CPS TECHNOLOGIES CORP/DE/
Form 10-Q
November 09, 2018

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

(Mark One)
[X] Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the period ended September 29, 2018
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)

Delaware (State or Other Jurisdiction of Incorporation or Organization)	04-2832509 (I.R.S. Employer Identification No.)
111 South Worcester Street Norton MA (Address of principal executive offices)	02766-2102 (Zip Code)

(508) 222-0614
(Registrant's 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.

[X] 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). [X] Yes [ ] No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting, or an emerging growth company. See definition of "large accelerated filer," accelerated filer," smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer [ ]   Accelerated filer [ ]   Non-accelerated filer [X]   Smaller reporting company [X]

Emerging growth company [ ]

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act):
[ ] Yes   [X] 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 November 7, 2018: 13,203,436.

PART I FINANCIAL INFORMATION

ITEM 1 FINANCIAL STATEMENTS (Unaudited)

CPS TECHNOLOGIES CORPORATION

Balance Sheets (Unaudited)
(continued on next page)

	September 29, 2018	December 30, 2017
ASSETS		
Current assets:		
Cash and cash equivalents	$87,976	$1,339,572
Accounts receivable- trade, net of allowance for doubtful accounts of $10,000	3,902,117	2,943,373
Inventories, net	3,571,276	2,109,513
Prepaid expenses and other current assets	108,993	101,086
Total current assets	7,670,362	6,493,544
Property and equipment:		
Production equipment	9,195,059	9,299,515
Furniture and office equipment	518,370	499,679
Leasehold improvements	891,816	891,817
Total cost	10,605,245	10,691,011
Accumulated depreciation and amortization	(9,566,102)	(9,287,006)
Construction in progress	383,432	86,493
Net property and equipment	1,422,575	1,490,498
Deferred taxes	3,313,666	3,038,666
Total assets	$12,406,603	$11,022,708

See accompanying notes to financial statements.

CPS TECHNOLOGIES CORPORATION
Balance Sheets (Unaudited)
(concluded)

	September 29, 2018	December 30, 2017
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Line of Credit	900,000	—
Accounts payable	1,992,992	946,385
Accrued expenses	902,576	655,489
Deferred revenue	—	100,000

Total current liabilities	3,795,568	1,701,874
Commitments (note 4)		
Stockholders' equity:		
Common stock, $0.01 par value, authorized 20,000,000 shares; issued 13,423,492; outstanding 13,203,436; at September 29, 2018 and December 30, 2017	134,235	134,235
Additional paid-in capital	35,875,614	35,739,916
Accumulated deficit	(26,881,761)	(26,036,264)
Less cost of 220,056 common shares repurchased at September 29, 2018 and December 30, 2017	(517,053)	(517,053)
Total stockholders' equity	8,611,035	9,320,834
Total liabilities and stockholders' equity	$12,406,603	$11,022,708

See accompanying notes to financial statements.

CPS TECHNOLOGIES CORPORATION
Statements of Operations (Unaudited)

	Fiscal Quarters Ended		Nine Months Ended	
	September 29, 2018	September 30, 2017	September 29, 2018	September 30, 2017
Revenues:				
Product sales	$6,116,448	$4,211,962	$15,500,173	$10,781,175
Total Revenues	6,116,448	4,211,962	15,500,173	10,781,175
Cost of product sales	5,152,598	3,450,915	13,786,762	9,686,103
Gross Margin	963,850	761,047	1,713,411	1,095,072
Selling, general and administrative expense	982,765	743,634	2,822,240	2,650,526
Operating income (loss)	(18,915)	17,413	(1,108,829)	(1,555,454)
Interest income (expense), net	(13,679)	2,815	(25,313)	8,065
Other income	13,645	—	13,645	—
Net income (loss) before income tax expense	(18,949)	20,228	(1,120,497)	(1,547,389)
Income tax (benefit) expense	(5,000)	7,000	(275,000)	(623,000)

Net income (loss)	$(13,949)	$13,228	$(845,497)	$(924,389)
Net income (loss) per basic common share	$(0.00)	$0.00	$(0.06)	$(0.07)
Weighted average number of basic common shares outstanding	13,203,436	13,203,436	13,203,436	13,203,436
Net income (loss) per diluted common share	$(0.00)	$0.00	$(0.06)	$(0.07)
Weighted average number of diluted common shares outstanding	13,203,436	13,229,868	13,203,436	13,203,436

See accompanying notes to financial statements.

CPS TECHNOLOGIES CORPORATION
Statements of Cash Flows (Unaudited)

	Nine Month Periods Ended	
	September 29, 2018	September 30, 2017
Cash flows from operating activities:		
Net loss	$(845,497)	$(924,389)
Adjustments to reconcile net loss to cash provided by (used in) operating activities		
Depreciation & amortization	411,499	412,982
Share-based compensation	135,698	149,068
Deferred taxes	(275,000)	(623,000)
Gain on sale of property and equipment	(13,645)	—
Changes in:		
Accounts receivable-trade	(958,744)	(1,074,569)
Inventories	(1,461,763)	295,623
Prepaid expenses	(7,907)	8,864
Accounts payable	1,046,607	174,735
Deferred revenue	(100,000)	—
Accrued expenses	247,087	(8,075)
Net cash provided by (used in) operating activities	(1,821,666)	(1,588,761)
Cash flows from investing activities:		
Purchases of property and equipment	(343,576)	(129,389)

Proceeds from sale of property and equipment	13,645	—
Net cash provided by (used in) investing activities	(329,931)	(129,389)
Cash flows from financing activities:		
Net borrowings on line of credit	900,000	—
Net cash provided by (used in) financing activities	900,000	—
Net increase (decrease) in cash and cash equivalents	(1,251,596)	(1,718,150)
Cash and cash equivalents at beginning of period	1,339,572	3,407,760
Cash and cash equivalents at end of period	$87,976	$1,689,610
Supplemental cash flow information:		
Cash paid for taxes, net of refunds	$486	$—

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 30, 2017 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 30, 2017.

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

Revenue Recognition - Change in Accounting Policy

The Company adopted Accounting Standards Codification (ASC) 606, "Revenue from Contracts with Customers" in fiscal 2018. The core principle of ASC 606 is to recognize revenue in a manner that depicts the transfer of promised goods or services to customers in an amount that reflects the consideration to which the Company expects to be entitled in exchange for those goods or services. The framework in support of this core principle includes: (1) identifying the contract with the customer; (2) identifying the performance obligations in the contract; (3) determining the transaction price; (4) allocating the transaction price to the performance obligations; and (5) recognizing revenue when (or as) the performance obligations are satisfied.

The adoption of FASB ASC Topic 606 did not have a material impact on the Company's financial statements and no cumulative catch-up adjustment was required.

Identifying the Contract with the Customer

The Company identifies contracts with customers as agreements that create enforceable rights and obligations. In the case of a few large customers the Company has executed long-term Master Sales Agreements ("MSA"). These are umbrella agreements which typically define the terms and conditions under which a customer can order goods from CPS. These in themselves do not constitute a contract as no products are committed to be transferred and the customer has no obligation to make payments.

The Company contract is only enforceable once both parties have approved it, and is usually in the form of a written purchase order from a customer combined with acknowledgement from the Company.

In cases without an MSA, the customer submits a blueprint for a product, the Company provides a quote and the customer responds with a purchase order. In these cases the Company's acceptance of the purchase order constitutes an enforceable contract.

Identifying the Performance Obligations in the Contract

For each contract, the Company considers the promise to transfer products, each of which are distinct, to be the identified performance obligations.

Shipping and handling activities for which the Company is responsible are not a separate promised service but instead are activities to fulfill the entity's promise to transfer goods. Shipping and handling fees will be recognized at the same time as the related performance obligations are satisfied.

The Company provides an assurance-type warranty. This guarantees that the product functions as promised and meets specifications. Under its terms and conditions the Company offers a 30 day warranty and replaces defective or non-conforming products. The expense of replacement is recorded at the time the Company agrees to replace a defective or non-conforming product. This assurance type warranty is not considered to be a distinct performance obligation.

Determining the Transaction Price

The Company determines the transaction price as the amount of consideration specified in the contract that it expects to receive in exchange for transferring promised goods to the customer. Amounts collected from customers for sales value added and other taxes are excluded from the transaction prices. Product sales are recorded net of trade discounts and sales returns.

If a contract includes a variable amount, such as a rebate, then the Company estimates the transaction price using either the expected value or the most likely amount of consideration to be received, depending upon the specific facts and circumstances. The Company includes estimated variable consideration in the transaction price only to the extent it is probable that a significant reversal of revenue will not occur when the uncertainty is resolved. The Company updates its estimate of variable consideration at the end of each reporting period to reflect changes in facts and circumstances.

When credit is granted to customers, payment is typically due 30 to 90 days from billing and accordingly our contracts with customers do not include a significant financing component.

Allocating the Transaction Price to the Performance Obligations

In virtually all cases the transaction price is tied to a specific product in the contract obviating the need for any allocation.

Recognizing Revenue When (or as) the Performance Obligations are Satisfied

The Company recognizes revenue at the point in time when it transfers control of the promised goods or services to the customer, which typically occurs once the product has shipped or has been delivered to the customer. Occasionally, for the purpose of insuring a steady flow of product, the Company ships products on consignment. In these instances, delivery is deemed to have occurred when the customer pulls inventory out of the warehouse for use in their production, or upon a specified period of time as agreed upon by both parties.

The Company generally expenses sales commissions when incurred because the amortization period would have been one year or less. The costs are recorded within, selling, general and administrative expenses.

The Company does not disclose the value of unsatisfied performance obligations for contracts with an original expected length of one year or less

Recent Issued Accounting Pronouncements Not Yet Effective

In February 2016 the FASB issued ASU No. 2016-02, Leases, which requires a lessee

to recognize lease liabilities for the lessee's obligation to make lease payments arising from a lease, measured on a discounted basis, and right-of-use assets, representing the lessee's right to use, or control the use of, specified assets for the lease term. Additionally, the new guidance has simplified accounting for sale and leaseback transactions. Lessor accounting is largely unchanged. The ASU is effective for fiscal years beginning after December 15, 2018. It is expected that assets and liabilities will increase based upon the present value of remaining lease payments for leases in place at the adoption date and such amounts may be material to the financial statements depending on terms of any lease renewals and other operating leases entered into.

(3) Net Income (loss) 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.

(4) Commitments & Contingencies

Commitments

In February 2018, the Company signed a lease for the Norton facilities through February 2021. The leased facilities comprise approximately 38 thousand square feet. 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 $152 thousand.

In February 2011, the Company entered into a lease for an additional 13.8 thousand square feet in Attleboro, MA. The lease terms have been for one year and have been renewed annually. The current lease expires in February 2019. Annual rental payments are $83 thousand.

Loss contingency

The Company manufactures baseplates for power module manufacturers. Most baseplates manufactured by CPS require a nickel coating be applied to the baseplate (“Ni plating”). CPS warranties its baseplates to meet the Ni plating specifications required by our customers, and flows this requirement to its Ni plating vendors.

On January 24, 2018 the Company received a “Claim and Non-Conformance Notification” from one of its European customers relating to the Ni plating on our baseplates. Upon investigation, it was determined that one employee of the Ni plating vendor used by CPS had deviated from the prescribed work instruction for Ni plating from mid-September 2017 until mid-January 2018. The Company's Ni plating vendor acknowledged this violation and worked with the customer to resolve the problem.

In the case of affected baseplates, which have not been assembled into modules, it was a straight-forward process for the Ni plating vendor to rework these baseplates and this work has been completed. The relavent issue is baseplates that have already been assembled into modules. During this four-month period approximately 15,000 baseplates from this Ni plating vendor were assembled into modules; only a small portion of these baseplates are affected.

On April 11, 2018 the Company received a “Follow-up Claim and Non-Conformance Notification” from the European customer. The customer estimated the total value of the claim to be $1.0 million “as of today”, and reserves the right to claim additional damages in the future.

The Company has informed its insurer of this claim and the Ni plating vendor has done the same with its insurer. The Company believes that it is not possible at this time to quantify the potential financial impact, if any, to the Company. No amounts for damages have been recorded in the accompanying financial statements.

Although the Company expects this issue to be resolved amicably, there is a possibility that this could result in legal proceedings.

(5) 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 or issued under the Plan during the quarters ended September 29, 2018 and September 30, 2017.

During the quarter ended September 29, 2018, 18,600 options were forfeited and 8,000 options expired. During the quarter ended September 30, 2017, 24,000 options were forfeited.

During the quarters ended September 29, 2018 and September 30, 2017 there were no shares repurchased.

During the three and nine months ended September 29, 2018 the Company recognized approximately $33 thousand and $136 thousand, respectively as share-based compensation expense related to previously granted shares under the Plan. These amounts are included as a component of selling, general and administrative expenses in the statement of operations.

During the three and nine months ended September 30, 2017 the Company recognized approximately $37 thousand and $149 thousand, respectively as share-based compensation expense related to previously granted shares under the Plan. These amounts are included as a component of selling, general and administrative expenses in the statement of operations.

(6) Inventories

Inventories consist of the following:

	September 29, 2018	December 30, 2017
Raw materials	$662,720	$478,567
Work in process	2,306,340	1,003,285
Finished goods	988,578	1,014,023
Total inventory	3,957,638	2,495,875
Reserve for obsolescence	(386,362)	(386,362)
Inventories, net	$3,571,276	$2,109,513

(7) Accrued Expenses

Accrued expenses consist of the following:

	September 29, 2018	December 30, 2017
Accrued legal and accounting	$78,250	$78,925
Accrued payroll	601,105	455,518
Accrued other	223,221	121,046
	$902,576	$655,489

(8) Line of Credit

In early November 2018, the Company renewed its $1.5 million revolving line of credit line with Santander Bank. The agreement will mature on June 30, 2019. The LOC is secured by the accounts receivable and other assets of the Company and has an interest rate of prime plus 100 basis points. Under the terms of the agreement, the Company is required to maintain its operating accounts with Santander Bank. The Company is also subject to certain financial covenants. These include specific earnings levels, a targeted current ratio and a targeted debt to tangible net worth ratio at the end of subsequent quarters. On November 8, 2018 the Company obtained a waiver for violating the net profit covenant and was in compliance with all other covenants at September 29, 2018. Also, at September 29, 2018 the Company had $900 thousand of borrowings under this LOC and its borrowing base at the time would have permitted an additional $600 thousand to have been borrowed.

(9) Income Taxes

A valuation allowance against deferred tax assets 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.

The Company recorded a tax benefit of $4 thousand and tax benefit of $231 thousand for federal income taxes during the three and nine months ended September 29, 2018, respectively. The Company recorded a tax benefit of $1 thousand and a tax benefit of $44 thousand for state income taxes during the three and nine months ended September 29, 2018, respectively.

The Company recorded a tax expense of $5 thousand and tax benefit of $495 thousand for federal income taxes during the three and nine months ended September 30, 2017, respectively. The Company recorded a tax expense of $2 thousand and a tax benefit of $128 thousand for state income taxes during the three and nine months ended September 30, 2017, respectively.

ITEM 2 MANAGEMENTS 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 30, 2017.

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 30, 2017, 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 30, 2017, other than the adoption of AS 606 as discussed in the financial statements..

Overview

CPS Technologies Corporation (the 'Company' or 'CPS') provides advanced material solutions to the electronics, power generation, automotive and other industries.

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.

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.

<u>Results of Operations for the Third Fiscal Quarter of 2018 (Q3 2018) Compared to the Third Fiscal Quarter of 2017 (Q3 2017); (all $ in 000’s</u>)

Total revenue was $6,116 in Q3 2018, a 45% increase compared with total revenue of $4,212 in Q3 2017. This increase was due to an increase in the sale of baseplates.

Gross margin in Q3 2018 totaled $964 or 16% of sales. In Q3 2017, gross margin was $761 or 18% of sales. This increase in margin dollars was due to higher sales volume.

Selling, general and administrative (SG&A) expenses were $983 in Q3 2018, 32% greater than SG&A expenses of $744 in Q3 2017. This increase was due to higher sales commissions, associated with higher sales, and, to a lesser extent, an increase in professional fees.

The operating loss for Q3 2018 totaled $19 compared with an operating income of $17 in Q3 2017. This $36 decrease was due to the fact that margin generated from higher sales volume was insufficient to cover the increase in SG&A expenses.

In Q3, 2018, the Company realized a gain of $14 on the sale of fully depreciated equipment but incurred a similar amount in interest expense on bank borrowings resulting in $0 for other income/expense for the quarter. This compares with $3 of interest earned on its cash balances in Q3, 2017.

The company incurred a net loss of $14 in Q3 2018 compared with net income of $13 in Q3 2017. The effective tax rate, due to the Tax Cuts and Jobs Act, declined to 26% for the quarter from 35% applied in Q3, 2017.

Results of Operations for the First Nine Months of 2018 Compared to the First Nine Months of 2017 (all $ in 000's)

Total revenue was $15,500 in the first nine months of 2018, a 44% increase compared with total revenue of $10,781 in the first nine months of 2017. This increase was due primarily to an increase in the sale of baseplates. There were no significant price changes during the first nine months of 2018 compared with the first nine months of 2017.

Gross margin in the first nine months of 2018 totaled $1,713 or 11% of sales. This compares with $1,095, or 10% of sales, generated during the first nine months of 2017. This improvement in margin was due almost entirely to the increase in revenues.

Selling, general and administrative (SG&A) expenses totaled $2,822 during the first nine months of 2018, an increase of 6% compared with SG&A expenses of $2,651 incurred during the first nine months of 2017. During 2017 the Company incurred approximately an additional $200 in legal and other costs associated with the annual proxy process. If it had not been for this one-time additional costs, the total SG&A spending would have been up 15% versus the same nine months last year, primarily due to higher sales commissions and, to a lesser degree, additional marketing spending.

The Company incurred net Other Expense of $12 for the first nine months of 2018. This was a combination of interest expense of $25, reduced by the gain from the sale of fully depreciated equipment in Q3 2018. During the first nine months of 2017 the Company earned interest of $8 on its cash balance.

The Company incurred an operating loss of $1,109 in the first nine months of 2018, compared with an operating loss of $1,555 in the same period last year. This improvement was due in large part to the increase in revenues. The net loss for the first nine months of 2018 totaled $845 versus a net loss of $924 in the first nine months of 2017. The effective tax rate was 25% in 2018 compared with 40% in 2017. This reduction in rate reflects the impact of the Tax Cuts and Job Act

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 000s unless noted)

The Company's cash and cash equivalents at September 29, 2018 totaled $88. The Company's net cash, which considers the $900 of bank borrowings, totaled a negative $812 at the end of the third quarter. This compares to cash and cash equivalents at December 30, 2017 of $1,340. The decrease in net cash was due to the combination of an increase in working capital associated with the increase in revenues, receivables and inventory; less payables and accruals, coupled with the losses from operations.

Accounts receivable at September 29, 2018 totaled $3,902 compared with $2,943 at December 30, 2017. Days Sales Outstanding (DSO) decreased from 70 days at the end of 2017 to 57 days at the end of Q3 2018. The accounts receivable balances at December 30, 2017, and September 29, 2018 were both net of an allowance for doubtful accounts of $10.

Inventories totaled $3,571 at September 29, 2018 compared with inventory totaling $2,110 at December 30, 2017. This increase was due primarily to the decision to assume responsibility for the plating process in the finished product sold to a major customer, coupled with an increase in customer demand. As a result of this change, the inventory at the platers is now owned by the company rather than by the customer. The inventory turnover in the most recent four quarters ending Q3 2018 was 6.0 times, down from 6.7 times averaged during the four quarters of 2017 (each based on a 5 point average).

All consigned inventory is shipped under existing purchase orders and per customers' requests. At September 29, 2018 and December 30, 2017, $2,336 and $742, respectively, was located at customer locations pursuant to consigned inventory agreements. This increase was due primarily to the Company's decision to assume responsibility for the plating process of a major European customer.

The Company financed its increase in working capital during the first nine months of 2018 from a combination of its cash at the beginning of the year and bank borrowings. The Company expects it will continue to be able to fund its working capital requirements for the remainder of 2018 from existing cash balances and bank borrowings.

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, raise additional capital or reduce certain discretionary spending could have a material adverse effect on the Company's ability to achieve its business objectives.

Contractual Obligations

In early November 2018, the Company renewed its revolving line of credit line with Santander Bank for $1.5 million. The agreement will mature on June 30, 2019. The LOC is secured by the accounts receivable and other assets of the Company and has an interest rate of prime plus 100 basis points. Under the terms of the agreement, the Company is required to maintain its operating accounts with Santander Bank. The Company is also subject to certain financial covenants. These include specific earnings levels, a targeted current ratio and a targeted debt to tangible net worth ratio at the end of subsequent quarters. On November 8, 2018 the Company obtained a waiver for violating the net profit covenant and was in compliance with all other covenants at September 29, 2018. Also, at September 29, 2018 the Company had $900 thousand of borrowings under this LOC and its borrowing base at the time would have permitted an additional $600 thousand to have been borrowed.

The financial covenant requirements at the end of Q3, 2018 are shown below, together with the actual ratios achieved:

Covenant	Requirement	Actual
Current Ratio	Minimum of 2.0X	2.0X
Liabilities to Tangible Net Worth	Maximum of 0.5X	0.4X
Borrowings under the line of credit	Maximum of $1,500	$900
Net Profit	Minimum of $50	* $(14)
	*Coverage violation waived by bank on Nov 8, 2018	
Debt Service Coverage Ratio	Minimum of 1.25X	4.6X

As of September 29, 2018 the Company had $383 of construction in progress and no outstanding commitments to purchase production equipment.

As of September 29, 2018, all our manufacturing, engineering, sales and administrative operations were and continue to be located in leased facilities in Norton, Massachusetts and Attleboro, Massachusetts.

In February 2018, the Company signed a lease for the Norton facilities through February 2021. The leased facilities comprise approximately 38 thousand square feet. 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 continue at $152 thousand.

In February 2011, the Company entered into a lease for an additional 13.8 thousand square feet in Attleboro, MA. The lease terms have been for one year and have been renewed annually. The current lease expires in February 2019 and the Company believes that this can be extended on similar terms for a year or more. Annual rental payments are $83 thousand.

Management believes that a combination of existing cash balances and borrowings, if necessary 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.

The Company's contractual obligations at September 29, 2018 consist of the following:

		Payments Due by Period			
	Total	Remaining in FY 2018	FY 2019	FY 2020	FY 2021
Operating lease obligation for facilities	$402,800	$58,800	$166,200	$152,400	$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 2017 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 3, 2018 the Company filed a report on Form 8-K of its earnings report for the fiscal second quarter ended June 30, 2018.

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, 2018
/s/ Grant C. Bennett
Grant C. Bennett
Chief Executive Officer

Date: November 9, 2018

/s/ Ralph M. Norwood

Ralph M. Norwood

Chief Financial Officer