

WINLAND ELECTRONICS INC
Form 10QSB
April 24, 2002

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 March 31, 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 2,959,842 shares of Common Stock, \$.01 par value, outstanding as of April 22, 2002.

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

PART I-FINANCIAL INFORMATION

ITEM 1: FINANCIAL STATEMENTS

WINLAND ELECTRONICS, INC.

BALANCE SHEETS

| ASSETS | March 31, 2002 (UNAUDITED) | December 31, 2001 |
|--|----------------------------------|----------------------|
| Current Assets | | |
| Cash | \$ 322,220 | \$ 399,749 |
| Accounts and notes receivable, net | 1,952,211 | 1,993,983 |
| Income tax receivable | 127,837 | 177,000 |
| Inventories | 2,409,324 | 2,439,727 |
| Prepaid expenses | 116,105 | 100,191 |
| Total current assets | 4,927,697 | 5,110,650 |
| Other Assets | | |
| Patent and trademarks, net of amortization | 918 | 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 | 3,665,092 | 3,675,897 |
| Data processing equipment | 1,306,446 | 1,301,598 |
| Office furniture and equipment | 352,834 | 353,932 |
| Total property and equipment | 8,580,859 | 8,587,914 |
| Less accumulated depreciation | (4,065,483) | (3,884,440) |
| Net property and equipment | 4,515,376 | 4,703,474 |
| Total assets | \$ 9,443,991 | \$ 9,815,151 |

See Notes to the Interim Financial Statements

BALANCE SHEETS

| LIABILITIES AND STOCKHOLDERS' EQUITY | March 31, 2002 (UNAUDITED) | December 31, 2001 |
|---|---|------------------------------|
| Current Liabilities | | |
| Note payable to bank | \$ 1,261,501 | \$ 1,981,501 |
| Current maturities of long-term debt | 427,540 | 472,325 |
| Accounts payable | 1,133,125 | 931,385 |
| Accrued expenses: | | |
| Compensation | 246,688 | 289,749 |
| Other | 135,710 | 68,024 |
| Total current liabilities | 3,204,564 | 3,742,984 |
| Deferred Revenue | 185,063 | 187,098 |
| Long-Term Debt, less current maturities | 2,342,131 | 2,453,909 |
| Total long-term liabilities | 2,527,194 | 2,641,007 |
| Total liabilities | 5,731,758 | 6,383,991 |
| Stockholders' Equity | | |
| Common stock | 29,598 | 29,598 |
| Additional paid-in capital | 2,249,702 | 2,249,702 |
| Retained earnings | 1,432,933 | 1,151,860 |
| Total stockholders' equity | 3,712,233 | 3,431,160 |
| Total liabilities and stockholders' equity | \$ 9,443,991 | \$ 9,815,151 |

See Notes to the Interim Financial Statements

WINLAND ELECTRONICS, INC.

STATEMENTS OF INCOME

For the Three Months Ended March 31, 2002 and 2001

(UNAUDITED)

| | 2002 | 2001 |
|---|-------------------|--------------|
| Net sales | \$ 4,285,647 | \$ 4,531,107 |
| Cost of sales | 3,200,079 | 3,832,059 |
| Gross profit | 1,085,568 | 699,048 |
| Operating expenses: | | |
| General and administrative | 303,242 | 318,632 |
| Sales and marketing | 236,037 | 169,327 |
| Research and development | 148,781 | 254,340 |
| | 688,060 | 742,299 |
| Operating income (loss) | 397,508 | (43,251) |
| Other income (expenses): | | |
| Interest expense | (78,768) | (155,941) |
| Other income, net | 11,333 | 638 |
| | (67,435) | (155,303) |
| Income (loss) before income taxes | 330,073 | (198,554) |
| Income tax (expense) benefit | (49,000) | 69,000 |
| Net income (loss) | \$ 281,073 | \$ (129,554) |
| Earnings (loss) per share data: | | |
| Basic | \$ 0.09 | \$ (0.04) |
| Diluted | 0.09 | (0.04) |
| Weighted-average number of common shares outstanding: | | |
| Basic | 2,959,842 | 2,952,313 |
| Diluted | 2,982,802 | 2,952,313 |

See Notes to the Interim Financial Statements

WINLAND ELECTRONICS, INC.

STATEMENTS OF CASH FLOWS

For the Three Months Ended March 31, 2002 and 2001

(UNAUDITED)

| | 2002 | 2001 |
|--|------------------|------------------|
| Cash Flows From Operating Activities | | |
| Net income (loss) | \$ 281,073 | \$ (129,554) |
| Adjustments to reconcile net income (loss) to net cash provided by operating activities: | | |
| Depreciation and amortization | 197,523 | 205,343 |
| Loss on disposal of equipment | 433 | 4,854 |
| Changes in assets and liabilities: | | |
| Accounts and notes receivable | 41,772 | 738,777 |
| Income taxes receivable | 49,163 | (69,000) |
| Inventories | 30,403 | 220,716 |
| Prepaid expenses | (15,914) | (38,380) |
| Accounts payable | 201,740 | (328,058) |
| Accrued expenses, including deferred revenue | 22,590 | (46,027) |
| Net cash provided by operating activities | 808,783 | 558,671 |
| Cash Flows From Investing Activities | | |
| Purchases of property and equipment | (9,749) | (43,223) |
| Proceeds from sale of equipment | - | 14,000 |
| Net cash used in investing activities | (9,749) | (29,223) |
| Cash flows From Financing Activities | | |
| Net payments on revolving credit agreement | (720,000) | (355,000) |
| Payments on long-term borrowings, including capital lease obligations | (156,563) | (193,256) |
| Net cash used in financing activities | (876,563) | (548,256) |
| Net decrease in cash | (77,529) | (18,808) |
| Cash | | |
| Beginning | 399,749 | 38,961 |
| End | \$ 322,220 | \$ 20,153 |
| Supplemental Disclosures of Cash Flow Information | | |
| Cash payments for: | | |
| Interest | \$ 79,030 | \$ 156,421 |
| Income taxes | 1,250 | - |

See Notes to Interim Financial Statements

WINLAND ELECTRONICS, INC.**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 March 31, 2002 and December 31, 2001 are as follows:

| | March 31, | December 31, |
|----------------------|------------------|---------------------|
| | 2002 | 2001 |
| Raw Materials | \$ 1,699,954 | \$ 2,006,461 |
| Work In Process | 193,659 | 138,859 |
| Finished Goods | 539,900 | 429,407 |
| Obsolescence reserve | (24,189) | (135,000) |
| Total | \$ 2,409,324 | \$ 2,439,727 |

Note 3. Financing Arrangement

The Company has a \$3,500,000 revolving line-of-credit agreement through September 15, 2002. Interest on advances is at two percentage points over the bank's reference rate (6.75 percent at March 31, 2002) and is due monthly. Advances outstanding on the revolving line-of-credit agreement at March 31, 2002 and December 31, 2001, were \$1,261,501 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 60 percent of eligible inventories. In addition, the agreement contains certain reporting and operating covenants.

The Company is currently discussing various options to meet and secure the future financial needs of the Company.

Note 4. Stock Options

As of March 31, 2002, options to purchase 354,000 shares of common stock were outstanding under the Company's 1989 and 1997 Stock Option Plans, of which 216,000 shares were exercisable. At March 31, 2002, the exercise prices of all outstanding options range from \$.53 to \$2.938 per share.

Note 5. Major Customers and Enterprisewide Disclosures

Major Customers: The Company has customers that accounted for more than 10 percent of net sales and accounts receivable for the three months ended March 31, 2002 and 2001, as follows:

| | Three Months Ended March 31, 2002 | Three Months Ended March 31, 2001 |
|-------------------|--------------------------------------|--------------------------------------|
| Sales percentage: | | |
| Customer A | 51% | 22% |
| Customer B | 16% | 19% |
| Customer C | 1% | 35% |

Accounts receivable percentage:

| | | |
|------------|-----|-----|
| Customer A | 50% | 38% |
| Customer B | 16% | 17% |
| Customer C | 1% | 18% |

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

| | Three Months Ended March 31, 2002 | Three Months Ended March 31, 2001 |
|--|--|--|
| Proprietary microprocessors and mechanically controlled sensors and alarms | \$ 681,083 | \$ 608,553 |
| Electronic controls and assemblies for OEM customers | 3,604,564 | 3,922,554 |
| | \$ 4,285,647 | \$ 4,531,107 |

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

RESULTS OF OPERATIONS

Three months ended March 31 2002 v.

Three months ended March 31, 2001

Net Sales: The Company recorded net sales of \$4,285,647 for the three months ended March 31, 2002, a decline of \$245,460 from \$4,531,107 for the same period in 2001. The reduction in sales for the three months ended March 31, 2002 is primarily attributed to a reduction to a previously significant OEM customer, offset almost entirely by increases in sales to the Company's other OEM customers, particularly Select Comfort Corporation, as well as an increase in sales of the Company's proprietary products.

The Company currently has orders and forecasts from its major OEM customers for delivery during the remainder of 2002 and 1st quarter of 2003 having an aggregate value of \$10.7 million. These are at various stages of completion. The Company expects to receive additional orders from current OEM customers for 2002 and 2003 production, including four new customers obtained in the third quarter of 2001.

The Company has continued to position itself as a full service designer and manufacturer of custom controls and assemblies for OEM customers. The Company has begun to explore additional geographic regions to market its OEM services, primarily through networking with referral sources in the Chicago area. 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 55.3 percent to \$1,085,568 or 25.3% of net sales for the three months ended March 31, 2002, compared to \$699,048 or 15.4% of net sales for the same period in 2001. As a percentage of sales, gross margin increased by 9.9 percentage points over the first quarter last year. The increase in gross profits for the quarter ended March 31, 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 quarter of 2002. Reductions in manufacturing costs were due to reduced salaries and employee related expenses, as well as lower information technology and facility expenses, offset in part by increased insurance premiums and obsolescence and warranty reserves. The increases in reserves will more closely match expenses with activities for the period.

Operating Expenses: General and administrative expense was \$303,242 or 7.1% of net sales for the three months ended March 31, 2002, compared to \$318,632 or 7.0% of net sales for the same period in 2001. The decrease in general and administrative expenses for the three months ended March 31, 2002 is attributed primarily to reductions in salaries and employee related expenses, leased vehicle expense and professional fees, offset in part by increased investor relations, board fees, and directors and officers insurance premium expenses.

Sales and marketing expense (including project management) was \$236,037 or 5.5% of net sales for the three months ended March 31, 2002, compared to \$169,327 or 3.7% of net sales for the same period in 2001. The increase in sales and marketing expense 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 trade show and travel expense, offset in part by decreased leased vehicle expense 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 \$148,781 or 3.5% of net sales for the three months ended March 31, 2002, compared to \$254,340 or 5.6% of net sales for the same period in 2001.

The decline in research and development expense for the three months ended March 31, 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.

Interest Expense: Interest expense was \$78,768 or 1.8% of net sales for the three months ended March 31, 2002, compared to \$155,941 or 3.4% of net sales for the same period in 2001. The decrease in interest expense for the first quarter 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 quarter of 2002, the Company paid down \$720,000 (36%) on its line-of-credit and paid down \$156,563 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 \$281,073 or \$0.09 per basic and diluted share and for the three months ended March 31, 2002, compared to a net loss of \$129,554 or (\$0.04) per basic and diluted share for the same period in 2001. The net income for the first quarter of 2002 is primarily due to higher 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 quarter 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 credits generated in previous years.

LIQUIDITY AND CAPITAL RESOURCES

Cash provided by operating activities was \$808,783 for the three months ended March 31, 2002, compared to \$558,671 for the same period in 2001, an improvement of \$250,112. Cash provided by operations was used to pay down \$720,000 of the Company's revolving line-of-credit (a reduction of over 36%), 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 March 31, 2002 and December 31, 2001 was 1.5 to 1 and 1.4 to 1, respectively. Working capital equaled \$1,723,133 on March 31, 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 cash, inventory, accounts receivable and income tax receivable.

The Company has a \$3,500,000 revolving line-of-credit agreement with Wells Fargo Bank, through September 15, 2002. Interest on advances is at two percentage points over the bank's reference rate (6.75 percent at March 31, 2002) and is due monthly. Advances outstanding on the revolving line-of-credit at March 31, 2002 and December 31, 2001 were \$1,261,501 and \$1,981,501, respectively. Advances are due on

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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 60 percent 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 September 15, 2002.

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A summary of our contractual cash obligations at March 31, 2002 is as follows:

| Contractual Obligations | Total | Payments due by period | | | | 2006 and thereafter |
|--|--------------|------------------------|------------|------------|--------------|---------------------|
| | | 2002 | 2003 | 2004 | 2005 | |
| Long-term debt, including interest | \$ 3,250,500 | \$ 474,500 | \$ 551,800 | \$ 964,300 | \$ 1,097,300 | \$ 162,600 |
| Operating leases | 22,700 | 12,700 | 10,000 | 0 | 0 | 0 |
| Purchase agreement for manufacturing equipment | 0 | 0 | 0 | 0 | 0 | 0 |
| Total contractual cash obligations | \$ 3,273,200 | \$ 487,200 | \$ 561,800 | \$ 964,300 | \$ 1,097,300 | \$ 162,600 |

We also have a commercial commitment as described below:

| Other Commercial Commitment | Total Amount Committed | Outstanding at 3/31/02 | Date of Expiration |
|-----------------------------|------------------------|------------------------|--------------------|
| Line of credit | \$ 3,500,000 | \$ 1,261,501 | September 15, 2002 |

The Company continues to explore other financing sources, including asset-based lending, to provide financing beyond September 15, 2002. There is no assurance that the Company will be successful in obtaining financing arrangements on terms acceptable to the Company. The Company may find it necessary to accept financing arrangements, which limit the Company's ability to achieve growth.

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 that are not subject to any long-term contracts with the Company. 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 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 proprietary products 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 proprietary products depends on the effectiveness of its new product development efforts as well as the timing of such and the availability and costs of any competing products on the market.

PART II OTHER INFORMATION

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) **Exhibits.** None.

(b) **Reports on Form 8-K.** No reports on Form 8-K were filed during the quarter ended March 31, 2002.

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.

WINLAND ELECTRONICS, INC.
(Company)

Dated: April 22, 2002

/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)