

CPS TECHNOLOGIES CORP/DE/  
Form 10-Q  
November 10, 2016

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549  
FORM 10-Q**

(Mark One)

☒ Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934  
For the period ended October 1, 2016  
or

☐ Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934  
For the transition period from to

Commission file number 0-16088

**CPS TECHNOLOGIES CORPORATION**

(Exact Name of Registrant as Specified in its Charter)

<u>Delaware</u>	<u>04-2832509</u>
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)

<u>111 South Worcester Street</u>	
<u>Norton MA</u>	<u>02766-2102</u>
(Address of principal executive offices)	(Zip Code)

(508) 222-0614  
Registrants Telephone Number, including Area Code:

**CPS Technologies Corporation**

111 South Worcester Street

Norton, MA 02766-2102

Former Name, Former Address and Former Fiscal Year if Changed since Last Report

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 than the registrant was required to file such reports), and (2) has been subject to the filing requirements for the past 90 days. ☒ Yes ☐ No

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

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. (Check one):

Large accelerated filer ☐ Accelerated filer ☐ Non-accelerated filer ☐ Smaller reporting company ☒

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

APPLICABLE ONLY TO CORPORATE ISSUERS:

Indicate the number of shares outstanding of each of the issuer’s classes of common stock, as of the latest practicable date. Number of shares of common stock outstanding as of October 31, 2016: 13,203,436.

**PART I FINANCIAL INFORMATION**

**ITEM 1 FINANCIAL STATEMENTS (Unaudited)**

**CPS TECHNOLOGIES CORPORATION**

**Balance Sheets (Unaudited)**

(continued on next page)

	October 1, 2016	December 26, 2015
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$3,458,475	\$3,412,649
Accounts receivable-trade, net	2,456,181	3,572,479
Inventories, net	2,141,921	2,632,444
Prepaid expenses and other current assets	116,261	104,761
Deferred taxes	707,188	467,374
Total current assets	8,880,026	10,189,707
Property and equipment:		
Production equipment	8,326,020	8,460,727
Furniture and office equipment	410,841	409,793
Leasehold improvements	854,215	854,215
Total cost	9,591,076	9,724,735
Accumulated depreciation and amortization	(8,550,359)	(8,593,236)
Construction in progress	787,365	557,054
Net property and equipment	1,828,082	1,688,553
Deferred taxes, non-current portion	1,683,375	1,683,375
Total assets	\$12,391,483	\$13,561,635

See accompanying notes to financial statements.

## **CPS TECHNOLOGIES CORPORATION**

### **Balance Sheets (Unaudited)**

**(concluded)**

LIABILITIES AND STOCKHOLDERS' EQUITY	October 1, 2016	December 26, 2015
Current liabilities:		
Accounts payable	817,568	1,622,564
Accrued expenses	608,948	931,916

Total current liabilities	1,426,516	2,554,480
Commitments (note 9)		
Stockholders' equity:		
Common stock, \$0.01 par value, authorized 20,000,000 shares; issued 13,413,492 and 13,412,292 shares; outstanding 13,203,436 and 13,197,918 shares; at October 1, 2016 and December 26, 2015, respectively	134,235	134,123
Additional paid-in capital	35,413,125	35,245,030
Accumulated deficit	(24,065,340)	(23,864,945)
Less cost of 220,056 and 214,374 common shares repurchased at October 1, 2016 and December 26, 2015, respectively	(517,053)	(507,053)
Total stockholders' equity	10,964,967	11,007,155
Total liabilities and stockholders' equity	\$ 12,391,483	\$ 13,561,635

See accompanying notes to financial statements.

## CPS TECHNOLOGIES CORPORATION

### Statements of Income (Unaudited)

	First Quarter Ended		Nine month Periods ended	
	October 1, 2016	September 26, 2015	October 1, 2016	September 26, 2015
Revenues:				
Product sales	\$3,326,930	\$5,423,107	\$ 12,477,543	\$ 16,307,008
Research and development under cooperative agreement	—	—	—	42,254
Total Revenues	3,326,930	5,423,107	12,477,543	16,349,262
Cost of product sales	2,941,098	4,448,991	10,399,236	12,905,775
Cost of research and development under cooperative agreement	—	—	—	34,970
Gross Margin	385,832	974,116	2,078,307	3,408,517
Selling, general and				

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administrative expense	763,260	960,321	2,563,906	3,085,454
Operating income (loss)	(377,428)	13,795	(485,599)	323,063
Interest income (expense), net	1,742	1,454	6,980	2,305
Other income	40,000	—	41,225	—
Net income (loss) before income tax expense	(335,686)	15,249	(437,395)	325,368
Income tax (benefit) expense	(196,900)	7,000	(237,000)	129,500
Net income (loss)	\$(138,786)	\$8,249	\$(200,395)	\$195,868
Net income (loss) per basic common share	\$(0.01)	\$0.00	\$(0.02)	\$0.01
Weighted average number of basic common shares outstanding	13,203,436	13,197,827	13,200,584	13,174,598
Net income (loss) per diluted common share	\$(0.01)	\$0.00	\$(0.02)	\$0.01
Weighted average number of diluted common shares outstanding	13,203,436	13,611,956	13,200,584	13,656,888

See accompanying notes to financial statements.

**CPS TECHNOLOGIES CORPORATION**

**Statements of Cash Flows (Unaudited)**

Nine Month Periods Ended

	October 1, 2016	September 26, 2015
Cash flows from operating activities:		
Net income (loss)	\$(200,395)	\$195,868
Adjustments to reconcile net income to cash provided by (used in) operating activities		
Depreciation & amortization	380,901	406,138
Share-based compensation	153,557	226,853
Deferred taxes	(237,000)	129,500
Excess tax benefit from stock options exercised	(2,814)	(49,379)
Gain on sale of property and equipment	(40,000)	—

## Changes in:

Accounts receivable-trade, net	1,116,298	(116,503)
Inventories	490,523	(82,443)
Prepaid expenses	(11,500)	65,440
Accounts payable	(804,996)	268,798
Accrued expenses	322,968	15,043

Net cash provided by (used in) operating activities	521,606	1,059,315
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## Cash flows from investing activities:

Purchases of property and equipment	(520,430)	(300,017)
Proceeds from sale of property and equipment	40,000	—

Net cash used in investing activities	(480,430)	(300,017)
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## Cash flows from financing activities:

Proceeds from issuance of common stock	11,836	172,671
Excess tax benefit from stock options exercised	2,814	49,379
Repurchase of common stock	(10,000)	(172,470)

Net cash provided by financing activities	4,650	49,581
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Net increase in cash and cash equivalents	45,826	808,879
Cash and cash equivalents at beginning of period	3,412,649	2,305,580

Cash and cash equivalents at end of period	\$3,458,475	\$3,114,458
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## Supplemental cash flow information:

Cash paid for taxes, net of refunds	\$8,000	\$27,005
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See accompanying notes to financial statements.

**CPS TECHNOLOGIES CORPORATION****Notes to Financial Statements****(Unaudited)**(1) Nature of Business

CPS Technologies Corporation (the “Company” or “CPS”) provides advanced material solutions to the electronics, power generation, automotive and other industries. The Company’s primary advanced material solution is metal-matrix composites which are a combination of metal and ceramic.

CPS also assembles housings and packages for hybrid circuits. These housings and packages may include components made of metal-matrix composites or they may include components made of more traditional materials such as aluminum, copper-tungsten, etc.

The Company sells into several end markets including the wireless communications infrastructure market, high-performance microprocessor market, motor controller market, and other microelectronic and structural markets.

## (2) Interim Financial Statements

As permitted by the rules of the Securities and Exchange Commission applicable to quarterly reports on Form 10-Q, these notes are condensed and do not contain all disclosures required by generally accepted accounting principles.

The accompanying financial statements are unaudited. In the opinion of management, the unaudited financial statements of CPS reflect all normal recurring adjustments which are necessary to present fairly the financial position and results of operations for such periods.

The Company's balance sheet at December 26, 2015 has been derived from the audited financial statements at that date, but does not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements.

For further information, refer to the financial statements and footnotes thereto included in the Registrant's Annual Report on Form 10-K for the year ended December 26, 2015.

The results of operations for interim periods are not necessarily indicative of the results to be expected for the full year.

## (3) Net Income Per Common and Common Equivalent Share

Basic net income (loss) per common share is calculated by dividing net income (loss) by the weighted average number of common shares outstanding during the period. Diluted net income (loss) per common share is calculated by dividing net income (loss) by the sum of the weighted average number of common shares plus additional common shares that would have been outstanding if potential dilutive common shares had been issued for granted stock options and stock purchase rights. Common stock equivalents are excluded from the diluted calculations when a net loss is incurred as they would be anti-dilutive.

The following table presents the calculation of both basic and diluted EPS:

	Three Months Ended		Nine-Months Ended	
	October 1, 2016	September 26, 2015	October 1, 2016	September 26, 2015
Basic EPS Computation:				
Numerator:				
Net income (loss)	\$(138,786)	\$8,249	\$(200,395)	\$195,868
Denominator:				
Weighted average				
Common shares				
Outstanding	13,203,436	13,197,827	13,200,584	13,174,598
Basic EPS	\$(0.01)	\$0.00	\$(0.02)	\$0.01
Diluted EPS Computation:				
Numerator:				
Net income (loss)	\$(138,786)	\$8,249	\$(200,395)	\$195,868
Denominator:				
Weighted average				
Common shares				
Outstanding	13,203,436	13,197,827	13,200,584	13,174,598
Dilutive effect of stock options	—	414,129	—	482,290
Total Shares	13,203,436	13,611,956	13,200,584	13,656,888
Diluted EPS	\$(0.01)	\$0.00	\$(0.02)	\$0.01

#### (4) Share-Based Payments

The Company measures the cost of employee services received in exchange for an award of equity instruments based on the grant date fair value of the award. That cost is recognized over the period during which an employee is required to provide services in exchange for the award, the requisite service period (usually the vesting period). The Company provides an estimate of forfeitures at initial grant date. Reductions in compensation expense associated with the forfeited options are estimated at the date of grant, and this estimated forfeiture rate is adjusted periodically based on actual forfeiture experience. The company uses the Black-Scholes option pricing model to determine the fair value of the stock options granted.

There were no stock options granted under the Plan during the quarters ended October 1, 2016 and September 26, 2015.

During the quarter ended October 1, 2016 there were no shares issued and during the quarter ended September 26, 2015 the Company issued 6,000 shares as a result of option exercises. During the quarter ended October 1, 2016 1,200 options expired. No options expired during the quarter ended September 26, 2015.



During the quarter ended October 1, 2016 there were no shares repurchased. During the quarter ended September 26, 2015 the Company repurchased 3,923 shares from employees to facilitate their exercise of stock options.

During the three and nine months ended October 1, 2016 the Company recognized approximately \$37 thousand and \$153 thousand, respectively as share-based compensation expense related to previously granted shares under the Plan. A tax benefit of approximately \$3 thousand was recognized as additional paid in capital in the nine months ended October 1, 2016 resulting from the excess tax benefit of option exercises.

During the three and nine months ended September 26, 2015 the Company recognized approximately \$84 thousand and \$227 thousand, respectively as share-based compensation expense related to previously granted shares under the Plan. A tax benefit of approximately \$49 thousand was recognized as additional paid in capital in the nine months ended September 26, 2015 resulting from the excess tax benefit of option exercises.

#### (5) Inventories

Inventories consist of the following:

	October 1, 2016	December 26, 2015
Raw materials	\$515,692	\$670,318
Work in process	1,301,547	970,598
Finished goods	810,182	1,447,028
Total inventory	2,627,421	3,087,944
Reserve for obsolescence	(485,500)	(455,500)
Inventories, net	\$2,141,921	\$2,632,444

#### (6) Accrued Expenses

Accrued expenses consist of the following:

	October 1, 2016	December 26, 2015
Accrued legal and accounting	\$95,324	\$101,000
Accrued payroll	352,272	666,846
Accrued other	161,352	164,070

\$608,948      \$931,916

(7) Line of Credit and Equipment Lease Facility Agreements

In May 2016, the Company renewed its \$2 million revolving line of credit ("LOC") and \$500 thousand of an equipment finance facility ("Lease Line") with Santander Bank. Both agreements mature in May 2017. The LOC is secured by the accounts receivable and other assets of the Company, has an interest rate of prime and a one-year term. Under the terms of the agreement, the Company is required to maintain its operating accounts with Santander Bank. The LOC and the Lease Line are cross defaulted and cross collateralized. The Company is also subject to certain financial covenants within the terms of the LOC that require the Company to maintain a targeted coverage ratio as well as targeted debt to equity and current ratios. At October 1, 2016, the Company was in compliance with all existing covenants. At October 1, 2016, the Company had not utilized the equipment finance facility and therefore had \$500 thousand available. At October 1, 2016 the Company had no borrowings under this LOC and its borrowing base at the time would have permitted an additional \$1,229 thousand to have been borrowed.

(8) Income Taxes

The Company has a current and non-current deferred tax asset aggregating \$2,390,563 and \$2,150,749 on the Company's balance sheet at October 1, 2016 and December 26, 2015, respectively. A valuation allowance is required to be established or maintained when it is "more likely than not" that all or a portion of deferred tax assets will not be realized. The Company believes that it will generate sufficient future taxable income to realize the tax benefits related to the remaining deferred tax assets and as such no valuation allowance has been provided against the deferred tax asset. At the end of 2015 the Company had utilized all of its net operating loss carryforwards.

The Company recorded a tax benefit of \$146,440 and \$177,720 for federal income taxes and a tax benefit of \$50,460 and \$59,280 for state income taxes during the three and nine months ended October 1, 2016, respectively.

The Company recorded a tax expense of \$5,000 and \$100,520 for federal income taxes and a tax expense of \$2,000 and \$28,980 for state income taxes during the three and nine months ended September 26, 2015, respectively.

(9) Commitments

The Company entered into a 10-year lease for the Norton facilities effective on March 1, 2006. The leased facilities comprise approximately 38 thousand square feet. In January 2016 this lease was amended to extend the lease to

February 28, 2017. As part of the agreement the Company obtained two, one-year options which enable the Company to continue to lease through February 28, 2019. In June 2016 the Company exercised the option to extend the lease through February 28, 2018. The lease is a triple net lease wherein the Company is responsible for payment of all real estate taxes, operating costs and utilities. The Company also has an option to buy the property and a first right of refusal during the term of the lease. Annual rental payments are \$100 thousand in year one increasing to \$152 thousand at the end of the extended term.

In February 2011, the Company entered into a lease for an additional 13.8 thousand square feet in Attleboro, MA. The lease term is for one year and has an option to extend the lease for five additional one-year periods. Monthly rent, which includes utilities, is \$6,900. The Company renewed the lease in 2013 for one additional year and also obtained two years of additional options which could extend the Company use through February 2019. In October 2015, the Company exercised its option to extend the lease through the end of February 2017.

## **ITEM 2     MANAGERMENTS DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

The following discussion and analysis of financial condition and results of operations is based upon and should be read in conjunction with the financial statements of the Company and notes thereto included in this report and the Company's Annual Report on Form 10-K for the year ended December 26, 2015.

### Forward-Looking Statements

This Quarterly Report on Form 10-Q contains forward-looking statements that involve a number of risks and uncertainties. There are a number of factors that could cause the Company's actual results to differ materially from those forecasted or projected in such forward-looking statements. Readers are cautioned not to place undue reliance on these forward-looking statements which speak only as of the date hereof. The Company undertakes no obligation to publicly release the results of any revisions to these forward-looking statements which may be made to reflect events or changed circumstances after the date hereof or to reflect the occurrence of unanticipated events.

### Critical Accounting Policies

The critical accounting policies utilized by the Company in preparation of the accompanying financial statements are set forth in Part II, Item 7 of the Company's Annual Report on Form 10-K for the year ended December 26, 2015, under the heading "Management's Discussion and Analysis of Financial Condition and Results of Operations". There have been no material changes to these policies since December 26, 2015.

## Overview

CPS Technologies Corporation (the 'Company' or 'CPS') provides advanced material solutions to the electronics, power generation, automotive and other industries. In 2008 the Company also entered into a cooperative agreement with the U.S. Army to further develop its composite technology to produce armor. The Cooperative Agreement was a four-year agreement which was subsequently extended through March 31, 2015.

The Company's products are generally used in high-power, high-reliability applications. These applications always involve energy use or energy generation and the Company's products allow higher performance and improved energy efficiency. The Company is an important participant in the growing movement towards alternative energy and "green" lifestyles. For example, the Company's products are used in mass transit, hybrid and electric cars, wind-turbines for electricity generation as well as routers and switches for the internet which in turn allows telecommuting.

The Company's primary advanced material solution is metal matrix composites (MMCs), a new class of materials which are a combination of metal and ceramic. CPS has a leading, proprietary position in metal matrix composites. Metal matrix composites have several superior properties compared to conventional materials including improved thermal conductivity, thermal expansion matching, stiffness and light weight which enable higher performance and higher reliability in our customers' products.

Like plastics several decades ago, we believe metal-matrix composites will penetrate many end markets over many years. CPS management believes our business model of providing advanced material solutions to a portfolio of high growth end markets which are, at any point in time, in various stages of the technology adoption lifecycle, provides CPS with the opportunity for sustained growth and a diversified customer base. We believe we have validated this model as we are now supplying customers at all stages of the technology adoption lifecycle.

CPS is the leader in supplying metal matrix composites to certain high growth electronics end markets which are well along in the adoption lifecycle and therefore generating significant demand. These end markets include high-performance integrated circuits and circuit boards used in internet switches and routers, as well as motor controllers used in high-speed electric trains, subway cars and wind turbines. CPS supplies heat spreaders, lids and baseplates to customers in these end markets. CPS is a fully qualified manufacturer for many of the world's largest electronics OEMs.

CPS also assembles housings and packages for hybrid circuits. These housings and packages may include components made of metal-matrix composites; they may include components made of more traditional materials such as aluminum, copper-tungsten, etc.

A market at an earlier stage of the adoption lifecycle is the market for hybrid and electric automobiles. In 2012 the Company announced a multi-year supply agreement with a major tier one automotive supplier for the supply of AlSiC

pin fin baseplates for use in motor controllers for hybrid and electric automobiles.

We are also actively working with customers in end markets at the beginning stages of the adoption lifecycle. An example of such a market is the market for armor. In 2008 the Company entered into a cooperative agreement with the Army Research Laboratory to further develop large hybrid metal matrix composite modules which integrally combine metal matrix composites and ceramics by enveloping ceramic tiles with MMCs. This system offers a lighter weight, durable, multi-hit capable and cost competitive alternative to conventional steel, aluminum and ceramic based armor systems. CPS hybrid hard face armor modules are comprised of multiple materials completely enveloped within and mechanically and chemically bonded to lightweight and stiff aluminum metal matrix composites.

The Company believes that its hybrid hard face armor tiles will find application in many military vehicles as well as armored commercial vehicles.

Our products are manufactured by proprietary processes we have developed including the Quickset™ Injection Molding Process ('Quickset Process') and the QuickCast™ Pressure Infiltration Process ('QuickCast Process').

CPS was incorporated in Massachusetts in 1984 as Ceramics Process Systems Corporation and reincorporated in Delaware in April 1987 through a merger into a wholly-owned Delaware subsidiary organized for purposes of the reincorporation. In July 1987, CPS completed our initial public offering of 1.5 million shares of our Common Stock. In March 2007, we changed our name from Ceramics Process Systems Corporation to CPS Technologies Corporation.

Results of Operations for the Third Fiscal Quarter of 2016 (Q3 2016) Compared to the Third Fiscal Quarter of 2015 (Q3 2015): (all \$ in 000's)

Total revenue was \$3,327 in Q3 2016, a 39% decrease compared with total revenue of \$ 5,423 in Q3 2015. About half of this decrease was due to a reduction in the sales of baseplates. Sales of hermetic packages, fracking balls and lids were also down from the previous year contributing to the shortfall.

Gross margin in Q3 2016 totaled \$386 or 12% of sales. In Q3 2015, gross margin was \$ 974 or 18% of sales. This decline in margin was due largely to the decline in revenues, offset in part by a reduction in the spending for factory support costs.

Selling, general and administrative (SG&A) expenses were \$763 in Q3 2016, 21% less than SG&A expenses of \$960 in Q3 2015. This decrease was due largely to a reduction in commissions related to volume, lower levels of incentive compensation and expenses for professional fees.

The operating loss for Q3 2016 totaled \$377 compared with an operating profit of \$14 in Q3 2015. This decrease was primarily due to lower sales, offset in part by a reduction in spending for factory support costs and SG&A.

The company generated other income in Q3, 2016 of \$40 due to the sale of used equipment in excess of book value. There was no other income in Q3, 2015.

The company experienced a net loss in Q3 2016 for \$139 compared with net income of \$8 in Q3 2015. The variance was due in large part to the same factors that contributed to the variance at the operating income level.

Results of Operations for the First Nine Months of 2016 Compared to the First Nine Months of 2015 (all \$ in 000's)

Total revenue was \$12,478 in the first nine months of 2016, a 24% decrease compared with total revenue of \$16,349 in the first nine months of 2015. This decrease was due to a reduction in the sales of baseplates, hermetic packages, fracking balls and lids, offset in small part by an increase in armor revenues. There were no significant price changes during the first nine months of 2016 compared with the first nine months of 2015.

Gross margin in the first nine months of 2016 totaled \$2,078 or 17% of sales. This compares with \$3,409, or 21% of sales, generated during the first nine months of 2015. This decline in margin was due to lower revenues, offset in part by reduced spending on factory support costs.

Selling, general and administrative (SG&A) expenses were \$2,564 during the first nine months of 2016, down 17% compared with SG&A expenses of \$3,085 incurred during the first nine months of 2015. This reduction was due to lower accruals for incentive compensation, lower sales commissions related to lower revenues, and a reduction in 401K expenses, professional and legal fees. These reductions were offset in a small part by higher spending for sales and marketing activities in China.

The company generated other income in the first nine months of 2016 totaling \$40 due to the sale of used equipment in excess of book value. There was no other income during the same period of 2015.

As a result of lower volume, offset in part by spending on factory overhead and SG&A costs, the Company incurred an operating loss of \$486 in the first nine months of 2016, compared with an operating profit of \$323 in the same

period last year. The net loss for the first nine months of 2016 totaled \$200 versus a net income of \$196 in the first nine months of 2015.

The Company continues to sell to a limited number of customers and the loss of any one of these customers could cause the Company to require additional external financing. Failure to generate sufficient revenues or reduce certain discretionary spending could have a material adverse effect on the Company's ability to achieve its business objectives.

#### Liquidity and Capital Resources (all \$ in 000's unless noted)

The Company's cash and cash equivalents at October 1, 2016 totaled \$3,458 compared with cash and cash equivalents at December 26, 2015 of \$3,413. This increase was due to a reduction in working capital, offset by operating losses and, to a lesser extent, capital expenditures in excess of depreciation.

Accounts receivable at October 1, 2016 totaled \$2,456 compared with \$3,572 at December 26, 2015. Days Sales Outstanding (DSOs) increased from 59 days at the end of 2015 to 66 days at the end of Q3, 2016. Both of these statistics are consistent with historical patterns.

Inventories totaled \$2,142 at October 1, 2016, compared with inventories of \$2,632 at December 26, 2015. The inventory turnover in 2015 was 6.5 times (based on a 5 point average) and 5.9 times for the most recent four quarters ending Q3 2016.

All consigned inventory is shipped under existing purchase orders and per customers' requests. Of the inventory of \$2,142 at October 1, 2016, \$802 was located at customers' locations pursuant to consigned inventory agreements. Of the total inventory of \$2,632 at December 26, 2015, \$763 was located at customers' locations pursuant to consigned inventory agreements.

The Company financed its working capital during Q3 2016 with a combination of cash balances and funds generated from operations. The Company expects it will continue to be able to fund its working capital requirements for the remainder of 2016 from a combination of operating cash flow, existing cash balances and borrowings under its line of credit, if necessary.

#### Contractual Obligations (all \$ in 000's)

In early May 2016, the Company renewed its \$2,000 revolving line of credit ("LOC") and \$500 of an equipment finance facility ("Lease Line") with Santander Bank. Both agreements mature in May 2017. The LOC is secured by the

accounts receivable and other assets of the Company, has an interest rate of prime and a one-year term. Under the terms of the agreement, the Company is required to maintain its operating accounts with Santander Bank. The LOC and the Lease Line are cross defaulted and cross collateralized. The Company is also subject to certain financial covenants within the terms of the LOC that require the Company to maintain a targeted coverage ratio as well as targeted debt to equity and current ratios. At October 1, 2016, the Company was in compliance with all existing covenants. At October 1, 2016, the Company had not utilized the equipment finance facility and therefore had \$500 available. At October 1, 2016 the Company had no borrowings under this LOC and its borrowing base at the time would have permitted an additional \$1,229 to have been borrowed.

The financial covenants with Santander Bank are identical for the LOC and Lease Line. The covenant requirements are shown below together with the actual ratios achieved:

Covenant	Requirement	<u>Actual</u>
Debt Service Coverage Ratio	Minimum of 1.25	N/A (no leases or interest)
Current Ratio	Minimum of 1.5X	6.2X
Liabilities to Tangible Net Worth	Maximum of 1.0X	0.1X
Borrowings under the lease line	maximum of \$500K	None
Borrowings under the line of credit*	maximum of \$1,229K	None
	*(based on receivables at 10/1/16)	

Management believes that cash flows from operations, existing cash balances and the leasing and credit line in place with Santander Bank will be sufficient to fund our cash requirements for the foreseeable future. However, there is no assurance that we will be able to generate sufficient revenues or reduce certain discretionary spending in the event that planned operational goals are not met such that we will be able to meet our obligations as they become due.

As of October 1, 2016 the Company had \$787 thousand of construction in progress and no outstanding commitments to purchase production equipment. The Company intends to finance production equipment in construction in progress and outstanding commitments under the lease agreement with existing cash balances and funds generated by operations.

The Company entered into a 10-year lease for the Norton facilities effective on March 1, 2006. The leased facilities comprise approximately 38 thousand square feet. In January 2016 this lease was amended to extend the lease to February 28, 2017. As part of the agreement the Company obtained two, one-year options which enabled it to continue to lease through February 28, 2019. In June 2016 the Company exercised the option to extend the lease through February 28, 2018. The lease is a triple net lease wherein the Company is responsible for payment of all real estate taxes, operating costs and utilities. The Company also has an option to buy the property and a first right of refusal during the term of the lease. Annual rental payments are \$100 thousand in year one increasing to \$152 thousand at the end of the extended term.

In February 2011, the Company entered into a lease for an additional 13.8 thousand square feet in Attleboro, MA. The lease term is for one year and has an option to extend the lease for five additional one-year periods. Monthly rent,



which includes utilities, is \$6,900. The Company renewed the lease in 2013 for one additional year and also obtained two years of additional options which could extend the Company use through February 2019. In October 2015, the Company exercised its option to extend the lease through the end of February 2017.

The Company's contractual obligations at October 1, 2016 consist of the following:

		Remaining in	Payments Due by Period	
	<u>Total</u>	<u>FY 2016</u>	<u>FY 2017 - 2018</u>	<u>FY 2019-</u>
Operating lease obligation for facilities	\$ 402,800	\$ 58,800	\$ 318,600	\$ 25,400

### ITEM 3 QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company is not significantly exposed to the impact of interest rate changes or foreign currency fluctuations. The Company has not used derivative financial instruments.

### ITEM 4 CONTROLS AND PROCEDURES

(a) The Company's Chief Executive Officer and Chief Financial Officer have evaluated the effectiveness of the Company's disclosure controls and procedures (as such term is defined in Rules 13a-14(c) and 15d - 14(c) under the Securities Exchange Act of 1934, as amended (the "Exchange Act")) as of the end of the period covered by this Form 10-Q (the "Evaluation Date"). Based on such evaluation, such officers have concluded that, as of the Evaluation Date, 1) the Company's disclosure controls and procedures are effective to ensure that information required to be disclosed by the Company in reports the Company files under the Securities Exchange Act is recorded, processed, summarized and reported within the time periods specified in the rules and forms of the SEC and 2) the Company's disclosure controls and procedures are effective to ensure that information required to be disclosed in the reports that the Company files or submits under the Exchange Act is accumulated and communicated to our management, including our chief executive officer and chief financial officer, to allow timely decisions regarding required disclosure.

(b) Changes in Internal Controls. There has been no change in our internal control over financial reporting that occurred during our most recent fiscal quarter that has materially affected or is reasonably likely to materially affect our internal control over financial reporting.

## PART II OTHER INFORMATION

**ITEM 1           LEGAL PROCEEDINGS**

None.

**ITEM 1A          RISK FACTORS**

There have been no material changes to the risk factors as discussed in our 2015 Form 10-K

**ITEM 2           UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS.**

None.

**ITEM 3           DEFAULTS UPON SENIOR SECURITIES**

None.

**ITEM 4           MINE SAFETY DISCLOSURES**

Not applicable.

**ITEM 5           OTHER INFORMATION**

Not applicable.

**ITEM 6           EXHIBITS**

(a)   Exhibits:

Exhibit 31.1 Certification of Chief Executive Officer Pursuant To 18 U.S.C. Section 1350, As Adopted Pursuant To Section 302 of The Sarbanes-Oxley Act Of 2002

Exhibit 31.2 Certification of Chief Financial Officer Pursuant To 18 U.S.C. Section 1350, As Adopted Pursuant To Section 302 of The Sarbanes-Oxley Act Of 2002

Exhibit 32.1 Certification Pursuant To 18 U.S.C. Section 1350, As Adopted Pursuant To Section 906 Of The Sarbanes-Oxley Act of 2002

(b)   Reports on Form 8-K

On August 5, 2016 the Company filed a report on Form 8-K of its earnings report for the fiscal second quarter ended July 2, 2016.

## **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.

### **CPS TECHNOLOGIES CORPORATION**

(Registrant)

Date: November 9, 2016

/s/ Grant C. Bennett

Grant C. Bennett

Chief Executive Officer

Date: November 9, 2016

/s/ Ralph M. Norwood

Ralph M. Norwood

Chief Financial Officer