

NORTECH SYSTEMS INC
Form 10-Q
May 10, 2013
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**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 quarterly period ended March 31, 2013

OR

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

For the transition period from to

NORTECH SYSTEMS INCORPORATED

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Commission file number **0-13257**

State of Incorporation: **Minnesota**

IRS Employer Identification No. **41-1681094**

Executive Offices: **1120 Wayzata Blvd E., Suite 201, Wayzata, MN 55391**

Telephone number: **(952) 345-2244**

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 that the registrant was required to file such reports), and (2) has been subject to such 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 Regulations S-T (§232.405 of this chapter) 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, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer, and smaller reporting company in Rule 12b-2 of the Exchange Act.

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 Exchange Act). Yes No

Number of shares of \$.01 par value common stock outstanding at May 1, 2013 - 2,742,992

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| | MARCH 31 2013 (Unaudited) | DECEMBER 31 2012 |
|--|--|-----------------------------|
| ASSETS | | |
| Current Assets | | |
| Cash | \$ 18,521 | \$ |
| Accounts Receivable, Less Allowance for Uncollectible Accounts | 14,046,725 | 13,607,933 |
| Inventories | 19,117,402 | 17,664,862 |
| Prepaid Expenses | 677,517 | 561,576 |
| Income Taxes Receivable | 20,486 | |
| Deferred Income Taxes | 851,000 | 857,000 |
| Total Current Assets | 34,731,651 | 32,691,371 |
| Property and Equipment, Net | 11,223,982 | 11,566,315 |
| Finite Life Intangible Assets, Net of Accumulated Amortization | 43,655 | 44,978 |
| Other Assets | 138,232 | 212,235 |
| Total Assets | \$ 46,137,520 | \$ 44,514,899 |
| | MARCH 31 2013 | DECEMBER 31 2012 |
| LIABILITIES AND SHAREHOLDERS EQUITY | | |
| Current Liabilities | | |
| Line of Credit | \$ 6,999,979 | \$ 7,923,487 |
| Current Maturities of Long-Term Debt | 564,705 | 453,105 |
| Accounts Payable | 9,221,341 | 9,051,978 |
| Accrued Payroll and Commissions | 2,770,491 | 1,965,657 |
| Other Accrued Liabilities | 642,910 | 676,336 |
| Income Taxes Payable | | 60,878 |
| Total Current Liabilities | 20,199,426 | 20,131,441 |
| Long-Term Liabilities | | |
| Long-Term Debt, Net of Current Maturities | 4,316,423 | 2,865,899 |
| Deferred Income Taxes | 156,000 | 227,000 |
| Other Long-Term Liabilities | 185,570 | 155,328 |
| Total Long-Term Liabilities | 4,657,993 | 3,248,227 |
| Total Liabilities | 24,857,419 | 23,379,668 |
| Shareholders Equity | | |
| Preferred Stock, \$1 par value; 1,000,000 Shares Authorized: 250,000 Shares Issued and Outstanding | 250,000 | 250,000 |

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Common Stock - \$0.01 par value; 9,000,000 Shares Authorized: 2,742,992 Shares

| | | |
|--|---------------|---------------|
| Issued and Outstanding | 27,430 | 27,430 |
| Additional Paid-In Capital | 15,729,173 | 15,725,392 |
| Accumulated Other Comprehensive Loss | (62,936) | (62,936) |
| Retained Earnings | 5,336,434 | 5,195,345 |
| Total Shareholders' Equity | 21,280,101 | 21,135,231 |
| Total Liabilities and Shareholders' Equity | \$ 46,137,520 | \$ 44,514,899 |

See Accompanying Condensed Notes to Consolidated Financial Statements

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NORTECH SYSTEMS INCORPORATED AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF INCOME

(UNAUDITED)

| | THREE MONTHS ENDED MARCH 31 | |
|---|--------------------------------|---------------|
| | 2013 | 2012 |
| Net Sales | \$ 25,925,401 | \$ 28,360,914 |
| Cost of Goods Sold | 22,687,976 | 25,352,679 |
| Gross Profit | 3,237,425 | 3,008,235 |
| Operating Expenses | | |
| Selling Expenses | 1,196,740 | 1,087,816 |
| General and Administrative Expenses | 1,817,063 | 1,591,989 |
| Total Operating Expenses | 3,013,803 | 2,679,805 |
| Income From Operations | 223,622 | 328,430 |
| Other Expense | | |
| Interest Expense | (93,526) | (136,779) |
| Miscellaneous Expense, net | (10,007) | (9,846) |
| Total Other Expense | (103,533) | (146,625) |
| Income Before Income Taxes | 120,089 | 181,805 |
| Income Tax Expense (Benefit) | (21,000) | 59,000 |
| Net Income | \$ 141,089 | \$ 122,805 |
| Earnings Per Common Share: | | |
| Basic and Diluted | \$ 0.05 | \$ 0.04 |
| Weighted Average Number of Common Shares Outstanding Used for Basic and Diluted Earnings Per Common Share | 2,742,992 | 2,742,992 |

See Accompanying Condensed Notes to Consolidated Financial Statements

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CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The accompanying unaudited consolidated financial statements for the interim periods have been prepared in accordance with Generally Accepted Accounting Principles in the United States of America (GAAP) for interim financial information and pursuant to the rules and regulations of the Securities and Exchange Commission. Accordingly, they do not include all of the financial information and footnotes required by GAAP for complete financial statements, although we believe the disclosures are adequate to make the information presented not misleading. It is suggested that these consolidated financial statements be read in conjunction with the consolidated financial statements and the notes thereto included in our latest shareholders' annual report on Form 10-K. The operating results for the interim periods presented are not necessarily indicative of the results expected for the full year or for any other interim period. In our opinion, all adjustments (consisting of normal recurring adjustments) considered necessary for a fair presentation have been included.

The preparation of financial statements in conformity with GAAP requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. In preparing these consolidated financial statements, we have made our best estimates and judgments of certain amounts included in the consolidated financial statements, giving due consideration to materiality. Changes in the estimates and assumptions used by us could have a significant impact on our financial results, since actual results could differ from those estimates.

Principles of Consolidation

The consolidated financial statements include the accounts of Nortech Systems Incorporated and its wholly owned subsidiary, Manufacturing Assembly Solutions of Monterrey, Inc. All significant intercompany accounts and transactions have been eliminated.

Revenue Recognition

We recognize revenue upon shipment of manufactured products to customers, when title has passed, all contractual obligations have been satisfied and collection of the resulting receivable is reasonably assured. We also provide engineering services separate from the manufacture of a product. Revenue for engineering services is recognized upon completion of the engineering process, providing standalone fair value to our customers. Our engineering services are short-term in nature. In addition, we have another separate source of revenue that comes from short-term repair services, which are recognized upon completion of the repairs and shipment of product back to the customer. Shipping and handling costs charged to our customers are included in net sales, while the corresponding shipping expenses are included in cost of goods sold.

Table of Contents**Stock Options**

Following is the status of all stock options as of March 31, 2013, including changes during the three-month period then ended:

| | Shares | Weighted-Average Exercise Price Per Share | Weighted-Average Remaining Contractual Term (in years) | Aggregate Intrinsic Value |
|-------------------------------|----------|---|--|---------------------------|
| Outstanding - January 1, 2013 | 288,750 | \$ 7.19 | | |
| Granted | 29,000 | \$ 3.20 | | |
| Cancelled | (50,000) | \$ 7.22 | | |
| Outstanding - March 31, 2013 | 267,750 | \$ 6.75 | 3.53 | \$ 3,190 |
| Exercisable - March 31, 2013 | 238,750 | \$ 7.19 | 2.76 | \$ |

There were no options exercised during the three months ended March 31, 2013 and 2012. The weighted-average fair value of options granted during the three months ended March 31, 2013 was \$1.65 per share. There were no stock options granted during the three months ended March 31, 2012.

Total compensation expense related to stock options for the three months ended March 31, 2013 and 2012 was \$3,781 and \$0, respectively. As of March 31, 2013, there was approximately \$44,000 of unrecognized compensation related to unvested option awards that we expect to recognize over a weighted-average period of 2.87 years.

Equity Appreciation Rights Plan

In November 2010, the Board of Directors approved the adoption of the Nortech Systems Incorporated Equity Appreciation Rights Plan (the 2010 Plan). The total number of Equity Appreciation Right Units (Units) the Plan can issue shall not exceed an aggregate of 750,000 Units. The 2010 Plan provides that Units issued shall fully vest three years from the base date as defined in the agreement unless terminated earlier. Units give the holder a right to receive a cash payment equal to the appreciation in book value per share of common stock from the base date, as defined, to the redemption date. Unit redemption payments under this plan shall be paid in cash within 90 days after we determine the value as of the redemption date.

During the year ended December 31, 2010, 100,000 Units were issued with a vesting date of December 31, 2012. A payment of \$86,817 was made during the quarter ended March 31, 2013 related to these Units.

On March 7, 2012, the Company granted an additional 250,000 Units with redemption dates ranging from December 31, 2014 through December 31, 2016. On February 13, 2013, the Company granted an additional 350,000 Units with redemption dates ranging from December 31, 2015 through December 31, 2019.

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Total compensation expense related to these Units based on the estimated appreciation over their remaining terms was \$13,992 and \$2,810 for the three months ended March 31, 2013 and 2012, respectively. As of March 31, 2013 and December 31, 2012, approximately \$29,000 and \$101,000 have been accrued under this plan, respectively. As of March 31, 2013, all of the balance is included in Other Long-term Liabilities. As of December 31, 2012, approximately \$86,000 of this balance was included in Other Accrued Liabilities and the remaining \$15,000 balance was included in Other Long-term Liabilities.

Earnings per Common Share

For the three months ended March 31, 2013 and 2012, the effect of all stock options is antidilutive. Therefore, no outstanding options were included in the computation of per-share amounts.

Segment Reporting Information

All of our operations fall under the Contract Manufacturing segment within the Electronic Manufacturing Services industry. We strategically direct production between our various manufacturing facilities based on a number of considerations to best meet our customers' requirements. We share resources for sales, marketing, engineering, supply chain, information services, human resources, payroll, and all corporate accounting functions. Consolidated financial information is available that is evaluated regularly by the chief operating decision maker in assessing performance and allocating resources.

Inventories

Inventories are stated at the lower of cost (first-in, first-out method) or market (based on the lower of replacement cost or net realizable value). Costs include material, labor, and overhead required in the warehousing and production of our products. Inventory reserves are maintained for the estimated value of the inventories that may have a lower value than stated or quantities in excess of future production needs.

Inventories are as follows:

| | March 31 2013 | December 31 2012 |
|-----------------|--------------------------|-----------------------------|
| Raw Materials | \$ 14,232,405 | \$ 13,325,525 |
| Work in Process | 3,315,460 | 2,704,653 |
| Finished Goods | 3,098,023 | 3,108,839 |
| Reserve | (1,528,486) | (1,474,155) |
| Total | \$ 19,117,402 | \$ 17,664,862 |

Finite Life Intangible Assets

We have a finite life intangible asset related to bond issue costs. The value of the asset at March 31, 2013 and December 31, 2012 is as follow:

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| | Remaining Lives (Years) | Gross Carrying Amount | Accumulated Amortization | Net Book Value |
|-------------------|-------------------------------|-----------------------------|-----------------------------|-------------------|
| March 31, 2013 | 8 | \$ 79,373 | \$ 35,718 | \$ 43,655 |
| December 31, 2012 | 9 | \$ 79,373 | \$ 34,395 | \$ 44,978 |

Amortization expense for the three months ended March 31, 2013 and 2012 was \$1,323 and \$12,600, respectively. Estimated future annual amortization expense for the asset is approximately \$5,000 per year through 2021 when the related bond matures.

Impairment Analysis

We evaluate long-lived assets, primarily property and equipment, as well as the related depreciation periods, whenever current events or changes in circumstances indicate that the carrying amount of an asset or asset group may not be recoverable. Recoverability for assets to be held and used is based on our projection of the undiscounted future operating cash flows of the underlying assets. To the extent such projections indicate that future undiscounted cash flows are not sufficient to recover the carrying amounts of related assets, a charge might be required to reduce the carrying amount to equal estimated fair value. Assets held for sale are reported at the lower of the carrying amount or fair value less costs to dispose. We recorded impairment charges in the first quarter of 2013 and 2012 of \$74,000 and \$0, respectively, which related to our assets held for sale and have been included in general and administrative expenses in the statements of income.

NOTE 2. CONCENTRATION OF CREDIT RISK AND MAJOR CUSTOMERS

Financial instruments that potentially subject us to concentrations of credit risk consist principally of cash and accounts receivable. With regard to cash, we maintain our excess cash balances in checking accounts at two high-credit quality financial institutions. These accounts may at times exceed federally insured limits. We grant credit to customers in the normal course of business and do not require collateral on our accounts receivable.

Our largest customer has two divisions and accounted for 10% or more of our net sales during the past two years. One division accounted for 20% and 17% of net sales for the three months ended March 31, 2013 and 2012, respectively. The other division accounted for 4% and 5% of net sales for the three months ended March 31, 2013 and 2012, respectively. Together, they accounted for 24% and 22% of net sales for the three months ended March 31, 2013 and 2012, respectively. Accounts receivable from both divisions represented 15% of total accounts receivable at March 31, 2013 and December 31, 2012, respectively.

Export sales represented 11% and 7% of consolidated net sales for the three months ended March 31, 2013 and 2012.

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NOTE 3. FINANCING ARRANGEMENTS

On May 2, 2012, we entered into the fourth amendment to the third amended and restated credit agreement with Wells Fargo Bank (WFB). The credit agreement with WFB provides for a line of credit arrangement of \$13.5 million, which expires if not renewed, on May 31, 2015. The credit arrangement also provides a \$1.8 million real estate term note with a maturity date of March 31, 2027 which replaced the \$0.9 million real estate term note that was to expire on May 31, 2012, and a new term loan of up to \$2.0 million for capital expenditures to be made prior to December 31, 2013 with a maturity date of December 31, 2017. At March 31, 2013, we ve used \$0.9 million of the \$2.0 million capital term loan.

On December 31, 2012, in connection with our purchase of the Mankato building, we again amended our credit agreement with WFB to include an additional \$1.7 million real estate term note that expires if not renewed on May 31, 2015. The purchase of the building was funded through our line of credit which was paid down when the new real estate term note was funded on January 9, 2013.

Under the agreement, both the line of credit and real estate term notes are subject to variations in the LIBOR rate. Our line of credit bears interest at three-month LIBOR + 2.75% (3.00% at March 31, 2013) while our real estate term notes bear interest at three-month LIBOR + 3.25% (3.5% at March 31, 2013). The weighted-average interest rate on our line of credit and real estate term notes were 3.13% and 3.42%, respectively for the three months ended March 31, 2013. We had borrowings on our line of credit of \$6,999,979 and \$7,923,487 outstanding as of March 31, 2013 and December 31, 2012, respectively.

The credit agreement contains certain covenants which, among other things, require us to adhere to regular reporting requirements, abide by annual shareholder dividend limitations, maintain certain financial performance, and limit the amount of annual capital expenditures.

The availability under the line is subject to borrowing base requirements, and advances are at the discretion of the lender. At March 31, 2013, we have net unused availability under our line of credit of approximately \$4.8 million. The line is secured by substantially all of our assets.

NOTE 4. INCOME TAXES

On a quarterly basis, we estimate what our effective tax rate will be for the full fiscal year and record a quarterly income tax provision based on the anticipated rate. As the year progresses, we refine our estimate based on the facts and circumstances by each tax jurisdiction. Our effective tax rate for the three months ended March 31, 2013 and 2012 was (17%) and 32%, respectively. The effective tax rate for the year ended December 31, 2013 is expected to be 24% compared to 32% for the year ended December 31, 2012. The decreases are principally due to the federal government reinstating the research and development credit for the 2012 tax year and extending it to 2013.

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The differences between federal income taxes computed at the federal statutory rate and reported income taxes for the three months ended March 31, 2013 and 2012 are as follows:

| | Three Months Ended | | | |
|-----------------------------------|--------------------|----------|------|----------|
| | March 31 | | | |
| | 2013 | | 2012 | |
| Statutory federal tax provision | \$ | 43,000 | \$ | 62,000 |
| State income taxes | | 10,000 | | 4,000 |
| Income tax credits | | (86,000) | | (3,000) |
| Change in uncertain tax positions | | 14,000 | | 10,000 |
| Other | | (2,000) | | (14,000) |
| Income tax expense | \$ | (21,000) | \$ | 59,000 |

At March 31, 2013, we had \$156,000 of net uncertain tax benefit positions recorded in other long-term liabilities that would reduce our effective income tax rate if recognized. The \$16,000 increase from December 31, 2012 primarily relates to 2012 and 2013 state research and experimentation credits.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONSOverview:

We are a Wayzata, Minnesota based full-service Electronics Manufacturing Services (EMS) contract manufacturer of wire and cable assemblies, printed circuit board assemblies, higher-level assemblies and box builds for a wide range of industries. We provide value added services and technical support including design, testing, prototyping and supply chain management to customers mainly in the Aerospace and Defense, Medical, and Industrial Equipment markets. We maintain manufacturing facilities in Baxter, Bemidji, Blue Earth, Mankato, Merrifield, and Milaca, Minnesota; Augusta, Wisconsin; and Monterrey, Mexico.

Summary of Results:

For the quarter ended March 31, 2013, we reported net sales of \$25.9 million compared to \$28.4 million reported in the same quarter of 2012, a 9% decrease year over year and a 4% increase sequentially from the fourth quarter of 2012. In the first quarter of 2012, our customers built inventory in anticipation of growth and recovery that did not materialize in the second half of the year.

Our gross profit percentage for the three months ended March 31, 2013 and 2012 was 12.5% and 10.6%, respectively. The improvement in gross margin is the result of cost reduction efforts in the second half of 2012, an increased investment in automation and lean productivity improvements.

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Income from operations was approximately \$224,000 and \$328,000 for the three months ended March 31, 2013 and 2012, respectively. \$74,000 of the decrease can be attributed to an impairment charge related to our asset held for sale.

Net income for the first quarter of 2013 was \$141,000 or \$0.05 per diluted common share, compared to net income of \$122,805 or \$0.04 per diluted common share for the same period in 2012.

Cash used in operating activities in the first quarter of 2013 was \$0.4 million while cash provided by operating activities was \$2.7 million in the first quarter of 2012. The difference in cash used in the first quarter of 2013 compared to the first quarter of 2012 is mainly due to a build up of inventory to support future production schedules and timing differences on collections of our accounts receivable.

Results of Operations:

The following table presents statements of income data as percentages of total net sales for the periods indicated:

| | Three Months Ended | |
|-------------------------------------|--------------------|--------|
| | March 31 | |
| | 2013 | 2012 |
| Net Sales | 100.0% | 100.0% |
| Cost of Goods Sold | 87.5 | 89.4 |
| Gross Profit | 12.5 | 10.6 |
| Selling Expenses | 4.6 | 3.8 |
| General and Administrative Expenses | 7.0 | 5.6 |
| Income from Operations | 0.9 | 1.2 |
| Other Expenses, Net | (0.4) | (0.5) |
| Income Before Income Taxes | 0.5 | 0.7 |
| Income Tax Expense | 0.0 | 0.3 |
| Net Income | 0.5% | 0.4% |

Net Sales:

We reported net sales of \$25.9 million and \$28.4 million for the three months ended March 31, 2013 and 2012, respectively. The majority of the decrease in sales is related to our Industrial customers who continue to be impacted by the slow economy while Aerospace and Defense customers are down 2% and Medical customers are up 2%.

Net sales by industry markets for the three month periods ended March 31, 2013 and 2012 are as follows:

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| (in thousands) | Three Months Ended | | |
|-----------------------|--------------------|----------|------|
| | 2013 | March 31 | 2012 |
| | \$ | \$ | % |
| Aerospace and Defense | 4,564 | 4,668 | (2) |
| Medical | 7,951 | 7,814 | 2 |
| Industrial | 13,410 | 15,879 | (16) |
| Total Sales | 25,925 | 28,361 | (9) |

Backlog:

Our 90-day order backlog as of March 31, 2013 was approximately \$20.3 million, compared to approximately \$18.3 million at December 31, 2012. Our backlog consists of firm purchase orders and we expect a major portion of the current 90 day backlog to be realized as revenue during the following quarter. Our Aerospace and Defense backlog has improved due to strong bookings in the fourth quarter of 2012, our Medical backlog is experiencing increased activity and our Industrial backlog is down due to continued economic pressures.

Backlog by industry market is shown below:

| (in thousands) | Backlog as of the Quarter Ended | | | |
|-----------------------|---------------------------------|----------|-------------|-------------|
| | March 31 | March 31 | December 31 | December 31 |
| | 2013 | 2013 | 2012 | 2012 |
| Aerospace and Defense | \$ | 5,496 | \$ | 3,789 |
| Medical | | 7,621 | | 7,017 |
| Industrial | | 7,230 | | 7,500 |
| Total Backlog | \$ | 20,347 | \$ | 18,306 |

Our 90 day backlog varies due to order size, manufacturing delays, contract terms and conditions and timing from customer delivery schedules and releases. These variables cause inconsistencies in comparing the backlog from one period to the next.

Gross Profit:

Gross profit as a percent of net sales for the three months ended March 31, 2013 and 2012 was 12.5% and 10.6% of net sales, respectively. The improvement in gross margin is the result of cost reduction efforts in the second half of 2012, an increased investment in automation and lean productivity improvements.

Selling Expense:

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Our selling expenses were \$1.2 million or 4.6% of net sales and \$1.1 million or 3.8% of net sales for the three months ended March 31, 2013 and 2012, respectively. Our selling expenses are up

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slightly as we continue to invest in business development infrastructure and marketing initiatives in an effort to stimulate sales.

General and Administrative Expense:

Our general and administrative expenses were \$1.8 million or 7.0% of net sales and \$1.6 million or 5.6% of net sales for the three months ended March 31, 2013 and 2012, respectively. The increase in general and administrative expenses compared to the first quarter of 2012 relates primarily to a \$74,000 impairment on an asset held for sale.

Income Taxes:

Our effective tax rate for the three months ended March 31, 2013 was (17%) compared with 32% for the three months ended March 31, 2012, respectively. The decreases are principally due to the federal government reinstating the research and development credit for the 2012 tax year and extending it to 2013. The differences between federal income taxes computed at the federal statutory rate and reported income taxes for the three months ended March 31, 2013 and 2012 are as follows:

| | Three Months Ended March 31 | |
|-----------------------------------|--|-------------|
| | 2013 | 2012 |
| Statutory federal tax provision | \$ 43,000 | \$ 62,000 |
| State income taxes | 10,000 | 4,000 |
| Income tax credits | (86,000) | (3,000) |
| Change in uncertain tax positions | 14,000 | 10,000 |
| Other | (2,000) | (14,000) |
| Income tax expense | \$ (21,000) | \$ 59,000 |

Liquidity and Capital Resources:

We have satisfied our liquidity needs over the past several years with cash flows generated from operations and an operating line of credit through WFB. We also have real estate and equipment term loans. Both the line of credit and real estate term notes are subject to fluctuations in the LIBOR rates. The line of credit, real estate term notes, and equipment loans with WFB contain certain covenants which, among other things, require us to adhere to regular reporting requirements, abide by annual shareholder dividend limitations, maintain certain financial performance, and limit the amount of annual capital expenditures. The availability under our line is subject to borrowing base requirements, and advances are at the discretion of the lender. The line of credit is secured by substantially all of our assets.

On March 31, 2013, we had outstanding advances of \$7.0 million under the line of credit and unused availability of \$4.8 million supported by our borrowing base. We believe our financing arrangements and cash flows to be provided by operations will be sufficient to satisfy our future working capital needs. Our working capital was \$14.5 million and \$12.6 million as of March 31,

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2013 and December 31, 2012, respectively. The increase in working capital relates primarily to increased inventories of \$1.5 million to support future production schedules.

Net cash used in operating activities for the three months ended March 31, 2013 was \$0.4 million. Increased inventories and accounts receivable were partially offset by an increase in accruals and non-cash addbacks for depreciation to account for the majority of the cash used.

Net cash used in investing activities of \$0.2 million for the three months ended March 31, 2013 is comprised of property and equipment purchases to support the business.

Net cash provided by financing activities for the three months ended March 31, 2013 was \$0.6 million, mainly due to loan proceeds of \$1.6 million, offset in part by repayments on the line of credit of \$0.9 million and payments on long-term debt of \$0.1 million.

Critical Accounting Policies and Estimates

Our significant accounting policies and estimates are summarized in Management's Discussion and Analysis of Financial Condition and Results of Operations in our Annual Report on Form 10-K for the year ended December 31, 2012. There have been no significant changes in these critical accounting policies since December 31, 2012. Some of our accounting policies require us to exercise significant judgment in selecting the appropriate assumptions for calculating financial estimates. Such judgments are subject to an inherent degree of uncertainty. These judgments are based on our historical experience, known trends in our industry, terms of existing contracts and other information from outside sources, as appropriate. Actual results could differ from these estimates.

Forward-Looking Statements:

Those statements in the foregoing report that are not historical facts are forward-looking statements made pursuant to the safe-harbor provisions of the Private Securities Litigation Reform Act of 1995. Such statements generally will be accompanied by words such as anticipate, believe, estimate, expect, forecast, intend, possible, potential, predict, project, or other similar words that convey the uncertainty of future outcomes. Although we believe these forward-looking statements are reasonable, they are based upon a number of assumptions concerning future conditions, any or all of which may ultimately prove to be inaccurate. Forward-looking statements involve a number of risks and uncertainties. Important factors that could cause actual results to differ materially from the forward-looking statements include, without limitation:

- Volatility in the marketplace which may affect market supply and demand for our products;
- Increased competition;
- Changes in the reliability and efficiency of operating facilities or those of third parties;

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- Risks related to availability of labor;
- Increase in certain raw material costs such as copper;
- Commodity and energy cost instability;
- General economic, financial and business conditions that could affect our financial condition and results of operations; and
- Availability of raw material components.

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The factors identified above are believed to be important factors (but not necessarily all of the important factors) that could cause actual results to differ materially from those expressed in any forward-looking statement made by us. Unpredictable or unknown factors not discussed herein could also have material adverse effects on forward-looking statements. All forward-looking statements included in this Form 10-Q are expressly qualified in their entirety by the forgoing cautionary statements. We undertake no obligations to update publicly any forward-looking statement (or its associated cautionary language) whether as a result of new information or future events.

Please refer to forward-looking statements and risks as previously disclosed in our report on Form 10-K for the fiscal year ended December 31, 2012.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures:

In accordance with Rule 13a-15(b) of the Securities Exchange Act of 1934 (the Exchange Act), as of the end of the period covered by this Quarterly Report on Form 10-Q, our management evaluated, with the participation of our Chief Executive Officer and President, Chief Operating and Financial Officer, the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rule 13a-15(e) and Rule 15d-15(e) under the Exchange Act). Based upon their evaluation of these disclosure controls and procedures, the Chief Executive Officer and President, Chief Operating and Financial Officer have concluded that the disclosure controls and procedures were effective as of the date of such evaluation in ensuring that information required to be disclosed in our Exchange Act reports is (1) recorded, processed, summarized and reported in a timely manner, and (2) accumulated and communicated to management, including our Chief Executive Officer and President, Chief Operating and Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

Changes in Internal Control Over Financial Reporting:

There was no change in our internal control over financial reporting that occurred during the period covered by this Quarterly Report on Form 10-Q that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

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PART II

ITEM 1. LEGAL PROCEEDINGS

We are subject to various legal proceedings and claims that arise in the ordinary course of business.

ITEM 6. EXHIBITS

Exhibits

31.1 Certification of the Chief Executive Officer pursuant to Rule 13a-14(a) and Rule 15d-14(a), promulgated under the Securities Exchange Act of 1934, as amended.

31.2 Certification of the President, Chief Operating and Financial Officer pursuant to Rule 13a-14(a) and Rule 15d-14(a), promulgated under the Securities Exchange Act of 1934, as amended.

32 Certification of the Chief Executive Officer and President, Chief Operating and Financial Officer, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

101 Financial statements from the quarterly report on Form 10-Q for the quarter ended March 31, 2013, formatted in XBRL: (i) Consolidated Balance Sheets, (ii) Consolidated Statements of Operations, (iii) Consolidated Statements of Cash Flows, and (iv) the Notes to Consolidated Financial Statements.

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.

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Nortech Systems Incorporated and Subsidiary

Date: May 10, 2013

by /s/ Michael J. Degen

Michael J. Degen
Chief Executive Officer

Date: May 10, 2013

by /s/ Richard G. Wasielewski

Richard G. Wasielewski
President, Chief Operating and Financial Officer