krueger
Lorin E. Krueger
Chief Executive Officer

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SARBANES-OXLEY SECTION 302 CERTIFICATION

I, Jennifer A. Thompson, certify that:

1. I have reviewed this quarterly report on Form 10-QSB of Winland Electronics, Inc.;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and we have:
 - a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
 - b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this quarterly report (the Evaluation Date); and
 - c) presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):
 - a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
 - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
6. The registrant's other certifying officers and I have indicated in this quarterly report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: November 1, 2002

/s/ Jennifer A. Thompson
Jennifer A. Thompson
Chief Financial Officer

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**SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549**

EXHIBIT INDEX TO FORM 10-QSB

**For the fiscal quarter ended
September 30, 2002**

Commission File No. 0-18393

WINLAND ELECTRONICS, INC.

| <u>Exhibit No.</u> | <u>Description</u> |
|---------------------------|--|
| 10.1 | Seventh Amendment dated September 15, 2002 to Credit Agreement dated July 31, 1998 between the Company and Wells Fargo Bank Minnesota, National Association. |
| 10.2 | Note Modification Agreement dated September 15, 2002 between the Company and Wells Fargo Bank Minnesota, National Association. |
| 99.1 | Certification of Chief Executive Officer |
| 99.2 | Certification of Chief Financial Officer |