

SPECTRUM CONTROL INC

Form 10-K

February 12, 2009

[Table of Contents](#)

## Securities and Exchange Commission

Washington, D.C. 20549

### Form 10-K

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

For the fiscal year ended November 30, 2008

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 0-8796

## Spectrum Control, Inc.

(a Pennsylvania Corporation)

Edgar Filing: SPECTRUM CONTROL INC - Form 10-K

(I.R.S. Employer Identification No. 25-1196447)

8031 Avonia Road, Fairview, Pennsylvania 16415

Telephone 814-474-2207

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

None

**Securities registered pursuant to Section 12(g) of the Act:**

**Title of each class**  
**Common Stock - No Par Value**

**Name of each exchange on which registered**  
**The Nasdaq Stock Market**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes  No .

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes  No .

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, and (2) has been subject to such filing requirements for the past 90 days. Yes  No .

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K .

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer  Accelerated filer  Non-accelerated filer

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

At May 31, 2008, the aggregate market value of voting Common Stock held by non-affiliates of the registrant based on a closing price of \$9.11 was \$109,906,092. Shares of Common Stock held by each officer and director and by each person who owns 10% or more of the outstanding Common Stock of the Company have been excluded because such persons may be deemed to be affiliates.

As of January 30, 2009, the registrant had outstanding 12,571,293 shares of Common Stock, no par value.

**Documents incorporated by reference**

Portions of the registrant's Proxy Statement for the annual meeting of shareholders to be held April 6, 2009 are incorporated by reference into Part III of this Form 10-K.



**Table of Contents****Table of Contents**

	<b>Page</b>
<b><u>PART I</u></b>	
Item 1. <u>Business</u>	3
Item 1A. <u>Risk Factors</u>	17
Item 1B. <u>Unresolved Staff Comments</u>	17
Item 2. <u>Properties</u>	18
Item 3. <u>Legal Proceedings</u>	19
Item 4. <u>Submission of Matters to a Vote of Security Holders</u>	19
 <b><u>PART II</u></b>	
Item 5. <u>Market for Registrant's Common Stock, Related Stockholder Matters and Issuer Purchases of Equity Securities</u>	19
Item 6. <u>Selected Financial Data</u>	21
Item 7. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	22
Item 7A. <u>Quantitative and Qualitative Disclosures About Market Risk</u>	31
Item 8. <u>Financial Statements and Supplementary Data</u>	35
Item 9. <u>Changes in and Disagreements with Accountants on Accounting and Financial Disclosure</u>	64
Item 9A. <u>Controls and Procedures</u>	64
Item 9B. <u>Other Information</u>	65
 <b><u>PART III</u></b>	
Item 10. <u>Directors and Executive Officers of the Registrant</u>	66
Item 11. <u>Executive Compensation</u>	67
Item 12. <u>Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters</u>	67
Item 13. <u>Certain Relationships and Related Transactions</u>	67
Item 14. <u>Principal Accountant Fees and Services</u>	67
 <b><u>PART IV</u></b>	
Item 15. <u>Exhibits, Financial Statement Schedules, and Reports on Form 8-K</u>	68
<u>Signatures</u>	70
<u>Schedule</u>	71
<u>Exhibits</u>	72

---

**Table of Contents**

**PART I**

**ITEM 1. BUSINESS**

Except for the historical information contained herein, the following discussion contains forward-looking statements that involve risks and uncertainties. The Company intends these forward-looking statements to qualify for the safe harbor from liability established by the Private Securities Litigation Reform Act of 1995. These forward-looking statements include, but are not limited to, descriptions of management's expectations regarding the future markets for the Company's products, future operating performance, and other future plans and objectives. Words such as "expect," "anticipate," "believe," "intend," and variations of such words identify forward-looking statements. These forward-looking statements are only predictions and are not guarantees of future performance. Actual results or events may differ materially from historical results or those suggested by these forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, those discussed herein under Item 1, Item 1A Risk Factors, as well as Item 7 entitled Management's Discussion and Analysis of Financial Condition and Results of Operations in this report.

**GENERAL**

Spectrum Control, Inc. and its subsidiaries (hereinafter referred to as "we," "us," "our," or the "Company") design, develop and manufacture custom electronic components and systems. The Company was founded as a solutions-oriented company, designing and manufacturing products to suppress or eliminate electromagnetic interference ("EMI"). Over the past decade, we have leveraged our core EMI filtering expertise to offer our customers a diverse line of custom components and systems. The Company's current operations are conducted in four reportable segments: signal and power integrity components; microwave components and systems; power management systems; and sensors and controls. The Company's Signal and Power Integrity Components Business designs and manufactures a broad range of products including coaxial filters, filtered connectors, power filters, antennas, and various specialty ceramic components. Our Microwave Components and Systems Business designs and manufactures radio frequency and microwave filters, amplifiers, frequency mixers, oscillators, synthesizers, multiple channel filter banks, and related products and integrated assemblies. The Power Management Systems Business designs and manufactures custom AC and DC power distribution units, power outlet strips, and our Smart Start power management systems. Our Sensors and Controls Business designs and manufactures rotary and linear precision sensors, temperature sensing probes, thermistors, resistance temperature detector sensors, and related assemblies.

Spectrum Control, Inc. (the "Parent company") was incorporated in Pennsylvania in 1968. The Parent company currently operates manufacturing facilities in Fairview, Pennsylvania; State College, Pennsylvania; and Wesson, Mississippi. Operations in Fairview include the design and manufacture of certain signal and power integrity products used primarily in military and defense applications. In State College, the Parent company's operations include the design and manufacture of power management systems. Operations in Wesson principally consist of metal fabrication manufacturing in support of our power integrity and power management systems product offerings. The Parent company's executive offices are located in Fairview, Pennsylvania.

Spectrum Control Technology, Inc. ("Spec Tech") is a wholly-owned subsidiary of the Parent company. Historically, Spec Tech operated a facility in New Orleans, Louisiana, with advanced manufacturing equipment used in the production of ceramic capacitors and other specialty ceramic components. As part of the New Orleans operation, Spec Tech manufactured substantially all of the ceramic discoidal and tubular capacitors used in the Company's EMI filter products. In late August of 2005, the New Orleans facility was virtually destroyed by Hurricane Katrina. To address our ongoing ceramic component needs and re-establish our own ceramic manufacturing capabilities, we acquired in December 2005 a ceramic manufacturing facility in State College, Pennsylvania. Among the other uses, the acquired facility has become the design and manufacturing center for our ceramic products, replacing the operations previously conducted in New Orleans.

Other wholly-owned operating subsidiaries of the Parent company include: Spectrum Microwave, Inc.; Spectrum SEI Microwave, Inc.; Spectrum FSY Microwave, Inc.; Spectrum Sensors and Controls, Inc. (CA Corp); Spectrum Sensors and Controls, Inc. (PA Corp.); Spectrum Control, GmbH; Spectrum Control de Mexico; and Spectrum Control (Hong Kong) Limited.

Spectrum Microwave, Inc. ("Spec Microwave"), designs and manufactures various radio frequency ("RF") and microwave products. These high-end components and integrated assemblies include amplifiers, frequency mixers, filters, and various types of oscillators (voltage control, dielectric resonator, and digitally tuned). Currently, Spec Microwave operates facilities in Philadelphia, Pennsylvania; Palm Bay, Florida; Marlborough, Massachusetts; as well as a portion of our facility in State College, Pennsylvania.

## Edgar Filing: SPECTRUM CONTROL INC - Form 10-K

Spectrum SEI Microwave, Inc. ( SEI ), located in Delmar, Delaware, designs and manufactures RF and microwave components and integrated assemblies. SEI s products include complex systems such as microwave synthesizers, multiple channel filter banks and preselectors.

## **Table of Contents**

Spectrum FSY Microwave, Inc., located in Columbia, Maryland, is primarily a design center, with limited manufacturing of certain RF and microwave products and systems.

Spectrum Sensors and Controls, Inc. (CA Corp.), located in Grass Valley, California, designs and manufactures precision co-molded conductive position sensors and related assemblies.

Spectrum Sensors and Controls, Inc. (PA Corp.), located in St. Marys, Pennsylvania, designs and manufactures a broad line of custom temperature sensors including temperature sensing probes and assemblies, positive and negative temperature coefficient thermistors, and resistance temperature detector sensors and related assemblies.

Spectrum Control, GmbH, located in Schwabach, Germany, acts as a distributor for the Company's signal and power products in the European market.

Spectrum Control de Mexico, located in Juarez, Mexico, commenced operations in June 2000 as the Company's low-cost manufacturing center for North America. Currently, this subsidiary manufactures various products for each of our four business segments for use in numerous commercial applications.

Spectrum Control (Hong Kong) Limited ( Spec HK ), currently is a holding company for our China subsidiary.

Spectrum Control Electronics (Dongguan) Co. Ltd. ( Spec China ), a wholly-owned subsidiary of Spec HK, located in Qiao Tou Town, China, commenced operations in 2003 as the Company's low-cost manufacturing center for Asia. Currently, Spec China manufactures certain signal and power integrity products, power management systems, and sensors and controls for various commercial customers.

## **RECENT DEVELOPMENTS**

### **ACQUISITION**

On September 26, 2008, we acquired substantially all of the assets and assumed certain liabilities of SatCon Electronics, Inc. ( SatCon ). SatCon, based in Marlborough, Massachusetts, designs and manufactures high performance microelectronic components used in numerous military and commercial applications, including secure communication systems and high frequency wireless devices. These sophisticated products include hybrid components and subsystems, signal converters, and a full line of thin and thick film circuits. SatCon's capabilities and technologies include high frequency millimeterwave products, which we believe are a natural complement and extension to our existing Microwave Components and Systems business segment. We also believe that our vertical manufacturing processes, low-cost manufacturing capabilities, and established military sales channels will provide additional revenue opportunities and improved profitability for SatCon products. The aggregate cash purchase price for SatCon was \$5.6 million.

The aggregate cash purchase price was primarily funded by borrowings under our domestic line of credit. The results of operations of the acquired business have been included in our financial statements since the acquisition date. Accordingly, SatCon net sales of \$2.3 million have been included in our consolidated net sales for the year ended November 30, 2008, with SatCon activities reported within our Microwave Components and Systems business for operating segment purposes.

### **STOCK BUYBACK PROGRAM**

The Board of Directors has authorized the Company to repurchase up to \$16.0 million of the Company's Common Stock at market prices. The amount and timing of the shares to be repurchased are at the discretion of management. During the year ended November 30, 2008, the Company repurchased 1,001,479 shares at an aggregate cost of \$8.2 million. Since the inception of the stock buyback program, the Company has repurchased 1,677,479 shares at an aggregate cost of \$11.8 million. The repurchased shares are held as treasury stock.

## **MARKETS**

Although our components and systems are used in many industries worldwide, our largest individual markets are military/defense and communications equipment which collectively represented approximately 66% of our fiscal 2008 sales. Military/defense

## Edgar Filing: SPECTRUM CONTROL INC - Form 10-K

applications for our products include secure communications, smart weapons and munitions, countermeasures for improvised explosive devices, radar systems, military vehicles, aircraft, missile defense systems, and simulation equipment. In communications, our products are used in numerous systems including wireless base stations and towers, broadband switching equipment, global positioning systems, wi-fi, optical networks, and Internet servers. Other significant markets for our products include medical equipment, industrial instrumentation, and commercial aerospace. Automotive represents an emerging market for our products, with significant applications in DC motors, telematics, and electronic safety controls.



## Table of Contents

### MILITARY/DEFENSE

Military forces worldwide are dependent on sophisticated electronic equipment. Military aircraft and naval vessels generally contain extensive communication equipment, electronic countermeasure equipment for defense against enemy weapons, smart weapons and munitions, and radar systems. The Company provides low pass EMI filters, multisection assemblies, custom position sensors, and numerous microwave components and subsystems to major equipment manufacturers for installation into these systems. The Company's customers, in turn, sell their equipment to major defense manufacturers or directly to governments.

Our engineers and technologists work closely with our military/defense customers to design new custom products. Major defense programs, for which our engineers and technologists are currently designing and developing products, include the following:

Light Airborne Multi Purpose Systems ( LAMPS ) Multi Mode Radar ( MMR ALQ-147 ) for helicopters

Advanced Extremely High Frequency ( AEHF ) Navy Multi Band Terminals ( NMT ) for satellite communications

Command Post Platforms ( CPP and CPP-ML/CP ) to direct operations and control forces

Warfighter Information Network Tactical Program ( WIN-T ) to increase communication bandwidth

Joint Counter Radio Controlled Improvised Explosive Device Electronic Warfare Program ( JCREW )

AEGIS combat systems and programs

Bradley Armored Fighting Vehicles

Eurofighter and Joint Strike Fighter Aircraft

#### Electronic Surveillance Systems

Military/defense sales were approximately \$62.7 million in 2008 and \$65.5 million in 2007, or approximately 48% of our total sales. Demand for military/defense products may be impacted by numerous economic, technological and political factors. Accordingly, while the Company has developed and will continue to develop products for military/defense programs, there can be no assurance that sales to such customers will not decrease in the future.

### COMMUNICATIONS EQUIPMENT

Several years ago, the communications equipment industry experienced a severe slowdown. Since then, market conditions in the industry have remained unpredictable and somewhat volatile. Beyond the current economic uncertainty in the communications equipment market, we believe the factors fostering long-term market growth remain in place. Prior to 2001, the communications industry experienced significant worldwide growth. This growth primarily resulted from increased business and consumer demand for wireless communication services and Internet access. Cost reductions and performance improvements in such wireless communication products as cellular, personal communication services, and satellite-based voice and data systems also contributed to this growth. As demand for wireless communication services continue to grow, and industry-wide excess inventory levels are consumed, service providers will need to make substantial investments in new equipment and infrastructure. Wireless

## Edgar Filing: SPECTRUM CONTROL INC - Form 10-K

communication systems can offer the functional advantages of wired communication systems without the costly and time consuming development of an extensive wired infrastructure. The relative advantages of wireless and wired communication systems with respect to cost, transmission quality, reliability and other factors depend on the specific applications for which such systems are used and the existence of a wired or wireless infrastructure already in place. The factors responsible for the market's long-term growth, coupled with regulatory changes in the United States and abroad as well as advances in wireless communication technology, have led to significant growth in existing wireless telecommunication systems and the emergence of new wireless applications.

The products designed and manufactured by the Company support a wide range of digital wireless communication protocols, systems and standards including Global System for Mobile Communications ( GSM ), Enhanced Data Rates for GSM Evolution ( EDGE ), Local Multipoint Distribution System ( LMDS ), Multi-Channel Multipoint Distribution System ( MMDS ), Third Generation Wireless ( 3G ), Bluetooth, and Voice over Internet ( VoIP ).

Worldwide demand for integrated voice, data and video communication services continues to increase. The volume of high-speed data traffic across global communications networks has grown dramatically as the public Internet and private business intranets have become essential for daily communications and electronic commerce. The number of persons using the Internet to buy and sell goods and services continues to grow. Servicing the increasing demand for higher bandwidth content and applications requires cost-effective and high-speed connections, which are often unavailable or inadequate over existing wire-based networks. For many users, wireless communications provide an advantageous access solution for high-speed Internet multimedia services. This is underscored by the increasing number of wireless subscribers worldwide.

## **Table of Contents**

A typical mobile or fixed wireless communications system comprises a geographic region containing a number of cells, each of which contains one or more base stations, which are linked in a network to form a service provider's coverage area. Each base station houses the equipment that receives incoming telephone calls from the switching offices of the local wire-based telephone company and broadcasts calls to the wireless users within the cell. A base station can process a fixed number of radio channels through the use of multiple transceivers, power amplifiers and tunable filters, along with an antenna to transmit and receive signals to and from the wireless user. The Company provides discrete EMI filters, filtered arrays, filtered connectors, power integrity products, low phase noise amplifiers, and power management systems to original equipment manufacturers ( OEM s ) of base station equipment. In addition, the Company's products are used in numerous other telecommunication applications including optical networks and switching equipment, wireless modems and local area networks ( LANs ), Internet servers and global positioning systems. Using our solutions-oriented approach, we provide our OEM customers with products tailored to their specific transmission needs, anticipating and solving system architecture and performance.

Worldwide Interoperability for Microwave Access ( WiMAX ) is a technology aimed at providing wireless data over long distances in a variety of ways, from point-to-point links to full mobile cellular-type access. There is currently increasing amounts of development activity in the industry aimed at this emerging technology. The Company has and continues to develop infrastructure-related products for this application.

Approximately 18% of the Company's total revenue during fiscal year 2008 was derived from sales of its products to OEM customers in the communications equipment industry. Most of these products are custom designed not only to conform to the specifications and requirements of the particular customer, but also to meet the performance and quality standards set by the agency or other governmental body whose regulations are applicable to the specific equipment or usage involved. A significant reduction in orders from such customers would have a materially adverse effect on the Company's business.

## **OUR SOLUTION**

We believe we are well positioned to capitalize on our long-term market opportunities. We combine engineering expertise, design and testing capabilities and vertically integrated and flexible manufacturing processes to provide custom solutions to our customers control products and systems needs.

*We Offer Integrated Design, Development and Testing Services.* We provide an integrated approach to problem solving by offering our customers consulting, diagnostic testing and design services. We believe that our testing facilities and capabilities exceed those of our major competitors and, accordingly, may give us a competitive advantage. Our engineers typically work closely with customers to develop a product or system design. Although our customers generally provide the initial engineering guidelines for a particular product, our design engineers are often called upon to work together with a customer's design team to develop a solution. An important part of our solution is ensuring at an early stage, before time and money are spent on manufacturing, that the product design will meet all performance specifications and can be produced efficiently and cost-effectively. Our design engineers include EMI, power, microwave, and sensor specialists. We believe that by integrating our product design and development efforts with those of our customers, we create increased reliance on us and increased incentives to utilize us as a single source strategic supplier.

*We Offer Flexible, Low-Cost Production Capabilities.* Once a design is completed, we apply our vertically integrated manufacturing processes to produce a solution that meets our customers' functionality and cost objectives. We currently maintain a state-of-the-art ceramic production facility in State College, Pennsylvania, with advanced manufacturing equipment primarily designed for the production of specialty ceramic capacitors. These ceramic products are critical components of our signal integrity products. Our State College facility, along with our extensive ceramic expertise, enables us to maintain short lead times for our signal product prototyping and production orders. We also maintain metal fabrication capabilities with computer numerically controlled ( CNC ) equipment to manufacture the metal utilized in many of our power integrity, microwave, sensors, and power management systems product offerings. By performing the metal fabrication in-house, we are able to shorten the lead time for these product offerings and reduce our overall material costs. Our philosophy of vertical integration, along with utilizing demand flow manufacturing processes, enables us to meet the growing OEM customer demands for flexible production schedules and just-in-time inventories.

*We Offer High Quality, High Performance Products.* Our customers demand a high level of quality and performance. We believe we meet our customers' requirements for high quality products manufactured to increasingly exacting specifications, including performance and quality standards that are set by agencies and other governmental bodies whose regulations may apply to specific telecommunications or other equipment. We emphasize a quality culture, driving continuous product improvement and a company-wide commitment to quality. As part of our commitment to high quality manufacturing, all of our domestic and foreign manufacturing facilities have achieved and maintain ISO 9001 certification, and we have been approved by defense customers

Edgar Filing: SPECTRUM CONTROL INC - Form 10-K

under the requirements of the U.S. military quality system. Most of our manufacturing facilities also have achieved and maintain the automotive industry quality standard of QS 9000.

---

## Table of Contents

### **OUR STRATEGY**

Our goal is to increase sales and profits by expanding in our existing markets and by entering new markets where we can apply our design and manufacturing capabilities. Key elements of our strategy for achieving this goal include:

*Leveraging Our Status as a Strategic Supplier to our OEM Customers.* Our status as a strategic supplier to many of our OEM customers presents us with opportunities to develop and design new products for these customers on a collaborative, solutions-oriented basis giving us an advantage over our competitors. We use our position as a strategic supplier to these OEM customers to accelerate the introduction of new, more complex custom electronic products and systems at higher profit margins. We seek to solidify our status as a strategic supplier to our OEM customers by continuing to provide:

- High levels of service;
- Extensive product lines;
- Custom and collaborative product design and manufacturing capabilities;
- Product delivery flexibility and reliability; and
- High quality products

*Introducing New Signal and Power Integrity Product Lines.* We are broadening our product lines to include a more comprehensive range of signal and power integrity products. For example, our product development efforts recently enabled us to introduce a complete line of surface mount filter solutions for addressing EMI at the printed circuit board ( PCB ) level. This new line of surface mount inductors, low pass filters, high frequency filters, and power EMI filters is designed to offer high performance EMI filtering in a minimal PCB footprint. These new products are ideal for applications where smaller size is critical, including certain digital equipment, wireless base stations, modems, digital subscriber line ( DSL ) equipment, global positioning systems ( GPS ), and LAN networking equipment. Other recently developed products include circular connectors (used in numerous military/defense applications) and antenna assemblies. On an ongoing basis, our primary focus is on new higher-margin products to exploit the long-term expected growth in wireless devices, optical networks, medical equipment, and defense applications. Our customers increasingly look for greater capability to produce value-added systems integrating our existing signal and power integrity products. To respond to our customers' needs, we intend increasingly to design and manufacture more sophisticated electronic control systems and assemblies.

*Expanding the Markets for Our Power Management Systems.* We continue to develop and expand our advanced systems product offerings to leverage our core competencies in design, manufacturing and assembly to become a diversified provider of higher margin power management systems. We have successfully introduced our SMART start and SMART start Jr. products. These multifunctional units direct and manage power to connected servers and networking equipment, while providing remote operational flexibility and control. More recently, we have expanded our product offerings to include a full line of off-the-shelf AC power strips. For several years, we have been a reliable and cost effective provider of custom AC power strip solutions for many large OEM customers. By creating a standard line of AC power strips, we are now providing these products to the general marketplace. Typical applications for our AC power strips include data centers, financial centers, communication base stations, portable deployable communication racks, transit cases, and network operating centers. Traditionally, our power management systems have primarily served the communication equipment market. Our current focus for these products has expanded into numerous military/defense applications including Command Post Platforms ( CPP ), Power Entry Panels ( PEP ), and Joint Light Tactical Vehicles ( JLTV ). We expect to continuously develop and introduce new power management system product offerings in the future.

*Pursuing Acquisitions that Enhance Our Product Offerings.* We continue to pursue acquisitions complementary to our core businesses. In addition to our recent acquisition of SatCon, which expanded our microwave capabilities and technologies to include high frequency millimeterwave products, we have made several other acquisitions in the past few years. In 2007, we acquired EMF

Systems, Inc. ( EMF ), a designer and manufacturer of custom oscillator-based products. In addition to a broad line of oscillator components, EMF s products include synthesizers, phase-locked oscillators, and other integrated microwave assemblies. These products further expanded our microwave capabilities and product offerings with additional applications in military radar systems, secure communications, and commercial weather radar. In 2006, we acquired Advanced Thermal Products, Inc. ( ATP ), a designer and manufacturer of custom temperature sensors. ATP s products include temperature sensing probes and assemblies, positive and negative temperature coefficient thermistors, and resistance temperature detector sensors and related assemblies. These products are used in numerous applications within the heating and air conditioning industry, food service, energy management, and electronic controls market. In 2005, we acquired JDK Controls, Inc. ( JDK ). With the acquisition of JDK, we expanded our product offerings to include position sensor and control products, including various potentiometers. Potentiometers (electro-mechanical control devices, converting rotary or linear motion) and other custom position sensors represent an entirely new product area for us with expanded market opportunities. With ATP s temperature sensing products added to JDK s custom precision sensors, we have established Sensors and Controls as the fourth major business segment for our Company. Acquisitions remain a significant element of our overall growth strategy, as we continue to expand our technologies and product offerings within our four business segments.

## **Table of Contents**

With OEM s increasingly demanding higher levels of service and lower overall product costs from their electronic component and systems suppliers, we believe that additional acquisition opportunities will emerge as smaller suppliers with insufficient technical and design expertise and limited access to capital choose to sell to larger organizations with greater technical and financial resources. We also expect to see acquisition opportunities from large manufacturers as they seek to focus their product offerings on those fully utilizing their core competencies.

*Remaining a Low-Cost, Efficient Producer.* Our customers are under worldwide competitive pressure to reduce their product costs and these pressures are passed along to component and systems manufacturers. We are constantly seeking to reduce our material and labor costs, develop cost-efficient manufacturing equipment and processes, and design our manufacturing plants for efficient production. We have been able to reduce the manufacturing cost for many of our products by increasing materials efficiency, improving production yields, and utilizing in-house metal fabrication capabilities. In addition, we have taken steps to reduce assembly direct labor costs by locating plants in areas with relatively low-cost labor, such as Juarez, Mexico and Qiao Tou Town, China (located in the Guangdong province of southern China). We believe our low-cost manufacturing centers in Mexico and China, along with our efforts to continuously reduce other operating costs, enable us to effectively compete in a global marketplace.

## **PRODUCTS**

The Company s product offerings include various signal and power integrity components, microwave components and systems, power management systems, and sensors and controls.

### **SIGNAL INTEGRITY COMPONENTS**

Control of unwanted electromagnetic waves is accomplished through various combinations of EMI suppression devices. The EMI suppression devices produced by the Company include those that are utilized as circuit components and whose function is to permit the desired frequencies to pass through a circuit while rejecting or preventing the unwanted signals. The majority of these products are composed of either reactive (reflecting energy) or loss (dissipating energy) elements or at times, combinations of the two. These products can be utilized as individual components or combined in various configurations to provide the amount of EMI control needed. Currently, the Company s primary signal integrity product offerings include low pass EMI filters, filtered arrays, filtered connectors, and specialty ceramic products.

#### *LOW PASS EMI FILTERS*

The Company s low pass EMI filter offerings include hermetically sealed and resin sealed/solder-in filters and capacitors. The Company s hermetically sealed filters are primarily used in military/secure communications, smart weapons and munitions, aerospace, power supplies, signal lines, and certain medical equipment. Resin sealed/solder-in filters are used in a wide range of products including communications equipment, transceivers, and industrial control systems.

#### *FILTERED ARRAYS*

The Company s filtered array products consist of various filter plate assemblies. Filter plates are predominantly utilized in communications equipment including wireless base stations, linear power amplifiers, and wireless microcell repeaters. This product offering often provides an economical method of meeting electromagnetic compatibility ( EMC ) requirements.

#### *FILTERED CONNECTORS*

The Company offers a range of custom connectors, datacomm interconnects, and D-Subminiature Connectors. These filtered connectors are used in numerous applications including communications equipment, wireless base stations, industrial process equipment, and certain personal computers. Additionally, the Company designs and manufactures various circular connectors used in numerous military applications.

#### *SPECIALTY CERAMIC PRODUCTS*

The Company sells a broad range of specialty ceramic products including miniature discoidal capacitors used in medical implantables, and patch antenna elements and assemblies used in global positioning systems.





## **Table of Contents**

### **POWER INTEGRITY COMPONENTS**

The Company's power product offerings currently include commercial custom assemblies, multisection filters, power line filters, power entry modules, and power terminal blocks. The Company's multisection products primarily serve the military/defense market with applications in satellite communications, electronic warfare, and ground/air weapons systems. Other power products are principally used in communications equipment, including telecommunication racks, wireless base stations, Internet servers, and networks.

During the year ended November 30, 2008, approximately 40% of the Company's total revenue was generated from the sale of signal and power integrity components.

### **MICROWAVE COMPONENTS AND SYSTEMS**

The Company manufactures and sells a wide range of RF and microwave products, including the following:

*RF and Microwave Amplifiers:* These products (which include low phase noise amplifiers, high and low power amplifiers, high reverse isolation amplifiers, and ultra-high linearity amplifiers) are primarily used in wireless base stations and other telecommunications infrastructure equipment.

*RF and Microwave Mixers:* These multioctave, narrowband, and ultra-broadband mixers are predominately used in various broadband telecommunications equipment and CATV.

*Voltage Controlled Oscillators ( VCO ) and Dielectric Resonator Oscillators ( DRO ):* Applications for these VCO, DRO, and frequency control products include weapons guidance systems, communication jamming systems, and other military electronic countermeasures.

*RF and Microwave Filters:* These components (which include bandpass filters, duplexers, lumped element filters, waveguides, and cavity filters) are used in wireless base stations, as well as numerous military, aerospace and medical applications.

*RF and Microwave Systems and Assemblies:* These complex systems, which include multiple channel filter banks and synthesizers, are principally used in radar systems and other military and aerospace applications.

During the year ended November 30, 2008, approximately 35% of the Company's total revenue was generated from the sale of microwave components and systems.

### **POWER MANAGEMENT SYSTEMS**

The Company's advanced systems product offerings currently include AC and DC power distribution units, fuse and breaker interface panels, and remote power management systems. Our power management systems include a line of digital radio-frequency control equipment designed to monitor various functions and equipment and provide automatic management, as well as remote management, through wireless or external communication links. These remote management systems incorporate highly flexible software that enable our customers to control and monitor their systems from remote locations. The primary markets for these systems include optical equipment, data centers, wireless base stations, IT hubs, and various military applications such as secure communications, simulators and unmanned remote vehicles.

During the year ended November 30, 2008, approximately 8% of the Company's total revenue was generated from the sale of power management systems.

### **SENSORS AND CONTROLS**

With the acquisitions of ATP and JDK, the Company now designs and manufactures a broad range of precision position sensors, transducers, temperature sensors, and thermal products. Our position sensor products include motorized potentiometers, fader and hollow shaft potentiometers, element segments and wiper assemblies. Our advanced thermal products consist of temperature sensing probes and assemblies, resistance temperature detector probes and assemblies, and positive and negative temperature coefficient thermistors. Major applications for our sensors and controls product offerings include military/defense aircraft and

Edgar Filing: SPECTRUM CONTROL INC - Form 10-K

vehicles, commercial aerospace, medical equipment, wind instruments, HVAC, industrial automation, and commercial food equipment.

During the year ended November 30, 2008, approximately 17% of the Company's total revenue was generated from the sale of sensors and controls.

**Table of Contents****REPORTABLE OPERATING SEGMENTS**

The Company designs, develops and manufactures custom electronic components and systems.

The Company's current operations are conducted in four reportable segments: signal and power integrity components, microwave components and systems, power management systems, and sensors and controls. The reportable segments are each managed separately because they manufacture and sell distinct products with different production processes.

The Company evaluates performance and allocates resources to its reportable segments based upon numerous factors, including segment income before income taxes. The accounting policies of the reportable segments are the same as those utilized in the preparation of the Company's consolidated financial statements. However, substantially all of the Company's general and administrative expenses, and nonoperating expenses, are not allocated to the Company's reportable operating segments and, accordingly, these expenses are not deducted in arriving at segment income. Segment reportable assets are comprised of certain tangible assets (property, plant, equipment, and inventories) and goodwill.

For each period presented, the accounting policies and procedures used to determine segment income have been consistently applied. For the years ended November 30, 2008, 2007, and 2006, reportable segment information is as follows (in thousands):

	Signal and Power Integrity Components	Microwave Components And Systems	Power Management Systems	Sensors And Controls	Total
2008					
Revenue from unaffiliated customers	\$ 52,060	\$ 45,942	\$ 9,879	\$ 22,813	\$ 130,694
Depreciation and amortization expense	1,990	1,977	258	875	5,100
Segment income	9,343	5,492	1,705	3,771	20,311
Segment assets					
Tangible assets	21,966	21,052	2,854	7,239	53,111
Goodwill	14,243	14,862	-	7,706	36,811
Capital expenditures	1,367	1,938	432	719	4,456
2007					
Revenue from unaffiliated customers	60,713	47,748	7,586	20,492	136,539
Depreciation and amortization expense	1,924	2,041	205	523	4,693
Segment income	11,314	8,791	1,338	2,815	24,258
Segment assets					
Tangible assets	22,030	16,100	2,903	5,946	46,979
Goodwill	14,243	13,720	-	7,706	35,669
Capital expenditures	1,999	1,524	372	1,892	5,787
2006					
Revenue from unaffiliated customers	58,472	48,716	6,657	11,827	125,672
Depreciation and amortization expense	1,739	1,709	109	330	3,887
Segment income	3,754	9,511	2,012	1,407	16,684
Segment assets					
Tangible assets	21,986	14,076	1,190	3,921	41,173
Goodwill	14,243	12,559	-	7,706	34,508
Capital expenditures	6,337	1,189	749	256	8,531

**Table of Contents**

For the years ended November 30, 2008, 2007, and 2006, reconciliations of reportable segment information to the Company's consolidated financial statements are as follows (in thousands):

<b>Depreciation and amortization expense</b>	<b>2008</b>	<b>2007</b>	<b>2006</b>
Total depreciation and amortization expense for reportable segments	\$ 5,100	\$ 4,693	\$ 3,887
Unallocated amounts:			
Depreciation and amortization expense related to general and administrative activities	81	130	224
Consolidated depreciation and amortization expense	\$ 5,181	\$ 4,823	\$ 4,111
<b>Income before provision for income taxes</b>	<b>2008</b>	<b>2007</b>	<b>2006</b>
Total income for reportable segments	\$ 20,311	\$ 24,258	\$ 16,684
Unallocated amounts:			
General and administrative expense	(6,967)	(6,394)	(7,370)
Interest expense	(369)	(561)	(545)
Other income, net of other expense	505	255	270
Consolidated income before provision for income taxes	\$ 13,480	\$ 17,558	\$ 9,039
<b>Assets</b>	<b>2008</b>	<b>2007</b>	<b>2006</b>
Total assets for reportable segments	\$ 89,922	\$ 82,648	\$ 75,681
Unallocated amounts:			
Cash and cash equivalents	5,397	5,183	3,501
Accounts receivable	24,043	25,461	22,676
Other current assets	3,991	2,243	4,531
Other noncurrent assets	11,431	11,384	12,818
Total consolidated assets	\$ 134,784	\$ 126,919	\$ 119,207
<b>Capital expenditures</b>	<b>2008</b>	<b>2007</b>	<b>2006</b>
Total capital expenditures for reportable segments	\$ 4,456	\$ 3,281	\$ 8,531
Unallocated amounts:			
Capital expenditures related to general and administrative activities	26	43	23
Total consolidated capital expenditures	\$ 4,482	\$ 3,324	\$ 8,554

**Table of Contents**

The Company has operations in the United States, Mexico, Germany and China. Sales are attributed to individual countries based on the location of the customer. The geographic distribution of sales and long-lived assets for 2008, 2007, and 2006, is as follows (in thousands):

	United States	Mexico	Germany	China	All Other Countries	Total
<b>2008</b>						
Revenue from unaffiliated customers	\$ 101,891	\$ 1,122	\$ 4,231	\$ 3,652	\$ 19,798	\$ 130,694
Long-lived assets:						
Property, plant and equipment	25,599	71	22	1,558	-	27,250
<b>2007</b>						
Revenue from unaffiliated customers	107,740	735	5,726	5,398	16,940	136,539
Long-lived assets:						
Property, plant and equipment	24,607	95	30	1,445	-	26,177
<b>2006</b>						
Revenue from unaffiliated customers	99,403	1,376	5,327	3,710	15,856	125,672
Long-lived assets:						
Property, plant and equipment	22,682	93	27	1,434	-	24,236

The Company expects that international sales will continue to account for a significant portion of its total sales. There can be no assurance, however, that the Company will be able to maintain or increase international demand for the Company's products or that the Company will be able to effectively meet that demand. The Company's international sales are denominated in several different currencies including U.S. Dollars, British Pounds Sterling, and the Euro. An increase in the value of these currencies relative to other foreign currencies could make the Company's products more expensive and, therefore, potentially less competitive in those markets. Additional risks inherent in the Company's international business activities include potentially adverse tax consequences, repatriation of earnings, and the burdens of complying with a variety of foreign laws. There can be no assurance that such factors will not have an adverse effect on the Company's future results of operations.

In 2008, the Company's largest single customer (a prime supplier to the military/defense industry) represented 4% of total consolidated net sales. Sales to this major customer consisted of various signal, power and microwave components and systems.

In 2007, sales to the Company's largest single customer (a distributor of electronic components) represented 5% of the Company's total consolidated net sales. Sales to this major customer principally consisted of signal and power integrity components.

In 2006, sales to the Company's largest single customer (a prime supplier to the military/defense industry) represented 7% of the Company's total consolidated net sales. Sales to this major customer primarily consisted of microwave components and systems.

## **Table of Contents**

### **PRODUCTION**

The Company substantially relies on its internal manufacturing capabilities for production of its custom products and systems. At its facility in State College, Pennsylvania, the Company designs and manufactures various ceramic components including tubular capacitors, discoidal capacitors, and resonators. Tubular and discoidal capacitors are primarily utilized in the manufacture of signal integrity products at the Company's facility in Fairview, Pennsylvania and its low-cost manufacturing center in Juarez, Mexico. Coaxial ceramic dielectric resonators are principally used in the manufacture of bandpass filters and duplexers at the Company's facility in Juarez, Mexico.

The Company designs and manufactures its microwave products in several locations including: Philadelphia and State College, Pennsylvania; Delmar, Delaware; Palm Bay, Florida; Marlborough, Massachusetts; and Columbia, Maryland. Manufacturing at these facilities primarily relates to military products and certain low-volume commercial components. Many of the Company's commercial microwave products are manufactured at our facility in Juarez, Mexico. The design and manufacture of most of our sensors and control products occur in Grass Valley, California (position sensors) and St. Marys, Pennsylvania (temperature sensors). Our power management systems are designed in State College, Pennsylvania. Manufacturing of these products for military and defense applications occur in State College, while most commercial applications for these systems are manufactured at our facility in Qiao Tou Town, China. The design of our power integrity components is currently performed at our facility in Fairview, Pennsylvania, with the manufacturing of these products conducted at our facilities in Juarez, Mexico; Wesson, Mississippi; Qiao Tou Town, China; and Fairview, Pennsylvania. Although the Company produces a standardized line of products for sale from inventory or through distributors, most orders require relatively short production runs of custom designed components.

The Company purchases brass bushings, castings, miniature metal stampings, as well as other hardware used in the assembly and production of its products. These items are available from numerous sources. The principal raw materials used by the Company in the manufacture of ceramic capacitors and resonators are barium titanate ceramic, silver, palladium, and platinum. Precious metals are available from many sources; however, their prices may be subject to significant fluctuations and such fluctuations may have a material and adverse affect on the Company's operating results.

The Company's customers demand a high level of quality. As a result, the Company maintains an extensive quality control system designed to meet the requirements of sophisticated defense and commercial products. The Company has been approved by defense customers under the requirements of the U.S. military quality system, which approval is also often accepted by commercial customers. In addition, all of the Company's facilities have achieved and maintain ISO 9001 certification, and most of the Company's North American facilities have achieved and maintain the automotive industry quality standard of QS 9000.

In recent years, a majority of the Company's capital investment has been expended to establish new production lines and improve manufacturing processes. There can be no assurance that the Company can continue to make such investments in a timely manner so as to take advantage of market demand.

### **SALES AND DISTRIBUTION**

The Company sells its products through a combination of manufacturers' representatives, internal sales force, and distribution. The Company maintains representatives throughout North America and Europe, and portions of South America, Asia and the Middle East. The Company's internal sales organization includes employees dedicated to certain microwave product sales, new business development, and distribution sales management. In fiscal 2008, approximately 15% of the Company's consolidated sales was through distribution. Domestic distribution is done through various national and regional distributors. International distribution is primarily done through the Company's wholly-owned German subsidiary, Spectrum Control GmbH.

During fiscal year 2008, the Company sold its products to approximately 1,600 accounts. Sales of products to the Company's top ten customers represented 25% (\$32.3 million) of total consolidated net sales in 2008. The top ten customers primarily consist of military/defense prime contractors and original equipment manufacturers of communications or medical equipment. All of the Company's major customers are unaffiliated with Spectrum Control, Inc. and its subsidiaries.

Shipments are made by common carrier. Most of the Company's signal integrity, sensors, and microwave products are either small or miniaturized and light weight. Accordingly, shipping charges for these products are not significant to the Company's business. However, transportation costs for the Company's power integrity products and power management systems may be significant. Accordingly, shipping charges and delivery time for these products may affect the Company's ability to compete for business, particularly in international markets.

No material portion of the Company's business is subject to renegotiation of profits or termination of contracts or sub-contracts at the election of the U.S. Government.

---

**Table of Contents****BACKLOG**

The Company's backlog, which consists of purchase orders by customers, totaled approximately \$69.9 million at November 30, 2008 and \$48.1 million at November 30, 2007. As part of our acquisition of SatCon in September of 2008, we assumed their sales order backlog of \$12.9 million. It is anticipated that approximately 90% of the Company's backlog as of November 30, 2008 will be shipped within one year. Annual requirement contracts are taken into backlog only to the extent that orders are actually released thereunder. Although the terms and conditions contained in the Company's quotation forms place certain restrictions on a customer's right to cancel, purchase orders generally provide for cancellation. In practice, the Company negotiates each cancellation and schedule change based on the cost it has incurred prior to such occurrence. The Company expects to continually reduce its average lead time (the length of time from the receipt of a customer order to shipment of finished product to the customer). As a result, the Company's backlog may decrease in the future due to reduced lead times.

**EMPLOYEES**

As of November 30, 2008, the Company had a total of 1,516 employees, including 65 in sales, marketing and customer support; 135 in engineering, product development and technical support; 1,278 in manufacturing; and 38 in finance, accounting and administration. The Company's future success depends in significant part upon the continued service of its key technical and senior management personnel and its continued ability to attract and retain highly qualified technical and managerial personnel. Competition for such personnel is intense, and there can be no assurance that the Company can retain its key managerial and technical employees or that it can attract, assimilate, or retain other highly qualified technical and managerial personnel in the future. None of the Company's employees is represented by a labor union. The Company has not experienced any work stoppages and considers its relations with its employees to be good.

**PROPRIETARY RIGHTS**

The Company relies on trade secrets, know-how, and to a lesser extent patents, to establish and protect proprietary rights to technologies and products. Trade secrets and know-how are protected through confidentiality agreements and internal procedures. In connection with the manufacture and sale of its custom products and systems, the Company owns numerous United States and foreign patents and has certain patents pending. None of these patents and patent applications are critical to the Company's business. The Company's policy is to file patent applications to protect proprietary technology, inventions and improvements. There can be no assurance that patents will issue from any of the Company's pending applications or that any claims allowed from existing or pending patents will be sufficiently broad to protect the Company's technology. While the Company intends to protect its intellectual property rights vigorously, there can be no assurance that any patents held by the Company will not be challenged, invalidated or circumvented, or the rights granted thereunder will provide competitive advantages to the Company.

The Company currently holds three (3) United States patents relating to polymer multilayer technology. The Company has entered into several agreements regarding licensing the technology covered by these patents. However, it is not known what commercial value, if any, these patents and related licenses may have.

**ENVIRONMENTAL MATTERS**

On December 30, 2005, we acquired certain land and ceramic manufacturing facilities in State College, Pennsylvania. The property, which was acquired from Murata Electronics North America ( Murata ), consists of approximately 53 acres of land and 250,000 square feet of manufacturing facilities. Among other uses, the acquired facilities have become the design and manufacturing center for our ceramic operations, replacing the ceramic operations previously conducted in New Orleans, Louisiana.

The purchase price for the acquired property consisted of: (a) \$1.00, plus (b) closing costs of \$695,000 including realtor commissions, transfer taxes, and legal fees; plus (c) the assumption of, and indemnification of Murata against, all environmental liabilities related to the property. The acquired property has known environmental conditions that require remediation, and certain hazardous materials previously used on the property have migrated into neighboring third party areas. These environmental issues arose from the use of chlorinated organic solvents including tetrachloroethylene ( PCE ) and trichloroethylene ( TCE ). As a condition to the purchase, we entered into an agreement with the Pennsylvania Department of Environmental Protection ( PADEP ) pursuant to which: (a) we agreed to remediate all known environmental conditions relating to the property to a specified industrial standard, with our costs for remediating such conditions being capped at \$4.0 million; (b) PADEP released Murata from further claims by Pennsylvania under specified state laws for the known environmental condition; and (c) we purchased an insurance policy



Edgar Filing: SPECTRUM CONTROL INC - Form 10-K

providing clean-up cost cap coverage (for known and unknown pollutants) with a combined coverage limit of approximately \$8.2 million, and pollution legal liability coverage (for possible third party claims) with an aggregate coverage limit of \$25.0 million. The total premium cost for the insurance policy, which has a ten year term and an aggregate deductible of \$650,000, was \$4.8 million. The cost of the insurance associated with the environmental clean-up (\$3.6 million) is being charged to general and

## **Table of Contents**

administrative expense in direct proportion to the actual remediation costs incurred. The cost of the insurance associated with the pollution legal liability coverage (\$1.2 million) is being charged to general and administrative expense on a pro rata basis over the ten year policy term.

Based upon our environmental review of the property, we recorded a liability of \$2.9 million to cover probable future environmental expenditures related to the remediation, the cost of which is expected to be entirely covered by the insurance policy. As of November 30, 2008, remediation expenditures of \$1.6 million have been incurred and charged against the environmental liability, with all such expenditures being reimbursed by the insurance carrier. The remaining aggregate undiscounted expenditures of \$1.3 million, which are anticipated to be incurred over the next seven years, principally consist of: (a) continued operation and monitoring of the existing on-site groundwater extraction, treatment, and recharge system; (b) implementation of a chemical oxidation system; (c) completion of soil investigations to determine the extent of potential soil contamination; (d) excavation and off-site disposal of soil containing contaminants above acceptable standards; and (e) implementation of soil vapor extraction systems in certain areas. Depending upon the results of future environmental testing and remediation actions, it is possible that the ultimate costs incurred could exceed the current aggregate estimate of \$2.9 million. We expect such increase, if any, to be entirely covered by the insurance policy. Insurance recoveries for actual environmental remediation costs incurred are recorded when it is probable that such insurance reimbursement will be received and the related amounts are determinable. Such insurance recoveries are credited to our general and administrative expense. Based on the current remediation plan, \$269,000 of the total remediation costs is expected to be incurred during the next twelve months.

We are subject to various laws and governmental regulations concerning environmental matters and employee safety and health in the United States and other countries. U.S. federal environmental legislation having particular impact on us includes the Toxic Substances Control Act; the Resource Conservation and Recovery Act; the Clean Air Act; the Clean Water Act; and the Safe Drinking Water Act. We also are subject to regulation by the Occupational Safety and Health Administration ( OSHA ) concerning employee safety and health matters. The United States Environmental Protection Agency ( EPA ), OSHA, and other federal agencies have the authority to promulgate regulations that have an impact on our operations.

In addition to these federal agencies, various states have been delegated certain authority under the aforementioned federal statutes. Many state and local governments have adopted environmental and employee safety and health laws and regulations, some of which are similar to federal requirements. State and federal authorities may seek fines and penalties for violation of these laws and regulations. As part of our continuing environmental program, we have been able to comply with such proceedings and orders without any materially adverse effect on our business. We are not currently involved in any significant legal proceedings involving environmental matters.

## **GOVERNMENT REGULATIONS**

In order to qualify as an approved supplier of products for use in equipment purchased by the military services or aerospace programs, the Company is required to meet the applicable portions of the quality specifications and performance standards designed by the Air Force, the Army, and the Navy. The Company's products must also conform to the specifications of the Defense Electronic Supply Center for replacement parts supplied to the military. To the extent required, the Company meets or exceeds all of these specifications.

The Company's products are often incorporated into communications systems which are subject to various FCC regulations. Regulatory changes, including changes in the allocation of available frequency spectrum, could significantly impact the Company's operations by restricting development efforts by the Company's customers, obsoleting current products or increasing the opportunity for additional competition. Changes in, or the failure by the Company to comply with, applicable domestic and international regulations could have an adverse effect on the Company's business, operating results and financial condition. In addition, the increasing demand for wireless communications has exerted pressure on regulatory bodies worldwide to adopt new standards for such products and services, generally following extensive investigation of and deliberation over competing technologies. The delays inherent in this government approval process may cause the cancellation, postponement or rescheduling of the installation of communications systems by the Company's customers, which in turn may have a material adverse effect on the sale of products by the Company to such customers.

## **Table of Contents**

### **COMPETITION**

The markets for the Company's products are intensely competitive and are characterized by technological change and product obsolescence. The principal competitors of our Signal Integrity Components Business include Amphenol Corporation; Conec Corporation; ITT Canon, an ITT Industries Company; and Tusonix, Inc. (recently acquired by CTS Corporation). The primary competitors of our Power Integrity Components Business include Corcom, a Tyco Electronics company; Delta Group Electronics, Inc.; Schaffner Holder AG; and Captor Corporation. The major competitors of our Power Management Systems include Emerson Network Power; Peco II, Inc.; Dataprobe, Inc.; Western Telematic, Inc.; and Dantel, Inc. Major competitors for our Microwave Components and Systems Business include K&L Microwave, a Dover company; Lorch Microwave, a Smiths Group company; Teledyne Cougar; M/A Com, a Tyco Electronics Company; and Murata Manufacturing Company. Competition for our Sensors and Controls Business comes from many sources including Betatronix, LLC; BetaTHERM Corporation; Honeywell Sensing and Controls; Thermalogic Corporation; and Smith Systems, Inc. Many of the Company's current and potential competitors have significantly greater financial, technical, manufacturing, and marketing resources than the Company. These competitors may be able to engage in sustained price reductions in the Company's primary markets to gain market share. Furthermore, the Company currently supplies custom products and systems to large OEM customers that are continuously evaluating whether to manufacture their own products and systems or purchase them from outside sources.

The Company believes that its ability to compete in its current markets depends on factors both within and outside the Company's control, including the timing and success of new product introductions by the Company and its competitors, availability of ceramic and assembly manufacturing capability, the Company's ability to support decreases in selling price through operating cost reductions, adequate sources of raw materials, product quality, and general economic conditions. There can be no assurance that the Company will be able to compete successfully in the future.

### **RESEARCH AND DEVELOPMENT**

The Company's position as a leading designer, developer and manufacturer of custom products and systems is largely the result of a long history of technological innovation. The Company's research and development efforts are focused on expanding the Company's materials technology, improving existing product offerings, developing new product offerings, and designing specialized production equipment to improve manufacturing efficiencies. As of November 30, 2008 the Company employed 135 individuals in engineering, technical support, and product development. In addition to their design and development activities, the engineering staff participates with the Company's marketing department in proposal preparation and applications support for customers. Research and development expense was \$3.7 million in 2008, \$3.5 million in 2007, and \$3.1 million in 2006.

### **WEBSITE ACCESS TO COMPANY REPORTS AND GOVERNANCE DOCUMENTS**

The Company's annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and all amendments to those reports are available free of charge on the Company's website at [www.spectrumcontrol.com](http://www.spectrumcontrol.com) as soon as reasonably practicable after such material is electronically filed with or furnished to the Securities and Exchange Commission. Copies of the Company's annual report are also available, free of charge, upon written request. Charters of the Company's Audit Committee, Compensation Committee, and Nominating and Corporate Governance Committee, along with the Company's Code of Ethics and other governance documents, are available for viewing on the Company's website.

### **OTHER MATTERS**

The business of the Company is not subject to any significant seasonal fluctuations.

The Company does not believe that it has any special practices or special conditions affecting working capital items that are significant for an understanding of its business.

**Table of Contents**

**Item 1A. Risk Factors**

The markets in which we compete are characterized by rapidly changing technologies, evolving industry standards and frequent improvements in products and services. If technologies supported by our products become obsolete or fail to gain widespread acceptance, as a result of a change in the industry standards or otherwise, our business could be harmed. Our future success will depend in part on factors including our ability to establish close working relationships with major customers for the design of their new systems and products; our ability to identify, develop and achieve market acceptance of new products that address technologies and meet our customer needs; our ability to continue to apply our expertise and technologies to existing and emerging markets; and our ability to achieve acceptable product costs on new products.

A number of factors could cause the market price of our common stock to fluctuate significantly, including: our quarterly operating results or those of our competitors; the public's reaction to our press releases, announcements, and our filings with the Securities and Exchange Commission; changes in earning estimates or recommendations by research analysts; changes in general economic conditions in the U.S. and worldwide; changes in industry-wide conditions, particularly within the military/defense, communications, and medical equipment markets; and developments affecting our competitors. In addition, the U.S. stock market has recently experienced extreme price and volume fluctuations. This volatility has had a significant effect on the market price of securities issued by many companies for reasons unrelated to the operating performance of these companies.

Other risk factors applicable to the Company are discussed under the heading Risk Factors That May Affect Future Results included in Management's Discussion and Analysis of Financial Condition and Results of Operations as set forth herein.

**Item 1B. Unresolved Staff Comments**

None

**Table of Contents****ITEM 2. PROPERTIES**

The Company's principal manufacturing and office facilities as of November 30, 2008 are as follows:

<b>LOCATION</b>	<b>FUNCTION</b>	<b>APPROXIMATE SQUARE FEET OF FLOOR AREA</b>	<b>OWNERSHIP</b>	<b>PRINCIPAL BALANCE OUTSTANDING AT 11/30/08 ON RELATED MORTGAGE</b>
8061 Avonia Road Fairview, PA	Manufacturing, EMI Testing	43,000	Owned	N/A
1900 West College Avenue State College, PA	Manufacturing	250,000	Owned	N/A
7100 Gateway Drive Columbia, MD	Design Center	7,000	Rented	N/A
3053 Hwy. 51N Wesson, MS	Manufacturing	55,000	Owned	\$ 605,000
38166 Old Stage Road Delmar, DE	Manufacturing	15,000	Owned	N/A
2144 Franklin Drive NE Palm Bay, FL	Manufacturing	51,000	Owned	N/A
2707 Black Lake Place Philadelphia, PA	Manufacturing	20,000	Owned	N/A
165 Cedar Hill Street Marlborough, MA	Manufacturing	26,000	Rented	N/A
424 Crown Point Circle Grass Valley, CA	Manufacturing	16,000	Rented	N/A
328 State Street St. Marys, PA	Manufacturing	22,000	Owned	N/A

Edgar Filing: SPECTRUM CONTROL INC - Form 10-K

Boulevard Zaragoza 2910	Manufacturing	50,000	Rented	N/A
Ciudad Juarez, Mexico				
2 <sup>nd</sup> Industrial Area	Manufacturing	75,000	Rented	N/A
North Ling Tou				
Industrial Road				
Qiao Tou Town				
Dong Guan City				
Guang Dong Province				
China				
8031 Avonia Road	Corporate Offices	10,000	Owned	\$ 427,000
Fairview, PA				

(1) The Company's manufacturing and office space are considered adequate for its existing requirements and its projected business needs.

(2) In addition to the facilities described above, the Company leases certain sales office and warehousing space.

**Table of Contents****ITEM 3. LEGAL PROCEEDINGS**

The Company is subject to certain legal proceedings and claims arising in the ordinary course of business. In the opinion of management, the amount of any ultimate liability with respect to these actions will not materially affect the Company's consolidated financial position or results of operations.

**ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS**

No matters were submitted to a vote of security holders during the quarter ended November 30, 2008.

**PART II****ITEM 5. MARKET FOR THE REGISTRANT'S COMMON STOCK, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES**

The Company's Common Stock is traded on the NASDAQ Stock Market under the symbol SPEC. The high and low sales prices for the Common Stock for each quarter during fiscal years 2008 and 2007 are set forth below.

	<b>High</b>	<b>Low</b>
<b>Fiscal 2008</b>		
First quarter	\$ 15.75	\$ 8.73
Second quarter	9.34	7.86
Third quarter	9.30	7.03
Fourth quarter	8.14	3.30
	<b>High</b>	<b>Low</b>
<b>Fiscal 2007</b>		
First quarter	\$ 12.15	\$ 8.77
Second quarter	15.50	10.25
Third quarter	17.78	12.62
Fourth quarter	17.27	13.82

At January 30, 2009, the Company had 12,571,293 shares of Common Stock outstanding, which were held by approximately 1,100 registered stockholders. In recent years, the Company has not paid cash dividends on its Common Stock. While subject to periodic review, the current policy of the Board of Directors is to retain all earnings to provide funds for the future growth of the Company.

**Table of Contents**

The following table sets forth information as of November 30, 2008 with respect to compensation plans under which equity securities of the Company are authorized for issuance.

Plan Category	(I)	(II)	(III)
	Number of securities to be issued upon exercise of outstanding options	Weighted-average exercise price of outstanding options	Number of securities remaining available for future issuance under plans (excluding securities listed in Column (I))
Equity compensation plans approved by security holders	1,103,734	\$7.48	1,205,983
Equity compensation plans not approved by security holders	-	-	-
<b>Total</b>	<b>1,103,734</b>	<b>\$7.48</b>	<b>1,205,983</b>

The Board of Directors has authorized the Company to repurchase up to \$16.0 million of the Company's Common Stock at market prices. The amount and timing of the shares to be repurchased are at the discretion of management, and there is no current expiration date for the Board's authorization. During the fourth quarter of fiscal 2008, the Company repurchased the following shares:

Period	Total Number of Shares Purchased	Average Price Paid Per Share	Number of Shares Purchased Under Publicly Announced Plan	Remaining Dollar Value of Shares That May Yet be Purchased
September 2008	5,264	\$ 7.07	5,264	\$ 5,836,000
October 2008	194,518	\$ 6.94	194,518	\$ 4,487,000
November 2008	45,302	\$ 6.07	45,302	\$ 4,211,000
	245,084	\$ 6.78	245,084	

Since the inception of the stock buyback program, the Company has repurchased 1,677,479 shares at an aggregate cost of \$11.8 million. The repurchased shares are held as treasury stock.

The following table shows the Company's total return to shareholders compared to the S&P 500 Index, the NASDAQ U.S. Index, and the NASDAQ Electronic Components Stock Index over the five year period from 2004 through 2008. The table assumes that \$100 was invested on December 1, 2003, in the Company's Common Stock and in each of the other indices.

2003 2004 2005 2006 2007 2008



Edgar Filing: SPECTRUM CONTROL INC - Form 10-K

Spectrum	\$ 100	\$ 103	\$ 88	\$ 122	\$ 205	\$ 58
S&P 500	\$ 100	\$ 111	\$ 118	\$ 132	\$ 140	\$ 85
NASDAQ U.S.	\$ 100	\$ 107	\$ 115	\$ 125	\$ 135	\$ 80
NASDAQ Electronic Components Stock Index	\$ 100	\$ 76	\$ 80	\$ 87	\$ 95	\$ 50

**Table of Contents****ITEM 6. Selected Financial Data**

	Years Ended November 30				
	(Amounts in Thousands, Except Per Share Data )				
	2008	2007	2006	2005	2004
<b>Operations</b>					
Net sales	\$ 130,694	\$ 136,539	\$ 125,672	\$ 98,354	\$ 80,477
Gross margin	32,762	36,363	28,780	25,775	22,549
Income from operations	13,344	17,864	9,314	7,134	6,705
Interest expense	369	561	545	110	112
Income before provision for income taxes	13,480	17,558	9,039	7,323	6,777
Net income	8,851	11,141	5,871	4,605	4,167
Earnings per common share :					
Basic	\$ 0.68	\$ 0.83	\$ 0.45	\$ 0.35	\$ 0.32
Diluted	\$ 0.67	\$ 0.81	\$ 0.44	\$ 0.35	\$ 0.32
Weighted average common shares outstanding :					
Basic	13,069	13,359	13,127	13,054	13,012
Diluted	13,189	13,798	13,381	13,160	13,162
<b>Financial Position</b>					
Working capital	\$ 42,590	\$ 43,277	\$ 31,808	\$ 39,470	\$ 42,291
Total assets	134,784	126,919	119,207	98,002	91,349
Long-term debt	545	1,031	1,131	1,426	1,716
Stockholders' equity	103,291	101,868	88,599	81,361	76,842

This table should be read in conjunction with the related consolidated financial statements; notes to consolidated financial statements, and management's discussion and analysis of financial condition and results of operations.

---

## **Table of Contents**

### **Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations**

The following discussion and analysis should be read in conjunction with, and is qualified in its entirety by reference to, the consolidated financial statements and related notes appearing elsewhere in this annual report. All references to we, us, our, or the Company in the following discussion and analysis mean Spectrum Control, Inc. and its Subsidiaries.

#### **Overview**

We design, develop and manufacture custom electronic components and systems. Although our components and systems are used in many industries worldwide, our largest individual markets are military/defense and communications equipment which represented 48.0% and 18.0%, respectively, of our fiscal 2008 sales. Military/defense applications for our products include secure communications, smart weapons and munitions, countermeasures for improvised explosive devices, radar systems, military aircraft and vehicles, and missile defense systems. In communications, our products are used in numerous systems including wireless base stations, broadband switching equipment, global positioning systems, wi-fi, and optical networks. Other markets for our products include medical imaging equipment and instrumentation, industrial automation and controls, computers, IT hubs, and storage devices.

Our operations are currently conducted in four reportable segments: signal and power integrity components; microwave components and systems; power management systems; and sensors and controls. Our Signal and Power Integrity Components Business designs and manufactures a broad range of products including coaxial filters, filtered connectors, power filters, antennas, and various specialty ceramic components. Our Microwave Components and Systems Business designs and manufactures radio frequency and microwave filters, amplifiers, frequency mixers, oscillators, synthesizers, multiple channel filter banks, and related products and integrated assemblies. The Power Management Systems Business designs and manufactures custom AC and DC power distribution units, power outlet strips, and our Smart Start power management systems. Our Sensors and Controls Business designs and manufactures rotary and linear precision sensors, temperature sensing probes, thermistors, resistance temperature detector sensors, and related assemblies.

We recognize revenue when all significant contractual obligations have been met, the sales price is fixed and determinable, and the collection of the resulting receivable is reasonably assured. As a result, product sales are generally recorded at the time of shipment when title passes under the terms FOB shipping point or Ex Works. Payments received from customers in advance of products shipped are recorded as deferred revenue until earned.

#### **Acquisitions**

On September 26, 2008, we acquired substantially all of the assets and assumed certain liabilities of SatCon Electronics, Inc. ( SatCon ). SatCon, based in Marlborough, Massachusetts, designs and manufactures high performance microelectronic components used in numerous military and commercial applications, including secure communication systems and high frequency wireless devices. These sophisticated products include hybrid components and subsystems, signal converters, and a full line of thin and thick film circuits. The aggregate cash purchase price for SatCon was \$5.6 million.

On January 26, 2007, we acquired substantially all of the assets and assumed certain liabilities of EMF Systems, Inc. ( EMF ). EMF, based in State College, Pennsylvania, designs and manufactures custom oscillator-based products. In addition to a broad line of oscillator components, EMF primarily designs and manufactures integrated microwave assemblies ( IMA ), including synthesizers and phase-locked oscillators. These IMA products are used in numerous military and commercial applications such as military radar systems, secure communications, and commercial weather radar. The aggregate cash purchase price for EMF was \$2.4 million.

On July 14, 2006, we acquired all of the outstanding common stock of Advanced Thermal Products, Inc. ( ATP ). ATP, based in St. Marys, Pennsylvania, designs and manufactures a broad line of custom temperature sensors. ATP's products include temperature sensing probes and assemblies, positive and negative temperature coefficient thermistors, and resistance temperature detector sensors and related assemblies. These products are used in numerous applications within the heating and air conditioning industry, consumer electronics, energy management, food service and electronic controls market. The aggregate cash purchase price for ATP was \$9.5 million.

**Table of Contents****Management's Discussion and Analysis of Financial Condition and Results of Operations (Continued)**

For each of these acquisitions, the purchase price was primarily funded by borrowings under our domestic line of credit, except the acquisition of EMF which was entirely funded through our available cash reserves. The results of operations of the acquired businesses have been included in the accompanying consolidated financial statements since their respective acquisition dates. Accordingly, our consolidated net sales for the years ended November 30, 2008, 2007, and 2006 include the following amounts related to these acquired businesses (in thousands):

	2008	2007	2006
SatCon	\$ 2,289	\$ -	\$ -
EMF	2,007	3,164	-
ATP	9,781	9,080	3,561

For operating segment purposes, SatCon and EMF are reported within our Microwave Components and Systems business segment, while ATP is included within our Sensors and Controls business segment.

**Forward-Looking Information**

The following discussion includes certain forward-looking statements within the meaning of the federal securities laws, including statements regarding: (1) our belief as to future market conditions for our products, (2) our projected capital expenditures, (3) our anticipated research and development expenses, and (4) our expected future operating requirements and financing needs. The words believe, expect, anticipate and similar expressions identify forward-looking statements. These forward-looking statements are subject to certain risks and uncertainties which could cause actual results to differ materially from historical results or those anticipated. Factors that could cause or contribute to such differences include those discussed in Risk Factors That May Affect Future Results, as well as those discussed elsewhere herein. Readers are cautioned not to place undue reliance on these forward-looking statements.

---

**Table of Contents**

**Management's Discussion and Analysis of Financial Condition and Results of Operations (Continued)**

**Executive Summary**

During fiscal 2008, our consolidated sales were \$130.7 million, a decrease of \$5.8 million or 4.3% from fiscal 2007. This decrease primarily reflects the following: (1) reductions in shipments for certain major military/defense programs dealing with RCIED (Radio Controlled Improvised Explosive Devices) Jammer Systems, and (2) soft market conditions in certain sectors of the telecom equipment industry. In 2008, total shipments in support of RCIED Jammer Systems were approximately \$3.0 million, compared to \$14.5 million in 2007 when these systems were given special priority under the Department of Defense Operation Iraqi Freedom Support . These RCIED programs remain active, with orders and shipments for system upgrades expected to continue throughout fiscal 2009 at volumes and rates similar to 2008. In 2008, the decrease in shipments supporting these Jammer Systems was partially offset by \$2.3 million of SatCon product sales and increased microwave product shipments under numerous other military/defense programs. Sales of our power management systems, as well as our sensors and controls, continued to grow in the current year. Aggregate shipments for these products were \$32.7 million in fiscal 2008, up \$4.6 million or 16.4% from fiscal 2007.

In fiscal 2008, our gross margin was \$32.8 million or 25.1% of sales, compared to \$36.4 million or 26.6% of sales in fiscal 2007. In addition to the impact of reduced sales volume, the decrease in gross margin principally reflects additional manufacturing overhead expense, including higher personnel costs and depreciation expense, as well as poorer absorption of manufacturing overhead with lower than expected production volumes. Selling, general and administrative expense was \$19.4 million or 14.9% of sales in 2008, compared to \$18.5 million or 13.5% of sales in 2007. This increase primarily reflects additions to travel expense, effective sales commission rates, equity-based compensation, and legal and professional fees.

Overall, we generated net income of \$8.9 million or 68 cents per share (67 cents diluted) in fiscal 2008, compared to net income of \$11.1 million or 83 cents per share (81 cents diluted) in fiscal 2007.

Our Board of Directors has authorized the Company to repurchase up to \$16.0 million of the Company's Common Stock at market prices. The amount and timing of the shares to be repurchased are at the discretion of management. In fiscal year 2008, we repurchased 1,001,479 shares at an aggregate cost of \$8.2 million. Since the inception of the stock buyback program, we have repurchased 1,677,479 shares at an aggregate cost of \$11.8 million. The repurchased shares are held as treasury stock.

During the year ended November 30, 2008, net cash provided by operating activities amounted to \$9.9 million. This positive cash flow, combined with \$8.0 million of borrowings under our domestic line of credit, enabled us to fund the stock repurchase program as well as expend \$4.5 million on capital equipment additions and \$5.6 million for the acquisition of SatCon.

At November 30, 2008, our cash and cash equivalents were \$5.4 million, our current ratio was 2.98 to 1.00, and our total debt to equity was 0.30 to 1.00.

**Table of Contents****Management's Discussion and Analysis of Financial Condition and Results of Operations (Continued)****Results of Operations**

The following table sets forth certain financial data, as a percentage of net sales, for the years ended November 30, 2008, 2007, and 2006:

	2008	2007	2006
Net sales	100.0%	100.0%	100.0%
Cost of products sold	74.9	73.4	77.1
Gross margin	25.1	26.6	22.9
Selling, general and administrative expense	14.9	13.5	15.5
Income from operations	10.2	13.1	7.4
Other income (expense)			
Interest expense	(0.3)	(0.4)	(0.4)
Other income and expense, net	0.4	0.2	0.2
Income before provision for income taxes	10.3	12.9	7.2
Provision for income taxes	3.5	4.7	2.5
Net income	6.8%	8.2%	4.7%

The following table sets forth our net sales by reportable operating segments for the years ended November 30, 2008, 2007, and 2006 (in thousands):

	2008	2007	2006
Signal and power integrity components	\$ 52,060	\$ 60,713	\$ 58,472
Microwave components and systems	45,942	47,748	48,716
Power management systems	9,879	7,586	6,657
Sensors and controls	22,813	20,492	11,827
	\$ 130,694	\$ 136,539	\$ 125,672

**2008 Compared to 2007***Net Sales*

## Edgar Filing: SPECTRUM CONTROL INC - Form 10-K

Our consolidated net sales were \$130.7 million in fiscal 2008, a decrease of \$5.8 million or 4.3% from fiscal 2007. This decrease primarily reflects reduced shipment levels in support of RCIED Jammer System programs. In addition, our 2008 sales were negatively impacted by soft market conditions in certain sectors of the telecom equipment industry.

Sales of our signal and power integrity components were \$52.1 million in fiscal 2008, down \$8.7 million or \$14.3% from a year ago. Approximately \$2.0 million of this decrease relates to reduced shipments in support of RCIED Jammer Systems, with the remaining shortfall reflecting certain sluggish telecom equipment markets. Total customer orders received for this business segment totaled \$55.9 million in fiscal 2008, compared to \$57.6 million in fiscal 2007.

Sales of our microwave components and systems were \$45.9 million in fiscal 2008, down \$1.8 million or 3.8% from fiscal 2007. Microwave assemblies shipped in fiscal 2008 under RCIED Jammer System programs were approximately \$9.5 million less than fiscal 2007 shipment levels. These RCIED programs remain active, with orders and shipments for system upgrades expected to continue throughout fiscal 2009 at volumes and rates similar to 2008. In fiscal 2008, the decrease in shipments supporting these Jammer Systems was partially offset by \$2.3 million of SatCon product sales and increased microwave product shipments under numerous other military/defense programs. Total customer orders received for our microwave components and systems were \$47.5 million in fiscal 2008, versus \$53.1 million in fiscal 2007.

---

**Table of Contents**

**Management's Discussion and Analysis of Financial Condition and Results of Operations (Continued)**

Sales and customer order rates for our other two business segments increased during the current year. For our power management systems, sales for fiscal 2008 were \$9.9 million and customer orders received amounted to \$10.5 million, up 30.2% and 31.0% from a year ago, respectively. In fiscal 2008, shipments for these advanced systems were particularly strong in applications for data storage, networking systems, and various military communication equipment. For our sensors and controls, sales in fiscal 2008 were \$22.8 million and customer orders received amounted to \$26.6 million, an increase from fiscal 2007 of 11.3% and 28.4% respectively. Demand for our custom position sensors (which are used in various medical equipment, commercial weather instruments, and military aircraft and vehicles) was particularly strong throughout fiscal 2008.

Total customer orders received in fiscal 2008 amounted to \$140.6 million, an increase of \$1.0 million from the preceding year. At November 30, 2008, our sales order backlog was \$69.9 million, up \$21.8 million from the end of fiscal 2007. Of this increase, \$12.9 million reflects the sales order backlog assumed as part of our acquisition of SatCon.

Overall, average selling prices remained relatively stable in 2008 for all of our major product lines.

*Gross Margin*

In fiscal 2008, our gross margin was \$32.8 million or 25.1% of sales, compared to \$36.4 million or 26.6% of sales in fiscal 2007. In addition to the impact of reduced sales volume, the decrease in gross margin primarily reflects higher manufacturing overhead costs.

Total material costs amounted to \$30.8 million or 23.5% of sales in fiscal 2008, versus \$35.2 million or 25.8% of sales last year. The decrease in material costs principally reflects reduced ceramic component costs, with our ceramic manufacturing operations in State College, Pennsylvania, improving product yields, achieving and maintaining full production, and thereby totally eliminating the need to purchase higher-priced third party ceramics. Direct labor costs were \$16.8 million or 12.8% of sales in 2008, compared to \$16.4 million or 12.0% of sales in 2007. The increase in direct labor costs was driven by changes in sales mix, as well as the full resumption of internal ceramic manufacturing. Manufacturing overhead costs amounted to \$50.4 million or 38.6% of sales in 2008, versus \$48.6 million or 35.6% of sales in the preceding year. This \$1.8 million increase in manufacturing overhead reflects higher personnel costs, greater depreciation expense, and increases to certain inventory reserves because of lower than expected operating requirements.

At November 30, 2008, we had a total workforce of 1,516 employees, down 5.7% from the end of last fiscal year. We expect to continuously review our organization and cost structure to enhance operating efficiencies, while maintaining flexibility for additional production requirements.

*Selling, General and Administrative Expense*

In fiscal 2008, selling expense amounted to \$10.8 million or 8.3% of sales, compared to \$10.5 million or 7.7% of sales in fiscal 2007. The increase in selling expense primarily reflects additional travel expense, as well as increases to our effective sales commission rate. Aggregate general and administrative expense was \$8.6 million in 2008, versus \$8.0 million in 2007. The increase in general and administrative expense includes \$235,000 of additional equity-based compensation expense, \$227,000 of added legal and professional fees, as well as numerous other operating expense increases.

*Interest Expense*

With lower interest rates and reduced short-term borrowings, our interest expense decreased in the current year. Total interest expense in fiscal 2008 was \$369,000, a decrease of \$192,000 from fiscal 2007. During the year ended November 30, 2008, weighted average borrowings under our domestic line of credit amounted to \$4.9 million, with an average interest rate of 3.95%. During the year ended November 30, 2007, weighted average borrowings under the domestic line of credit were \$6.0 million, with an average interest rate of 6.61%.

*Other Income and Expense*



## Edgar Filing: SPECTRUM CONTROL INC - Form 10-K

We hold several United States and foreign patents relating to polymer multilayer ( PML ) technology, and we have granted several licenses to other entities for the use of PML technology. In connection with our PML technology, we received license fee and royalty income of \$340,000 in 2008 and \$93,000 in 2007. It is not known what remaining commercial value, if any, our PML licenses may have.

Our wholly-owned foreign subsidiaries transact business with certain customers and vendors in currencies other than their local currency. As a result, we recognize gains and losses on foreign currency transactions. Foreign currency transaction net losses of \$13,000 in 2008 and \$6,000 in 2007 were recognized and included in nonoperating income and expense.

We realized interest income of \$178,000 in 2008 and \$168,000 in 2007 from temporary cash investments.

---

**Table of Contents**

**Management's Discussion and Analysis of Financial Condition and Results of Operations (Continued)**

*Income Taxes*

Our effective income tax rate was 34.3% in 2008 and 36.5% in 2007, compared to an applicable federal and state statutory income tax rate of approximately 40.0%. For the year ended November 30, 2008, the difference between the effective tax rate and statutory tax rate principally reflects state tax provisions, research activities tax credits, and U.S. domestic production activities deductions. For the year ended November 30, 2007, the difference between the effective tax rate and statutory tax rate primarily reflects state tax provisions, foreign income tax rates, and changes in estimated tax rates applied to temporary differences.

At November 30, 2008, we had recorded certain deferred tax assets. In assessing the realizability of deferred tax assets, we consider whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which the temporary differences become deductible. We consider the scheduled reversal of deferred tax liabilities, projected future taxable income, and tax planning strategies in making this assessment. Based upon our level of historical taxable income and projections for future taxable income, we believe it is more likely than not that the benefits of the deferred tax assets will be realized. Accordingly, no deferred tax asset valuation allowance was recorded at November 30, 2008.

**2007 Compared to 2006**

*Net Sales*

In 2007, our net sales increased by \$10.9 million or 8.6%, with consolidated sales of \$136.5 million in 2007 and \$125.6 million in 2006. Of this \$10.9 million increase, \$8.7 million relates to our acquisitions of EMF and ATP. The remaining \$2.2 million increase reflects additional shipments of signal and power integrity components, power management systems, and sensors and controls, which were partially offset by reduced shipments of microwave products.

Sales of our signal and power integrity products were \$60.7 million in fiscal 2007, up \$2.2 million from a year ago, primarily reflecting improved overall market conditions. Sales of our sensors and controls were \$20.5 million in fiscal 2007, an increase of \$8.7 million from fiscal 2006. In addition to ATP product sales increases of \$5.5 million, the fiscal 2007 growth in sensor sales principally reflects increased shipments of our custom position sensors used in various medical, commercial weather instruments, and military applications. Sales of our power management systems increased by \$929,000, with sales of \$7.6 million in 2007 and \$6.7 million in 2006. Throughout fiscal 2007, our power management systems were predominantly used in various communication equipment applications, servers, and data storage devices. Including EMF product sales of \$3.2 million, fiscal year 2007 sales of our microwave components and systems were down from a year ago (\$47.7 million in 2007 versus \$48.7 million in 2006) as certain major military-related programs were winding down and not yet fully renewed or replaced with the next generation of products.

Total customer orders received in 2007 amounted to \$139.6 million, an increase of \$14.9 million or 12.0% from the preceding year. At November 30, 2007, our sales order backlog was \$48.1 million.

Overall, average selling prices remained relatively stable in 2007 for all of our major product lines.

---

**Table of Contents**

**Management's Discussion and Analysis of Financial Condition and Results of Operations (Continued)**

*Gross Margin*

Our gross margin in fiscal 2007 was \$36.4 million or 26.6% of sales, compared to \$28.8 million or 22.9% of sales in fiscal 2006. This increase in gross margin percentage principally reflects reduced material costs from the resumption of internal ceramic manufacturing. Total material costs (including ceramic components) amounted to \$35.2 million or 25.8% of sales in fiscal 2007, compared to \$38.6 million or 30.7% of sales in fiscal 2006.

Prior to its destruction by Hurricane Katrina in late August of 2005, our New Orleans operations designed and manufactured specialty ceramic capacitors. These custom ceramic components are an essential element of our signal integrity products. With this disruption to our internal ceramic manufacturing capabilities, we began purchasing these ceramic components from third party suppliers at prices significantly greater than our previous manufactured costs. To address our ongoing ceramic component needs and to re-establish our own ceramic manufacturing capabilities, we acquired in December 2005 a ceramic manufacturing facility in State College, Pennsylvania. Among other uses, the acquired facility has become the design and manufacturing center for our ceramic products, replacing the operations previously conducted in New Orleans. In June 2006, limited production commenced at our new State College operations with additional production being systematically increased thereafter. During the second quarter of fiscal 2007, full ceramic production was achieved and substantially all purchases of specialty ceramic components from third party suppliers were eliminated. Accordingly, as a percentage of sales, our material costs in the second half of fiscal 2007 returned to a more normalized level.

Total labor costs were \$16.4 million or 12.0% of sales in 2007, compared to \$14.0 million or 11.2% of sales in 2006. In addition to greater sales volume and changes in product mix, the increase in labor costs primarily reflects our resumption of internal ceramic production. As a percentage of sales, manufacturing overhead remained relatively stable throughout the period. Aggregate manufacturing overhead was \$48.6 million or 35.6% of sales in fiscal 2007, versus \$44.3 million or 35.2% of sales in fiscal 2006.

At November 30, 2007, we had a total workforce of 1,607 employees, up 3.8% from the end of fiscal 2006.

*Selling, General and Administrative Expense*

In fiscal 2007, selling expense amounted to \$10.5 million or 7.7% of sales, compared to \$10.4 million or 8.3% of sales in fiscal 2006. The decrease in selling expense, as a percentage of sales, principally reflects the impact of higher sales volume and certain fixed selling expenses. General and administrative expense was \$8.0 million in 2007 versus \$9.0 million in 2006. This decrease in general and administrative expense was driven by numerous factors, including the following: (1) \$635,000 associated with asset impairments from Hurricane Katrina, reflecting the difference between an aggregate asset impairment loss of \$387,000 recorded in fiscal 2006 and a \$248,000 credit to general and administrative expense realized in fiscal 2007 upon the settlement of all related insurance claims; (2) Pre-production start-up costs of \$254,000 recognized in 2006 in connection with our State College facility; and (3) \$179,000 of additional equity-based compensation expense recorded in 2006 from our adoption of Statement of Financial Accounting Standards No. 123 (revised), Share-Based Payment (SFAS No. 123R). These decreases to general and administrative expense were partially offset in 2007 by additional professional fees of \$145,000 associated with our initial-year compliance with Section 404 of the Sarbanes-Oxley Act.

*Interest Expense*

Interest expense was \$561,000 in fiscal 2007 and \$545,000 in fiscal 2006. During the year ended November 30, 2007, weighted average borrowings under our domestic line of credit amounted to \$6.0 million, with an average interest rate of 6.61% and maximum month-end borrowings of \$9.0 million. During the year ended November 30, 2006, weighted average borrowings under the domestic line of credit were \$6.4 million, with an average interest rate of 6.43% and maximum month-end borrowings of \$14.0 million.

*Other Income and Expense*

In 2007, other income and expense consists of interest income from short-term investments of \$168,000, PML license and royalty fee income of \$93,000, and net losses on foreign currency transactions of \$6,000. In 2006, other income and expense reflects

\$133,000 of interest income, \$114,000 of PML license and royalty fee income, and net gains on foreign currency transactions of \$23,000.

---

**Table of Contents**

**Management's Discussion and Analysis of Financial Condition and Results of Operations (Continued)**

*Income Taxes*

Our effective income tax rate was 36.5% in 2007 and 35.0% in 2006, compared to an applicable federal and state statutory income tax rate of approximately 40.0%. Differences between the effective tax rate and statutory tax rate primarily arise from state tax provisions, foreign income tax rates, changes in estimated tax rates applied to temporary differences, and the U.S. domestic manufacturers deduction.

At November 30, 2007, we had recorded certain deferred tax assets. Based upon our level of historical taxable income and projections for future taxable income, we believe it is more likely than not that the benefits of the deferred tax assets will be realized. Accordingly, no deferred tax asset valuation allowance was recorded at November 30, 2007.

**Risk Factors That May Affect Future Results**

Military aircraft, naval vessels, and certain military vehicles contain extensive communications equipment, electronic countermeasure equipment for defense against enemy weapons, smart weapons and munitions, and radar systems. We provide low pass filters, multisection assemblies, and various microwave components and integrated assemblies to major equipment manufacturers for installation into these systems. In addition, our precision position sensors are used in numerous military vehicles and aircraft. In 2008, military/defense sales were approximately 48.0% of our total consolidated sales. In recent years, demand for our products has been favorably impacted by an upward trend in U.S. defense spending. Future defense budgets, however, may be impacted by numerous economic and political factors. In addition, the specific programs in which we participate, or in which we may seek to participate in the future, must compete with other programs for consideration during the budget formulation and appropriation processes. While we believe many of our products are used in high priority military/defense programs, one or more of the programs that we currently serve could be phased-out or terminated. Reductions in these existing programs, unless offset by other programs and opportunities, would adversely affect our future revenues and profitability.

In fiscal year 2008, approximately 18.0% of our sales were to customers in the communications equipment industry. Several years ago, capital expenditures for wireless infrastructure equipment by service providers declined dramatically. Market conditions in the industry remain unpredictable and overall capital spending for wireless infrastructure equipment is still volatile. If the current market conditions deteriorate, it will have a material negative impact on our future operating performance.

Raw materials used in the manufacture of certain ceramic capacitors include silver, palladium, and platinum. Precious metals are available from many sources; however, their prices may be subject to significant fluctuations and such fluctuations may have a material and adverse affect on our operating results.

The markets for our products are extremely competitive and are characterized by rapid technological change, new product development and evolving industry standards. We face competition from component manufacturers which have integration capabilities, as well as from the internal capabilities of large communications original equipment manufacturers and defense prime contractors. Our future success will depend in part upon the extent to which these parties elect to purchase from outside sources rather than manufacture their own components and systems. Many of our current and potential competitors have substantially greater financial, technical, marketing, distribution and other resources than us, and have greater name recognition and market acceptance of their products and technologies. Our competitors may develop new technologies or products that may offer superior price or performance features, and new products or technologies may render our customers' products obsolete.

We must also continue to make significant investments in research and development efforts in order to develop necessary product enhancements, new designs and technologies. We may not be able to obtain a sufficient number of engineers, or other technical support staff, or the funds necessary to support our research and development efforts when needed. In addition, our research and development efforts may not be successful, and our new products may not achieve market acceptance. Our customers' technologies are complex and new products and enhancements developed by our customers can in turn require long development periods for our new products or for enhancement or adaptation of our existing products. If we are unable to develop and introduce new products or enhancements in a timely manner in response to changing market conditions or customer requirements, or if our new products do not achieve market acceptance, our business, financial condition and operating results could suffer.

## Edgar Filing: SPECTRUM CONTROL INC - Form 10-K

In addition, our results of operations may be negatively affected in the future by a variety of other factors including: competitive pricing pressures; product cost changes; the global credit crisis and recessionary pressures; cancellation of existing customer order backlog; unanticipated impairment of assets; difficulties in integrating acquired businesses and product lines; changes in product mix; inability to timely ramp up production to meet some of our customers' increased demands; and litigation involving antitrust, intellectual property, environmental, product warranty, product liability, and other issues.

---

**Table of Contents**

**Management's Discussion and Analysis of Financial Condition and Results of Operations (Continued)**

**Liquidity, Capital Resources and Financial Condition**

We maintain a domestic line of credit with our principal lending institution, PNC Bank, N.A. of Erie, Pennsylvania (the Bank), in the aggregate amount of \$25.0 million, with an additional \$10.0 million expansion feature. Borrowings under the line of credit are secured by substantially all of our tangible and intangible personal property, and bear interest at rates below the prevailing prime rate. At November 30, 2008, \$10.0 million was outstanding under this line of credit arrangement. The line of credit agreement contains certain covenants, the most restrictive of which require us to maintain designated minimum levels of net worth and profitability, and impose certain restrictions on us regarding additional indebtedness. At November 30, 2008, we were in compliance with all debt covenants. The current line of credit agreement expires in December 2010. Our ability to borrow in the future under this Bank credit facility is dependent on our ongoing compliance with the restrictive covenants. Whether we continue to comply with these covenants is largely dependent on our ability to attain certain levels of operating performance and profitability in the future, for which there can be no assurance.

Our wholly-owned German subsidiary maintains an unsecured Euro line of credit with a German financial institution aggregating approximately \$1.3 million (Euro 1.0 million). At November 30, 2008, no borrowings were outstanding under this line of credit. Future borrowings, if any, will bear interest at rates below the prevailing prime rate and will be payable upon demand.

In fiscal 2008, our net working capital remained relatively stable. At November 30, 2008, we had net working capital of \$42.6 million, compared to \$43.3 million at November 30, 2007. At November 30, 2008, current assets were 2.98 times current liabilities, compared to 3.87 at the end of fiscal 2007. This reduction in our current ratio primarily reflects the impact of borrowing under our domestic line of credit to partially fund our stock repurchase program and the cash purchase price for the acquisition of SatCon. Our net working capital was \$31.8 million at November 30, 2006 and our current ratio was 2.54 to 1.00 at the end of fiscal 2006. The increase in our working capital and current ratio in 2007 was primarily driven by growth in our accounts receivable and inventories (from additional sales volume and production requirements), as well as a reduction of \$7.0 million in our short-term bank borrowings.

In fiscal year 2008, we expended \$4.5 million for capital additions and improvements, including \$1.9 million in our Microwave Components and Systems Business to increase manufacturing capabilities and efficiencies. The remainder of our 2008 capital expenditures principally consists of normal replacements and enhancements of manufacturing equipment. Our capital expenditures for property, plant and equipment were \$5.8 million in 2007, including \$1.3 million for the acquisition of a machining center used in our sensors and controls business. The balance of our 2007 capital expenditures primarily relate to manufacturing capacity expansion and building improvements at our State College operations. Excluding the assets acquired from ATP, our capital expenditures for property, plant and equipment amounted to \$8.6 million in 2006. Of these capital expenditures, \$5.1 million relate to our State College operations with the remaining capital expenditures principally supporting manufacturing capacity expansion in our microwave business.

In connection with the fixed assets destroyed or damaged by Hurricane Katrina, we received insurance proceeds of \$1.7 million in 2007 and \$2.5 million in 2006. At November 30, 2008, we had not entered into any material commitments for additional capital expenditures. We currently expect our aggregate capital expenditures in fiscal 2009 to approximate our fiscal 2008 levels.

In September 2008, we acquired substantially all of the assets and assumed certain liabilities of SatCon. The net cash purchase price for SatCon was \$5.6 million, which was substantially funded by borrowings under our domestic line of credit. In January 2007, we acquired substantially all of the assets and assumed certain liabilities of EMF. The net cash purchase price for EMF was \$2.4 million, which was primarily funded by existing cash reserves. In July 2006, we acquired all of the outstanding common stock of ATP, with the net cash purchase price of \$9.0 million being substantially funded by borrowings under our domestic line of credit.

We have adopted a stock repurchase program. Under this program, we may repurchase up to \$16.0 million of the Company's outstanding Common Stock. Acquired shares are to be purchased in the open market or through privately negotiated transactions at prevailing market prices. Funding for these repurchases is expected to come from available cash reserves and borrowings under our revolving line of credit facility. The amount and timing of the shares repurchased are based on our ongoing assessment of the Company's capital structure, liquidity, and the market price of the Company's Common Stock. The repurchased shares are held as treasury stock. During the year ended November 30, 2008, we repurchased 1,001,479 shares at an aggregate cost of \$8.2 million. No shares were repurchased in fiscal 2007 and 2006. Since the inception of the stock repurchase program, 1,677,479 shares have

been repurchased at a total cost of \$11.8 million.



**Table of Contents****Management's Discussion and Analysis of Financial Condition and Results of Operations (Continued)**

Research and development expenditures, which encompass the personnel and related expenses devoted to developing new products and processes, amounted to \$3.7 million in 2008, \$3.5 million in 2007, and \$3.1 million in 2006. We expect to continue our investment in research and development in 2009, as we continuously enhance existing product lines, design new products and processes, and increase our participation in emerging markets.

Income taxes paid during the fiscal years ended November 30, 2008, 2007, and 2006 amounted to \$6.8 million, \$3.5 million, and \$2.3 million, respectively. As a result of certain temporary differences and 2008 prepayments, we expect cash outlays for income taxes to be less than income tax expense for fiscal 2009.

As of November 30, 2008, our obligations and firm commitments are as follows (in thousands):

Contractual obligations	Total	Payments Due by Period					
		2009	2010	2011	2012	2013	Thereafter
Long-term debt	\$ 1,032	\$ 487	\$ 65	\$ 70	\$ 75	\$ 80	\$ 255
Operating leases	3,517	1,396	1,304	389	321	107	-

Current financial resources, including working capital and existing lines of credit, and anticipated funds from operations are expected to be sufficient to meet operating cash requirements throughout fiscal year 2009, including scheduled long-term debt repayment, lease commitments, planned capital expenditures, research and development expenses, and possible stock repurchases. There can be no assurance, however, that unplanned capital replacement or other future events will not require us to seek additional debt or equity financing and, if so required, that it will be available on terms acceptable to us.

Net cash provided by operating activities was \$9.9 million in fiscal 2008. This operating cash flow was negatively impacted by a \$3.3 million growth in inventories, principally reflecting replenishment of ceramic component safety stocks and additional work-in-process inventories in support of our increased sales order backlog. Primarily driven by our enhanced profitability, net cash provided by operating activities grew to \$13.6 million in fiscal 2007. During the year ended November 30, 2007, accounts receivable and inventory turnover rates decreased slightly. Net cash generated by operating activities was \$403,000 in 2006, down \$8.5 million from the preceding year. With sales volume and production requirements significantly growing, accounts receivable and inventories increased in 2006 by \$4.9 million and \$2.7 million, respectively. Operating cash flow in 2006 also reflects the payment of a ten year insurance premium in the amount of \$4.8 million. The related insurance policy provides environmental clean-up cost cap coverage and pollution legal liability coverage for our State College facility acquired in fiscal 2006.

At November 30, 2008, goodwill represented 27.3% of our total assets and 35.6% of our stockholders' equity. In addition to a total of \$8.1 million of goodwill recognized in connection with our recent acquisitions of SatCon, EMF, and ATP, another \$28.7 million of goodwill was realized in earlier acquisitions. In accordance with the provisions of Statement of Financial Accounting Standards No. 142, Goodwill and Other Intangible Assets, we have performed the required annual impairment tests of goodwill (as of September 1 of each fiscal year) and determined that no impairment loss need be recognized in the years ended November 30, 2008, 2007, and 2006.

**Quantitative and Qualitative Disclosures About Market Risk***Foreign Currency*

Certain of our European sales and related selling expenses are denominated in Euros, British Pounds Sterling, and other local currencies. In addition, certain of our operating expenses are denominated in Mexican Pesos and Chinese Yuan. As a result, fluctuations in currency exchange rates may affect our operating results and cash flows. To manage our exposure to the Euro and British Pound Sterling, we occasionally enter into forward currency exchange contracts. At November 30, 2008, we did not have any forward currency exchange contracts outstanding. For each of the three years ended November 30, 2008, currency exchange rate gains and losses were not material.



---

**Table of Contents****Management's Discussion and Analysis of Financial Condition and Results of Operations (Continued)***Interest Rate Exposure*

We have market risk exposure relating to possible fluctuations in interest rates. From time to time, we utilize interest rate swap agreements to minimize the risks and costs associated with variable rate debt. We do not enter into derivative financial instruments for trading or speculative purposes. The interest rate swap agreements are entered into with major financial institutions, and we have never experienced nonperformance by any counterparties to these agreements. At November 30, 2008, no interest rate swap agreements were outstanding.

**Environmental Matters**

On December 30, 2005, we acquired certain land and ceramic manufacturing facilities in State College, Pennsylvania. The property, which was acquired from Murata Electronics North America ( Murata ), consists of approximately 53 acres of land and 250,000 square feet of manufacturing facilities. Among other uses, the acquired facilities have become the design and manufacturing center for our ceramic operations, replacing the ceramic operations previously conducted in New Orleans, Louisiana.

The purchase price for the acquired property consisted of: (a) \$1.00, plus (b) closing costs of \$695,000 including realtor commissions, transfer taxes, and legal fees; plus (c) the assumption of, and indemnification of Murata against, all environmental liabilities related to the property. The acquired property has known environmental conditions that require remediation, and certain hazardous materials previously used on the property have migrated into neighboring third party areas. These environmental issues arose from the use of chlorinated organic solvents including tetrachloroethylene ( PCE ) and trichloroethylene ( TCE ). As a condition to the purchase, we entered into an agreement with the Pennsylvania Department of Environmental Protection ( PADEP ) pursuant to which: (a) we agreed to remediate all known environmental conditions relating to the property to a specified industrial standard, with our costs for remediating such conditions being capped at \$4.0 million; (b) PADEP released Murata from further claims by Pennsylvania under specified state laws for the known environmental conditions; and (c) we purchased an insurance policy providing clean-up cost cap coverage (for known and unknown pollutants) with a combined coverage limit of approximately \$8.2 million, and pollution legal liability coverage (for possible third party claims) with an aggregate coverage limit of \$25.0 million. The total premium cost for the insurance policy, which has a ten year term and an aggregate deductible of \$650,000, was \$4.8 million. The cost of the insurance associated with the environmental clean-up (\$3.6 million) is being charged to general and administrative expense in direct proportion to the actual remediation costs incurred. The cost of the insurance associated with the pollution legal liability coverage (\$1.2 million) is being charged to general and administrative expense on a pro rata basis over the ten year policy term.

Based upon our environmental review of the property, we recorded a liability of \$2.9 million to cover probable future environmental expenditures related to the remediation, the cost of which is expected to be entirely covered by the insurance policy. As of November 30, 2008, remediation expenditures of \$1.6 million have been incurred and charged against the environmental liability, with all such expenditures being reimbursed by the insurance carrier. The remaining aggregate undiscounted expenditures of \$1.3 million, which are anticipated to be incurred over the next seven years, principally consist of: (a) continued operation and monitoring of the existing on-site groundwater extraction, treatment, and recharge system; (b) implementation of a chemical oxidation system; (c) completion of soil investigations to determine the extent of potential soil contamination; (d) excavation and off-site disposal of soil containing contaminants above acceptable standards; and (e) implementation of soil vapor extraction systems in certain areas. Depending upon the results of future environmental testing and remediation actions, it is possible that the ultimate costs incurred could exceed the current aggregate estimate of \$2.9 million. We expect such increase, if any, to be entirely covered by the insurance policy. Insurance recoveries for actual environmental remediation costs incurred are recorded when it is probable that such insurance reimbursement will be received and the related amounts are determinable. Such insurance recoveries are credited to the Company's general and administrative expense. Based on the current remediation plan, \$269,000 of the total remediation costs are expected to be incurred during the next twelve months.

We are subject to various laws and governmental regulations concerning environmental matters and employee safety and health in the United States and other countries. U.S. federal environmental legislation having particular impact on us includes the Toxic Substances Control Act; the Resource Conservation and Recovery Act; the Clean Air Act; the Clean Water Act; and the Safe Drinking Water Act. We also are subject to regulation by the Occupational Safety and Health Administration ( OSHA ) concerning employee safety and health matters. The United States Environmental Protection Agency ( EPA ), OSHA, and other federal

agencies have the authority to promulgate regulations that have an impact on our operations.

---

**Table of Contents**

**Management's Discussion and Analysis of Financial Condition and Results of Operations (Continued)**

In addition to these federal agencies, various states have been delegated certain authority under the aforementioned federal statutes. Many state and local governments have adopted environmental and employee safety and health laws and regulations, some of which are similar to federal requirements. State and federal authorities may seek fines and penalties for violation of these laws and regulations. As part of our continuing environmental program, we have been able to comply with such proceedings and orders without any materially adverse effect on our business. We are not currently involved in any significant legal proceedings involving environmental matters.

**Other Legal Matters**

We are subject to certain legal proceedings and claims arising in the ordinary course of business. The amount of any ultimate liability with respect to these actions is not expected to materially affect our consolidated financial position, results of operations, or cash flows.

**Impact of Inflation**

In recent years, inflation has not had a significant impact on our operations. However, we continuously monitor operating price increases, particularly in connection with the supply of precious metals used in our manufacturing of certain ceramic capacitors. To the extent permitted by competition, we pass increased costs on to our customers by increasing sales price over time. Sales price increases, however, were not significant in any of the years presented herein.

**Recent Accounting Pronouncements Not Yet Adopted**

In May 2008, the Financial Accounting Standards Board ( FASB ) issued Statement of Financial Accounting Standards No. 162, The Hierarchy of Generally Accepted Accounting Principles ( SFAS No. 162 ). The purpose of this statement is to improve financial reporting by providing a consistent framework for determining applicable accounting principles generally accepted in the United States. SFAS No. 162 will become effective 60 days after the SEC's approval. We believe that the adoption of this standard on its effective date will not have a material effect on our consolidated financial condition, results of operations, or cash flows.

In April 2008, the FASB issued FASB Staff Position No. 142-3, Determination of the Useful Life of Intangible Assets ( FSP or the Position ). This Position amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under FASB Statement No. 142, Goodwill and Other Intangible Assets . The intent of the FSP is to improve the consistency between the useful life of a recognized intangible asset and the period of expected cash flows used to measure the fair value of the asset under FASB Statement No. 141 (revised 2007), Business Combinations ( SFAS No. 141R ), and other U.S. generally accepted accounting principles. This FSP is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2008 (the Company's 2010 fiscal year). We are currently assessing the impact of this FSP on our financial condition, results of operations, and cash flows.

In March 2008, the FASB issued Statement of Financial Accounting Standards No. 161, Disclosures about Derivative Instruments and Hedging Activities, an amendment of FASB Statement No. 133 ( SFAS No. 161 ), which requires enhanced disclosures about an entity's derivative and hedging activities. Entities will be required to provide additional disclosures about: (1) how and why an entity uses derivative instruments; (2) how derivative instruments and related hedged items are accounted for under existing accounting pronouncements, and (3) how derivative instruments and related hedged items affect an entity's financial position, financial performance, and cash flows. This standard is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008, and encourages but does not require comparative disclosures for earlier periods at the initial adoptions. We are currently in the process of assessing the expected impact of this standard on our financial statement disclosures.

In December 2007, the FASB issued SFAS No. 141R. The objective of SFAS No. 141R is to improve the relevance, representational faithfulness, and comparability of the information that a reporting entity provides in its financial reports about a business combination and its effects. Specifically, it establishes principles and requirements over how the acquirer: (1) recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree; (2) recognizes and measures the goodwill acquired in the business combination or gain from a bargain purchase, and

(3) determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination. SFAS No. 141R will change the accounting treatment for certain specific items, including acquisition-related costs, acquired contingent liabilities, and restructuring costs associated with the acquisition. SFAS No. 141R applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008 (the Company's 2010 fiscal year). Once adopted, we believe SFAS No. 141R will have an impact on accounting for business combinations, but the effect is dependent upon the nature and terms of the acquisitions made at that time.

**Table of Contents**

**Management's Discussion and Analysis of Financial Condition and Results of Operations (Continued)**

**Critical Accounting Policies**

The methods, estimates and judgments we use in applying our most critical accounting policies have a significant impact on the results we report in our financial statements. The U.S. Securities and Exchange Commission has defined the most critical accounting policies as the ones that are most important to the portrayal of our financial condition and results, and require us to make our most difficult and subjective judgments, often as a result of the need to make estimates of matters that are inherently uncertain. Based on this definition, we believe our most critical accounting policies relate to the valuation and carrying amounts of accounts receivable, inventories, long-lived assets, and deferred tax assets.

We evaluate the collectibility of our accounts receivable based on a combination of factors including an assessment of the customer's financial condition and the length of time a receivable is past due. At November 30, 2008, our allowance for doubtful accounts was \$933,000 or approximately 3.7% of our aggregate accounts receivable. In determining the adequacy of this allowance, we have assumed that conditions in our major served markets (military/defense, communications equipment, and medical/industrial instrumentation) will not significantly deteriorate during fiscal 2009. If current economic and market conditions do significantly deteriorate, our customers may not be able to meet their financial obligations to us. Accordingly, our estimate of the recoverability of amounts due us could be reduced by a material amount.

At November 30, 2008, we had recorded inventory reserves in the aggregate amount of \$1.7 million for excess and slow-moving items. In determining the adequacy of these reserves, we considered numerous factors including current customer forecasts and estimated usage. Should these forecasts and estimates change due to market, technological or other factors, the net realizable value of our inventories may be materially less than our current carrying values.

We review goodwill for possible impairment at least annually. Impairment losses are recognized when the implied fair value of goodwill is less than its carrying value. The implied fair value of goodwill is contingent upon many factors, including estimates of future discounted operating cash flows. Long-lived assets other than goodwill are reviewed for impairment whenever indicators of possible impairment exist. Impairments are recognized when the expected future operating cash flows derived from such assets are less than their carrying values. No impairment losses (other than losses for certain tangible assets damaged or destroyed by Hurricane Katrina) have been recognized in any of the periods presented herein. However, our future cash flow expectations assume that the general economic climate and conditions within our major served markets will improve within the next few years. If long-term market conditions do not improve, or in fact deteriorate, our long-lived assets may become materially impaired.

We record valuation allowances to reduce deferred tax assets when it is more likely than not that some portion of the asset may not be realized. Presently, we believe that all deferred tax assets will more likely than not be realized and a valuation allowance is not required. We evaluate the need for valuation allowances on a regular basis and make adjustments as needed. These adjustments, when made, may have a materially negative impact on our consolidated financial statements.

**Table of Contents**

**ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA**

The following consolidated financial statements of Spectrum Control, Inc. and subsidiaries are included herein:

	Page Number
<u>Report of Independent Registered Public Accounting Firm</u>	36
<u>Consolidated Balance Sheets as of November 30, 2008 and 2007</u>	37
<u>Consolidated Statements of Income for the years ended November 30, 2008, 2007, and 2006</u>	38
<u>Consolidated Statements of Stockholders' Equity for the years ended November 30, 2008, 2007, and 2006</u>	39
<u>Consolidated Statements of Cash Flows for the years ended November 30, 2008, 2007, and 2006</u>	40
<u>Notes to Consolidated Financial Statements</u>	41-63



**Table of Contents**

**Report of Independent Registered Public Accounting Firm**

**The Board of Directors and Shareholders**

**Spectrum Control, Inc.**

We have audited the accompanying consolidated balance sheets of Spectrum Control, Inc. and subsidiaries as of November 30, 2008 and 2007, and the related consolidated statements of income, stockholders' equity, and cash flows for each of the three years in the period ended November 30, 2008. Our audits also included the financial statement schedule listed in the Index at Item 15(a). These financial statements and schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Spectrum Control, Inc. and subsidiaries at November 30, 2008 and 2007, and the consolidated results of their operations and their cash flows for each of the three years in the period ended November 30, 2008, in conformity with U.S. generally accepted accounting principles. Also, in our opinion, the related financial statement schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Spectrum Control, Inc. and subsidiaries' internal control over financial reporting as of November 30, 2008, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated February 11, 2009, expressed an unqualified opinion thereon.

/S/ ERNST & YOUNG LLP

Pittsburgh, Pennsylvania

February 11, 2009

**Table of Contents****SPECTRUM CONTROL, INC. AND SUBSIDIARIES****CONSOLIDATED BALANCE SHEETS****NOVEMBER 30, 2008 AND 2007****( Dollar Amounts in Thousands )**

	2008	2007
<b>Assets</b>		
Current assets		
Cash and cash equivalents	\$ 5,397	\$ 5,183
Accounts receivable, less allowances of \$ 933 in 2008 and \$ 971 in 2007	24,043	25,461
Inventories, net	30,638	25,458
Deferred income taxes	1,684	1,332
Prepaid expenses and other current assets	2,307	911
Total current assets	64,069	58,345
Property, plant and equipment, net	27,250	26,177
Other assets		
Goodwill	36,811	35,669
Other noncurrent assets	6,654	6,728
Total other assets	43,465	42,397
Total assets	\$ 134,784	\$ 126,919
<b>Liabilities and Stockholders Equity</b>		
Current liabilities		
Short-term debt	\$ 10,000	\$ 2,000
Accounts payable	6,541	6,764
Income taxes payable	36	1,391
Accrued liabilities	4,415	4,813
Current portion of long-term debt	487	100
Total current liabilities	21,479	15,068
Long-term debt	545	1,031
Other liabilities	978	1,370
Deferred income taxes	8,491	7,582
Stockholders equity		
Common stock, no par value, authorized 25,000,000 shares, issued 14,248,772 shares in 2008 and 14,128,914 shares in 2007	47,830	46,950
Retained earnings	66,604	57,753
Treasury stock, 1,677,479 shares in 2008 and 676,000 shares in 2007, at cost	(11,788)	(3,628)
Accumulated other comprehensive income	645	793
Total stockholders equity	103,291	101,868

Total liabilities and stockholders' equity	\$ 134,784	\$ 126,919
--	------------	------------

The accompanying notes are an integral part of the consolidated financial statements.

**Table of Contents****SPECTRUM CONTROL, INC. AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF INCOME****FOR THE YEARS ENDED NOVEMBER 30, 2008, 2007, AND 2006****( Amounts in Thousands Except Per Share Data )**

	2008	2007	2006
Net sales	\$ 130,694	\$ 136,539	\$ 125,672
Cost of products sold	97,932	100,176	96,892
Gross margin	32,762	36,363	28,780
Selling, general and administrative expense	19,418	18,499	19,466
Income from operations	13,344	17,864	9,314
Other income ( expense ) :			
Interest expense	(369)	(561)	(545)
Other income and expense, net	505	255	270
	136	(306)	(275)
Income before provision for income taxes	13,480	17,558	9,039
Provision for income taxes	4,629	6,417	3,168
Net income	\$ 8,851	\$ 11,141	\$ 5,871
Earnings per common share :			
Basic	\$ 0.68	\$ 0.83	\$ 0.45
Diluted	\$ 0.67	\$ 0.81	\$ 0.44
Weighted average common shares outstanding :			
Basic	13,069	13,359	13,127
Diluted	13,189	13,798	13,381

The accompanying notes are an integral part of the consolidated financial statements.

**Table of Contents****SPECTRUM CONTROL, INC. AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY****FOR THE YEARS ENDED NOVEMBER 30, 2008, 2007, AND 2006****( Dollar Amounts in Thousands )**

	Common Stock		Retained	Treasury	Accumulated	Total
	Shares	Amount	Earnings	Stock	Other Comprehensive Income ( Loss )	Stockholders Equity
Balance - November 30, 2005	13,737,818	\$ 44,376	\$ 40,741	\$ (3,628)	\$ (128)	\$ 81,361
Net income	-	-	5,871	-	-	5,871
Foreign currency translation adjustments	-	-	-	-	382	382
Comprehensive income	-	-	-	-	-	6,253
Issuance of common stock upon exercise of employee stock options	186,467	1,073	-	-	-	1,073
Purchase and retirement of common stock	(49,518)	(419)	-	-	-	(419)
Tax benefits from exercise of stock options	-	123	-	-	-	123
Equity-based compensation	-	208	-	-	-	208
Balance - November 30, 2006	13,874,767	45,361	46,612	(3,628)	254	88,599
Net income	-	-	11,141	-	-	11,141
Foreign currency translation adjustments	-	-	-	-	539	539
Comprehensive income	-	-	-	-	-	11,680
Issuance of common stock upon exercise of employee stock options	308,167	1,922	-	-	-	1,922
Purchase and retirement of common stock	(54,020)	(718)	-	-	-	(718)
Tax benefits from exercise of stock options	-	356	-	-	-	356
Equity-based compensation	-	29	-	-	-	29
Balance - November 30, 2007	14,128,914	46,950	57,753	(3,628)	793	101,868
Net income	-	-	8,851	-	-	8,851
Foreign currency translation adjustments	-	-	-	-	(148)	(148)
Comprehensive income	-	-	-	-	-	8,703
Issuance of common stock upon exercise of employee stock options	151,733	816	-	-	-	816
Purchase and retirement of common stock	(31,875)	(302)	-	-	-	(302)
	-	-	-	(8,160)	-	(8,160)

Edgar Filing: SPECTRUM CONTROL INC - Form 10-K

Purchase of common stock, held in treasury								
Tax benefits from exercise of stock options	-	102	-	-	-	-	-	102
Equity-based compensation	-	264	-	-	-	-	-	264
Balance - November 30, 2008	14,248,772	\$ 47,830	\$ 66,604	\$ (11,788)	\$	645	\$	103,291

The accompanying notes are an integral part of the consolidated financial statements.

**Table of Contents****SPECTRUM CONTROL, INC. AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF CASH FLOWS****FOR THE YEARS ENDED NOVEMBER 30, 2008, 2007, AND 2006****( Dollar Amounts in Thousands )**

	2008	2007	2006
<b>Cash Flows From Operating Activities :</b>			
Net income	\$ 8,851	\$ 11,141	\$ 5,871
Adjustments to reconcile net income to net cash provided by operating activities :			
Depreciation	4,447	3,925	3,258
Amortization	734	898	853
Deferred income taxes	557	693	1,532
Equity-based compensation	264	29	208
Tax benefits from exercise of stock options	(102)	(356)	(123)
Loss on sale of property, plant and equipment	34	-	204
Non-cash insurance recoveries	(479)	(743)	(418)
Changes in assets and liabilities, excluding effects of business acquisitions :			
Accounts receivable	2,810	(2,156)	(4,950)
Inventories	(3,290)	(3,270)	(2,652)
Prepaid expenses and other assets	(958)	1,522	(3,822)
Accounts payable and accrued liabilities	(3,009)	1,906	442
Net cash provided by operating activities	9,859	13,589	403
<b>Cash Flows From Investing Activities :</b>			
Proceeds from sale of property, plant and equipment	8	-	246
Insurance proceeds related to property, plant and equipment	-	1,748	2,500
Purchase of property, plant and equipment	(4,482)	(5,810)	(8,554)
Payments for acquired businesses, net of cash received	(5,587)	(2,365)	(9,006)
Net cash used in investing activities	(10,061)	(6,427)	(14,814)
<b>Cash Flows From Financing Activities :</b>			
Net proceeds ( repayment ) of short-term borrowings	8,000	(7,000)	9,000
Repayment of long-term debt	(99)	(295)	(290)
Net proceeds from issuance of common stock	514	1,204	654
Purchase of common stock	(8,160)	-	-
Tax benefits from exercise of stock options	102	356	123
Net cash provided by ( used in ) financing activities	357	(5,735)	9,487
Effect of exchange rate changes on cash	59	255	39
Net increase ( decrease ) in cash and cash equivalents	214	1,682	(4,885)
Cash and cash equivalents, beginning of year	5,183	3,501	8,386
Cash and cash equivalents, end of year	\$ 5,397	\$ 5,183	\$ 3,501

The accompanying notes are an integral part of the consolidated financial statements.



## Table of Contents

### SPECTRUM CONTROL, INC. AND SUBSIDIARIES

### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the year ended November 30, 2008

#### 1. Summary of Significant Accounting Policies

##### Principles of Consolidation

The consolidated financial statements include the accounts of Spectrum Control, Inc. and its subsidiaries (the Company). All significant intercompany accounts are eliminated upon consolidation.

##### Nature of Operations

The Company designs and manufactures custom electronic components and systems and has operations in the United States, Mexico, China and Germany. The Company offers a broad line of products which are included in its four reportable business segments: Signal and Power Integrity Components; Microwave Components and Systems; Power Management Systems; and Sensors and Controls. Although its products are used in many industries worldwide, the Company's largest markets are military/defense, communications, and medical/industrial equipment.

##### Cash Equivalents

The Company invests its excess cash in money market funds. All highly liquid money market instruments with original maturities of three months or less are considered to be cash equivalents.

##### Accounts Receivable

Trade accounts receivable are recorded at the invoiced amount and do not bear interest. An allowance for doubtful accounts is maintained for potential credit losses based upon the expected collectibility of all accounts receivable. The Company determines the allowance based on an evaluation of numerous factors, including historical write-off experience and current economic conditions. On a monthly basis, all significant customer balances over 90 days past due are reviewed individually for collectibility. Account balances are charged off against the allowance after all reasonable means of collection have been exhausted and the potential for recovery is considered remote. The Company does not have any off-balance-sheet credit exposure related to its customers.

##### Derivative Financial Instruments

The Company occasionally enters into forward currency exchange contracts in the regular course of business to manage its exposure against foreign currency fluctuations on sales denominated in foreign currencies. The terms of the forward currency exchange contracts are generally nine months or less. In accordance with Statement of Financial Accounting Standards No. 133, *Accounting for Derivative Instruments and Hedging Activities*, and its related amendments, these contracts are considered derivatives and are recognized on the balance sheet at fair value. Derivatives that are not considered effective hedges are adjusted to fair value through income. If the derivative is considered an effective hedge, depending on the nature of the hedge, changes in the fair value of the derivative are either offset against the change in fair value of assets, liabilities, or firm commitments through earnings or recognized in accumulated other comprehensive income or loss until the hedged item is recognized in earnings. The ineffective portion of a derivative's change in fair value is immediately recognized in earnings.

##### Inventories

Inventories are valued at the lower of cost or market, with cost for raw materials, work-in-process and finished goods at standard cost, which approximates the first-in, first-out basis.



## Table of Contents

### **NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

#### Property, Plant and Equipment

Property, plant and equipment are stated at cost. Depreciation is computed over the estimated useful lives of the assets using the straight-line method. Estimated useful lives are generally 20 years for land improvements, 15 to 30 years for buildings and improvements, and 3 to 8 years for machinery and equipment. Expenditures for maintenance and repairs are charged against earnings in the year incurred; major replacements, renewals and betterments are capitalized and depreciated over their estimated useful lives. The cost and accumulated depreciation of assets sold or retired are removed from the respective accounts and any gain or loss is reflected in earnings.

#### Goodwill

Goodwill represents the excess of cost over the fair value of net tangible and identifiable intangible assets of acquired businesses. At least annually (on September 1), goodwill is tested for impairment at the reporting unit (business segment) level by comparing the fair value of the reporting unit with its carrying value. Fair value is primarily determined by computing the future discounted cash flows expected to be generated by the reporting unit. If the carrying value exceeds the fair value, goodwill may be impaired. If this occurs, the fair value of the reporting unit is then allocated to its assets and liabilities in a manner similar to a purchase price allocation in order to determine the implied fair value of the reporting unit goodwill. This implied fair value is then compared with the carrying amount of the reporting unit goodwill, and if it is less, the Company would then recognize an impairment loss.

No goodwill impairment losses have been recognized in any of the periods presented herein.

#### Other Noncurrent Assets

Customer-related intangible assets (principally consisting of customer lists, sales order backlogs, and noncontractual customer relationships) acquired in business combinations are amortized to expense on a straight-line basis over estimated useful lives ranging from 3 to 10 years. Patents and patent rights are amortized to expense on a straight-line basis over periods not exceeding 17 years. The carrying value of these long-lived assets is periodically reviewed by the Company and impairments are recognized when the expected future operating cash flows derived from such intangible assets is less than their carrying value. No impairment losses have been recognized in any of the periods presented herein.

Debt issuance costs are amortized to expense on a straight-line basis over the term of the related indebtedness, which does not differ materially from the effective interest method.

#### Income Taxes

The Company uses the asset and liability method in accounting for income taxes. Under this method, deferred tax assets and liabilities are recorded for temporary differences between the tax basis of assets and liabilities and their reported amounts in the consolidated financial statements, using statutory tax rates in effect for the year in which the differences are expected to reverse. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in the results of operations in the period that includes the enactment date. A valuation allowance is recorded to reduce the carrying amounts of deferred tax assets unless it is more likely than not that such assets will be realized.

The Company recognizes the financial statement benefit of a tax position only after determining that the relevant tax authority would more-likely-than-not sustain the position following an audit. For tax positions meeting the more-likely-than-not threshold, the amount recognized in the financial statements is the largest benefit that has a greater than fifty percent likelihood of being realized upon ultimate settlement with the relevant tax authority.

#### Foreign Currency Translation

The assets and liabilities of the Company's foreign operations are translated into U.S. dollars at year-end exchange rates. Revenue and expense accounts of these operations are translated at average exchange rates prevailing during the year. These translation

adjustments are accumulated in a separate component of stockholders' equity and other comprehensive income or loss.

Foreign Currency Transactions

Foreign currency transaction gains and losses are included in determining net income for the year in which the exchange rate changes.

**Table of Contents****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Revenue Recognition**

Revenue is recognized when all significant contractual obligations have been met, the sales price is fixed and determinable, and collection of the resulting receivable is reasonably assured. Product sales are generally recorded at the time of shipment when title passes under the terms FOB shipping point or Ex Works. Payments received from customers in advance of products shipped are recorded as deferred revenue until earned. Sales of consigned inventories are recorded when the customer has taken title and assumed the risks and rewards of ownership as specified in the customer's purchase order or sales agreement. Sales to third party distributors are made under contractual agreements that allow for limited rights of return and replacement. The contractual agreements do not provide any price protection for unsold inventory held by the distributor. Service revenues are recorded when the related services are performed. Patent licensing fees are recorded when the related technology rights are transferred.

The Company's contracts and customer purchase orders do not include any customer acceptance clauses. In addition, the Company does not normally offer or grant any discounts. The Company's product warranties generally extend for one year, and are limited to the repair and replacement value of the product. The Company does not have any other post shipment obligations. Sales returns and warranty expense are recorded as incurred and were not material in any of the periods presented herein.

**Shipping and Handling Costs**

Shipping and handling costs are included in cost of products sold.

**Advertising and Promotion**

Advertising and promotion costs are expensed as incurred. Advertising and promotion expense amounted to \$786,000 in 2008, \$781,000 in 2007, and \$795,000 in 2006.

**Research and Development**

Research and development costs are expensed as incurred. Research and development expense amounted to \$3,743,000 in 2008, \$3,477,000 in 2007, and \$3,078,000 in 2006.

**Equity - Based Compensation**

Compensation cost for all share-based payments (including employee stock options) is measured in accordance with the provisions of Statement of Financial Accounting Standards No. 123 (revised), Share-Based Payment (SFAS No. 123R). Accordingly, for employee services received in exchange for equity awards, the Company measures the related cost based on the grant-date fair value of the awards. The cost is then recognized as compensation expense on a straight-line basis over the requisite service period of the awards.

For the years ended November 30, 2008, 2007, and 2006, equity-based compensation expenses (related solely to stock options) was as follows (in thousands):

	2008	2007	2006
Equity-based compensation expense	\$ 264	\$ 29	\$ 208

The above amounts are included in selling, general and administrative expense in the accompanying consolidated statements of income.



Table of Contents**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The fair value of each option granted under the Company's stock option plans is determined, as of the date of grant, using the Black-Scholes option pricing model. Within this valuation model, expected volatilities are based upon the historical volatility of the Company's stock, and historical data is used to estimate option exercise and employee terminations. In addition, risk-free interest rates within the contractual life of the options are based on the U.S. Treasury yield curve in effect at the time of grant. During the year ended November 30, 2008, options to purchase 380,500 shares of the Company's Common Stock were granted with the following weighted average assumptions:

	2008
Expected volatility	33.10%
Risk-free interest rate	2.75%
Expected dividend yield	0.00%
Expected option life in years	5.00
Fair value per share	\$ 3.89

Options granted during the year ended November 30, 2008, included options for 191,000 shares at an exercise price of \$15.00 per share (the original options). These options were subsequently modified by canceling all 191,000 of the original options and then concurrently replacing them with options for 95,500 shares at an exercise price of \$9.30 per share (the replacement options). All other terms of the replacement options remained the same as the original options. The fair value of the replacement options was determined to be less than the fair value of the original options immediately before cancellation. Accordingly, in accordance with the provisions set forth in SFAS No. 123R, no incremental compensation cost is being recognized for the modification of the original options.

No options were granted by the Company during the fiscal years ended November 30, 2007 and 2006.

At November 30, 2008, the total future equity-based compensation expense related to nonvested options is expected to be recognized as follows (in thousands):

2009	\$ 292
2010	292
2011	292
2012	28
2013	-
	\$ 904

Earnings Per Common Share

Basic earnings per common share is computed by dividing net income by the weighted average number of common shares outstanding during the period. Diluted earnings per common share is computed by dividing net income by the sum of the weighted average number of common shares outstanding during the period and the effect of all dilutive common stock options. The treasury stock method is used to calculate the effect of dilutive shares, which reduces the gross number of dilutive shares by the number of shares that could be repurchased from the proceeds of the options assumed to be exercised.

Estimates

The preparation of the consolidated financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the consolidated financial statements, the disclosure of contingent assets and liabilities, and the reported amounts of

revenues and expenses during the reporting period. Actual results could differ from those estimates.



---

**Table of Contents**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**Adoption of Recent Accounting Pronouncements**

Effective December 1, 2007, the Company adopted Financial Accounting Standards Board ( FASB ) Interpretation No. 48, Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109 ( FIN 48 or the Interpretation ). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise s financial statements in accordance with FASB Statement of Financial Accounting Standards No. 109, Accounting for Income Taxes . The Interpretation prescribes a minimum recognition threshold and measurement attributes for the financial statement recognition and measurement of a tax position taken or expected to be taken on a tax return. FIN 48 requires that an enterprise determine whether it is more-likely-than-not that a tax position will be sustained upon examination, including resolution of any related appeals or litigation processes, based on the technical merits of the position. A tax position that meets the more-likely-than-not threshold is then measured to determine the amount of benefit to recognize in the financial statements. Additionally, FIN 48 provides guidance on derecognition, classification, interest and penalties, accounting for interim periods, disclosure, and transition.

The adoption of FIN 48 did not give rise to any cumulative effect adjustment to retained earnings or any reclassification of the Company s income tax assets and liabilities.

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157, Fair Value Measurements ( SFAS No. 157 ), which addresses how companies should measure fair value when they are required to use a fair value measure for recognition or disclosure purposes under accounting principles generally accepted in the United States. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007 (the Company s 2008 fiscal year). In February 2008, the FASB issued FASB Staff Position No. 157-2, Effective Date of FASB Statement No. 157 ( FSB 157-2 ). FSP 157-2 delays the effective date of SFAS No. 157 for certain non-financial assets and non-financial liabilities to fiscal years beginning after November 15, 2008 (the Company s 2009 fiscal year). SFAS No. 157 defines fair value, establishes a framework for measuring fair value under generally accepted accounting principles and enhances disclosures about fair value measurements. Valuation techniques used to measure fair value under SFAS No. 157 must maximize the use of observable inputs and minimize the use of unobservable inputs. The standard describes a fair value hierarchy based on three levels of inputs, of which the first two are considered observable and the last unobservable, that may be used to measure fair value.

Level 1 Quoted prices in active markets for identical assets or liabilities.

Level 2 Inputs other than Level 1 that are observable, either directly or indirectly, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3 Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

The Company has adopted SFAS No. 157 for financial assets and liabilities. The adoption of SFAS No. 157 did not have a material impact on the Company s consolidated financial condition, results of operations, or cash flows.

**Recent Accounting Pronouncements Not Yet Adopted**

In May 2008, the FASB issued Statement of Financial Accounting Standards No. 162, The Hierarchy of Generally Accepted Accounting Principles ( SFAS No. 162 ). The purpose of this statement is to improve financial reporting by providing a consistent framework for determining applicable accounting principles generally accepted in the United States. SFAS No. 162 will become effective 60 days after the SEC s approval. The Company believes that the adoption of this standard on its effective date will not have a material effect on its consolidated financial condition, results of operations, or cash flows.

## Edgar Filing: SPECTRUM CONTROL INC - Form 10-K

In April 2008, the FASB issued FASB Staff Position No. 142-3, *Determination of the Useful Life of Intangible Assets* ( FSP or the Position ). This Position amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under FASB Statement No. 142, *Goodwill and Other Intangible Assets* . The intent of the FSP is to improve the consistency between the useful life of a recognized intangible asset and the period of expected cash flows used to measure the fair value of the asset under FASB Statement No. 141 (revised 2007), *Business Combinations* ( SFAS No. 141R ), and other U.S. generally accepted accounting principles. This FSP is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2008 (the Company s 2010 fiscal year). The Company is currently assessing the impact of this FSP on its consolidated financial condition, results of operations, and cash flows.

**Table of Contents****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

In March 2008, the FASB issued Statement of Financial Accounting Standards No. 161, Disclosures about Derivative Instruments and Hedging Activities, an amendment of FASB Statement No. 133 ( SFAS No. 161 ), which requires enhanced disclosures about an entity's derivative and hedging activities. Entities will be required to provide additional disclosures about: (1) how and why an entity uses derivative instruments; (2) how derivative instruments and related hedged items are accounted for under existing accounting pronouncements, and (3) how derivative instruments and related hedged items affect an entity's financial position, financial performance, and cash flows. This standard is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008, and encourages but does not require comparative disclosures for earlier periods at the initial adoption. The Company is currently in the process of assessing the expected impact of this standard, if any, on its consolidated financial statement disclosures.

In December 2007, the FASB issued SFAS No. 141R. The objective of SFAS No. 141R is to improve the relevance, representational faithfulness, and comparability of the information that a reporting entity provides in its financial reports about a business combination and its effects. Specifically, it establishes principles and requirements over how the acquirer: (1) recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree; (2) recognizes and measures the goodwill acquired in the business combination or a gain from a bargain purchase, and (3) determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination. SFAS No. 141R will change the accounting treatment for certain specific items, including acquisition-related costs, acquired contingent liabilities, and restructuring costs associated with the acquisition. SFAS No. 141R applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008 (the Company's 2010 fiscal year), with early adoption prohibited. Once adopted, the Company believes SFAS No. 141R will have an impact on accounting for business combinations, but the effect is dependent upon the nature and terms of the acquisitions made at that time.

**2. Acquisitions**

On September 26, 2008, the Company acquired substantially all of the assets and assumed certain liabilities of SatCon Electronics, Inc. ( SatCon ). SatCon, based in Marlborough, Massachusetts, designs and manufactures high performance microelectronic components used in numerous military and commercial applications, including secure communication systems and high frequency wireless devices. These sophisticated products include hybrid components and subsystems, signal converters, and a full line of thin and thick film circuits. SatCon's capabilities and technologies include high frequency millimeterwave products, which the Company believes are a natural complement and extension to its existing Microwave Components and Systems business segment. The Company also believes that its vertical manufacturing processes, low-cost manufacturing capabilities, and established military sales channels will provide additional revenue opportunities and improved profitability for SatCon products. These factors contributed to a purchase price resulting in the recognition of goodwill.

The aggregate cash purchase price for SatCon was \$5,587,000. The purchase price has been allocated to the assets acquired and liabilities assumed based upon their respective fair market values. Machinery and equipment values were determined by reference to undepreciated cost as of the date of acquisition, which approximates fair value. The fair market values of identifiable intangible assets were determined by estimating the present value of future cash flows. The excess of the aggregate purchase price over the fair values of the net assets acquired was recognized as goodwill. The aggregate cash purchase price, which includes legal fees and other costs directly related to the acquisition of \$53,000, was primarily funded by borrowings under the Company's domestic line of credit.

The allocation of the purchase price to the SatCon assets acquired and liabilities assumed is as follows (in thousands):

Accounts receivable	\$ 1,611
Inventories	1,950
Machinery and equipment	1,100
Identifiable intangible assets	1,128

Edgar Filing: SPECTRUM CONTROL INC - Form 10-K

Accounts payable	(1,120)
Accrued liabilities	(224)
Goodwill	1,142
	\$ 5,587

**Table of Contents****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The identifiable intangible assets (consisting of customer-related intangible assets such as customer lists, sales order backlog, and noncontractual customer relationships) will be amortized to expense over estimated useful lives ranging from 3 to 10 years, with a weighted average amortization period of 7.4 years. The SatCon goodwill acquired has been assigned to the Company's Microwave Components and Systems reportable operating segment. For tax purposes, the Company will amortize the acquired goodwill ratably over a 15 year period.

The results of operations of the SatCon business have been included in the accompanying consolidated financial statements since the date of acquisition. The following unaudited pro forma consolidated financial information for the years ended November 30, 2008 and 2007, has been prepared as if the SatCon acquisition had occurred on December 1, 2006 (in thousands, except per share data):

	2008	2007
Net sales	\$ 139,862	\$ 146,121
Net income	8,800	11,706
<b>Earnings per common share:</b>		
Basic	0.67	0.88
Diluted	0.67	0.85

Pro forma amounts are based upon certain assumptions and estimates, and do not reflect any benefits from economies which might be achieved from combined operations. The pro forma information does not necessarily represent results which would have occurred if the acquisition had taken place on the basis assumed above, nor are they necessarily indicative of the results of future combined operations.

On January 26, 2007, the Company acquired substantially all of the assets and assumed certain liabilities of EMF Systems, Inc. ( EMF ). EMF, based in State College, Pennsylvania, designs and manufactures custom oscillator-based products. In addition to a broad line of oscillator components, EMF primarily designs and manufactures integrated microwave assemblies, including synthesizers and phase-locked oscillators. These products are used in numerous military and commercial applications such as military radar systems, secure communications, and commercial weather radar. The aggregate cash purchase price for EMF was \$2,365,000, which was primarily funded by existing cash reserves.

The results of operations of the EMF business have been included in the accompanying consolidated financial statements since the date of acquisition. The following unaudited pro forma consolidated financial information for the years ended November 30, 2007 and 2006, has been prepared as if the EMF acquisition had occurred on December 1, 2005 (in thousands, except per share data):

	2007	2006
Net sales	\$ 137,025	\$ 128,684
Net income	11,170	6,038
<b>Earnings per common share:</b>		
Basic	0.84	0.46
Diluted	0.81	0.45

On July 14, 2006, the Company acquired all of the outstanding common stock of Advanced Thermal Products, Inc. ( ATP ). ATP, based in St Marys, Pennsylvania, designs and manufactures a broad line of custom temperature sensors. ATP's products include temperature sensing probes and assemblies, positive and negative temperature coefficient thermistors, and resistance temperature detector sensors and related assemblies. These products are used in numerous applications within the heating and air conditioning industry, consumer electronics, energy management, food service, and electronic controls market. The aggregate cash purchase

price for ATP was \$9,507,000, which was primarily funded by borrowings under the Company's domestic line of credit.

**Table of Contents****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The results of operations of the ATP business have been included in the accompanying consolidated financial statements since the date of acquisition. The following unaudited pro forma consolidated financial information for the years ended November 30, 2006 and 2005, has been prepared as if the ATP acquisition had occurred on December 1, 2004 (in thousands, except per share data):

	2006	2005
Net sales	\$ 130,872	\$ 106,001
Net income	5,514	5,046
Earnings per common share:		
Basic	0.42	0.39
Diluted	0.41	0.38

**3. Inventories**

Inventories by major classification are as follows:

	November 30	
	2008	2007
	(in thousands)	
Finished goods	\$ 3,464	\$ 3,084
Work-in-process	11,371	7,741
Raw materials	15,803	14,633
	\$ 30,638	\$ 25,458

At November 30, 2008 and 2007, inventories are presented net of inventory reserves of \$1,705,000 and \$1,228,000, respectively.

**4. Property, Plant and Equipment**

Property, plant and equipment consist of the following:

	November 30	
	2008	2007
	(in thousands)	
Land and improvements	\$ 2,276	\$ 2,252
Buildings and improvements	15,889	15,765
Machinery and equipment	42,358	37,109
	60,523	55,126
Less accumulated depreciation	33,273	28,949





**Table of Contents****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****5. Goodwill**

Changes in the carrying amount of goodwill for the years ended November 30, 2008 and 2007, in total and for each reportable segment, are summarized as follows (in thousands):

	2008	2007
Goodwill, beginning of year	\$ 35,669	\$ 34,508
Goodwill acquired	1,142	1,161
Goodwill, end of year	\$ 36,811	\$ 35,669

	Signal and Power Integrity Components	Microwave Components and Systems	Sensors and Controls
<u>2008</u>			
Goodwill, beginning of year	\$ 14,243	\$ 13,720	\$ 7,706
Goodwill acquired	-	1,142	-
Goodwill, end of year	\$ 14,243	\$ 14,862	\$ 7,706
<u>2007</u>			
Goodwill, beginning of year	\$ 14,243	\$ 12,559	\$ 7,706
Goodwill acquired	-	1,161	-
Goodwill, end of year	\$ 14,243	\$ 13,720	\$ 7,706

During the year ended November 30, 2008, the Company recorded \$1,142,000 of goodwill in connection with its acquisition of SatCon. During the year ended November 30, 2007, the Company recorded \$1,161,000 of goodwill in connection with its acquisition of EMF.

**6. Other Noncurrent Assets**

Other noncurrent assets consist of the following:

November 30  
2008      2007  
(in thousands)

Edgar Filing: SPECTRUM CONTROL INC - Form 10-K

Amortizable assets:		
Customer-related intangibles	\$ 6,926	\$ 5,798
Patents and patent rights	306	280
Debt issuance costs	38	205
	7,270	6,283
Less accumulated amortization	3,198	2,651
	4,072	3,632
Other assets:		
Prepaid environmental liability insurance (see Note 10)	2,487	2,994
Deferred charges	95	102
Other noncurrent assets	\$ 6,654	\$ 6,728

During each of the five years ending November 30, 2013, amortization expense is expected to approximate \$784,000, \$693,000, \$621,000, \$502,000 and \$502,000, respectively.

**Table of Contents****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****7. Short-Term Debt**

Short-term debt consists of the following:

	November 30 2008      2007 (in thousands)	
Notes payable - domestic line of credit (1)	\$ 10,000	\$ 2,000
Notes payable - foreign line of credit (2)	-	-
	<b>\$ 10,000</b>	<b>\$ 2,000</b>

- (1) The Company maintains a domestic line of credit with its principal lending institution (the Bank) in the aggregate amount of \$25,000,000, with an additional \$10,000,000 expansion feature. Borrowings under the line of credit are secured by substantially all of the Company's tangible and intangible personal property, and bear interest at rates below the prevailing prime rate. During the year ended November 30, 2008, weighted average borrowings under the revolving line of credit amounted to \$4,888,000 with an average interest rate of 3.95%, and maximum month-end borrowings of \$10,000,000. During the year ended November 30, 2007, weighted average borrowings were \$5,984,000, with an average interest rate of 6.61%, and maximum month-end borrowings of \$9,000,000. The line of credit agreement contains certain covenants, the most restrictive of which require the Company to maintain designated minimum levels of net worth and profitability, and impose certain restrictions on the Company regarding additional indebtedness. At November 30, 2008, the Company was in compliance with all debt covenants. The current line of credit agreement expires in December 2010.
- (2) The Company's wholly-owned German subsidiary maintains an unsecured Euro line of credit with a German financial institution aggregating \$1,279,000 (Euro 1,000,000). During the years ended November 30, 2008 and 2007, no borrowings were outstanding under this line of credit arrangement. Future borrowings, if any, will bear interest at rates below the prevailing prime rate and will be payable upon demand.

**8. Accrued Liabilities**

Accrued liabilities consist of the following:

	November 30 2008      2007 (in thousands)	
Accrued salaries and wages	\$ 3,540	\$ 3,771
Accrued environmental remediation costs (see Note 10)	269	356
Accrued interest	121	109
Accrued other expenses	485	577
	<b>\$ 4,415</b>	<b>\$ 4,813</b>



**Table of Contents****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****9. Long-Term Debt**

Long-term debt consists of the following:

	November 30 2008      2007 (in thousands)	
Industrial revenue bonds at an interest rate of 5.36% (1)	\$ 605	\$ 665
Mortgage note payable to bank at an interest rate of 8.50% (2)	427	466
<b>Total</b>	<b>1,032</b>	<b>1,131</b>
Less current portion	487	100
<b>Long-term debt</b>	<b>\$ 545</b>	<b>\$ 1,031</b>

(1) The industrial revenue bonds are collateralized by certain land and building and an irrevocable letter of credit issued by the Company, through its principal lending institution, in the aggregate principal amount of the bonds plus accrued interest. The bonds require annual principal payments ranging from \$40,000 to \$90,000 through the year 2015.

(2) The mortgage note payable is collateralized by certain land and building and requires monthly principal payments of approximately \$3,000 through July 2009, with a final principal payment of \$400,000 due in August 2009.

The aggregate maturities of all long-term debt during each of the five years ending November 30, 2013, are \$487,000 in 2009, \$65,000 in 2010, \$70,000 in 2011, \$75,000 in 2012, and \$80,000 in 2013.

**10. Other Liabilities**

Other liabilities consist of the following:

	November 30 2008      2007 (in thousands)	
Accrued environmental remediation costs	\$ 1,247	\$ 1,726
Less current portion	269	356
	<b>\$ 978</b>	<b>\$ 1,370</b>

In December 2005, the Company acquired certain land and manufacturing facilities in State College, Pennsylvania. The property, which was acquired from Murata Electronics North America ( Murata ), consists of approximately 53 acres of land and 250,000 square feet of manufacturing facilities. Among other uses, the acquired facilities have become the design and manufacturing center for the Company's ceramic operations, replacing the ceramic operations previously conducted by the Company in New Orleans,

Louisiana.

---

**Table of Contents****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The purchase price for the acquired property consisted of: (a) \$1.00, plus (b) closing costs of \$695,000 including realtor commissions, transfer taxes, and legal fees; plus (c) the assumption of, and indemnification of Murata against, all environmental liabilities related to the property. The acquired property has known environmental conditions that require remediation, and certain hazardous materials previously used on the property have migrated into neighboring third party areas. These environmental issues arose from the use of chlorinated organic solvents including tetrachloroethylene ( PCE ) and trichloroethylene ( TCE ). As a condition to the purchase, the Company entered into an agreement with the Pennsylvania Department of Environmental Protection ( PADEP ) pursuant to which: (a) the Company agreed to remediate all known environmental conditions relating to the property to a specified industrial standard, with the Company's costs for remediating such conditions being capped at \$4,000,000; (b) PADEP released Murata from further claims by Pennsylvania under specified state laws for the known environmental conditions; and (c) the Company purchased an insurance policy providing clean-up cost cap coverage (for known and unknown pollutants) with a combined coverage limit of approximately \$8,200,000, and pollution legal liability coverage (for possible third party claims) with an aggregate coverage limit of \$25,000,000. The total premium cost for the insurance policy, which has a ten year term and an aggregate deductible of \$650,000, was \$4,762,000. The cost of the insurance associated with the environmental clean-up (\$3,604,000) is being charged to general and administrative expense in direct proportion to the actual remediation costs incurred. The cost of the insurance associated with the pollution legal liability coverage (\$1,158,000) is being charged to general and administrative expense on a pro rata basis over the ten year policy term.

Based upon its environmental review of the property, the Company recorded a liability of \$2,888,000 to cover probable future environmental expenditures related to the remediation, the cost of which is expected to be entirely covered by the insurance policy. As of November 30, 2008, remediation expenditures of \$1,641,000 have been incurred and charged against the environmental liability, with all such expenditures being reimbursed by the insurance carrier. The remaining aggregate undiscounted expenditures of \$1,247,000 which are anticipated to be incurred over the next seven years, principally consist of: (a) continued operation and monitoring of the existing on-site groundwater extraction, treatment, and recharge system; (b) implementation of a chemical oxidation system; (c) completion of soil investigations to determine the extent of potential soil contamination; (d) excavation and off-site disposal of soil containing contaminants above acceptable standards; and (e) implementation of soil vapor extraction systems in certain areas. Depending upon the results of future environmental testing and remediation actions, it is possible that the ultimate costs incurred could exceed the current aggregate estimate of \$2,888,000. The Company expects such increase, if any, to be entirely covered by the insurance policy. Insurance recoveries for actual environmental remediation costs incurred are recorded when it is probable that such insurance reimbursement will be received and the related amounts are determinable. Such insurance recoveries are credited to the Company's general and administrative expense.

Based on the Company's current remediation plan, \$269,000 of the total remediation costs are expected to be incurred during the next twelve months.

**11. Fair Value of Financial Instruments**

The carrying amounts of cash, cash equivalents, accounts receivable, accounts payable, and accrued liabilities approximate fair value due to the short-term maturities of these assets and liabilities. The carrying amounts of the Company's long-term debt approximate fair value, based on borrowing rates currently available for debt of similar terms and maturities. The Company utilizes letters of credit to collateralize certain long-term borrowings. The letters of credit reflect fair value as a condition of their underlying purpose and are subject to fees competitively determined in the marketplace.

To protect against the reduction in value of forecasted foreign currency cash flows resulting from export sales, the Company maintains a foreign currency cash flow hedging program. Under this program, the Company occasionally hedges portions of its forecasted revenue denominated in foreign currencies with forward contracts. When the dollar strengthens significantly against the foreign currencies (primarily the Euro and British Pound Sterling), the decline in value of future foreign currency revenue is offset by gains in the value of the forward contracts designated as hedges. Conversely, when the dollar weakens, the increase in the value of future foreign currency cash flows is offset by losses in the value of the forward contracts. At November 30, 2008 and 2007, the Company did not have any material forward currency exchange contracts outstanding. Hedging ineffectiveness during the years ended November 30, 2008, 2007, and 2006 was not material.





**Table of Contents****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****12. Treasury Stock**

The Board of Directors has authorized the Company to repurchase up to \$16,000,000 of the Company's Common Stock at market prices. The amount and timing of the shares to be repurchased are at the discretion of management. During the year ended November 30, 2008, the Company repurchased 1,001,479 shares at an aggregate cost of \$8,160,000. Since the inception of the stock buyback program, the Company has repurchased 1,677,479 shares at an aggregate cost of \$11,788,000. The repurchased shares are held as treasury stock.

**13. Accumulated Other Comprehensive Income (Loss)**

The components of accumulated other comprehensive income (loss) are as follows (in thousands):

	Foreign Currency Translation Adjustments
Balance November 30, 2005	\$ (128)
2006 Foreign currency translation adjustments	382
Balance November 30, 2006	254
2007 Foreign currency translation adjustments	539
Balance November 30, 2007	793
2008 Foreign currency translation adjustments	(148)
Balance November 30, 2008	\$ 645

**14. Other Income and Expense**

Other income and expense for the years ended November 30, 2008, 2007, and 2006 consist of the following (in thousands):

	2008	2007	2006
Patent licensing fees	\$ 340	\$ 93	\$ 114
Investment income	178	168	133
Gain (loss) on foreign currency transactions	(13)	(6)	23
	\$ 505	\$ 255	\$ 270



**Table of Contents****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****15. Income Taxes**

For the years ended November 30, 2008, 2007, and 2006, income before income taxes consists of the following (in thousands):

	2008	2007	2006
U.S. operations	\$ 13,414	\$ 16,697	\$ 8,677
Foreign operations	66	861	362
	\$ 13,480	\$ 17,558	\$ 9,039

For the years ended November 30, 2008, 2007, and 2006, the provision for income taxes consists of the following (in thousands):

	2008	2007	2006
<b>Current</b>			
U.S. Federal	\$ 3,561	\$ 5,004	\$ 1,371
Foreign	(5)	112	66
State	514	608	199
<b>Deferred</b>			
U.S. Federal	603	617	1,291
State	(44)	76	241
	\$ 4,629	\$ 6,417	\$ 3,168

The difference between the provision for income taxes and the amount computed by applying the U.S. federal income tax rate in effect for the years ended November 30, 2008, 2007, and 2006 (35% in 2008 and 2007, 34% in 2006) consists of the following (in thousands):

	2008	2007	2006
Statutory federal income tax	\$ 4,718	\$ 6,145	\$ 3,073
State income taxes, net of federal tax effect	305	445	290
Research activities tax credit	(193)	-	-
Domestic production activities deduction	(186)	(95)	-
Foreign tax rates	(28)	(190)	(56)
Tax rate changes on existing temporary differences	-	127	-
Other items	13	(15)	(139)
	\$ 4,629	\$ 6,417	\$ 3,168

Tax benefits realized upon the exercise of non-qualified stock options and disqualified incentive stock options are credited directly to stockholders' equity. For the years ended November 30, 2008, 2007, and 2006, these tax benefits and related credits to stockholders' equity amounted to \$102,000, \$356,000, and \$123,000, respectively.



**Table of Contents****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Significant components of the Company's net deferred tax assets and liabilities are as follows:

	November 30	
	2008	2007
	(in thousands)	
<b>Deferred tax assets:</b>		
Inventory valuation	\$ 770	\$ 428
Accrued compensation	602	570
Amortization of intangible assets	437	359
Allowance for doubtful accounts	327	345
Deferred tax assets	2,136	1,702
<b>Deferred tax liabilities:</b>		
Amortization of intangible assets	4,371	3,793
Depreciation of plant and equipment	2,488	2,234
Investment in subsidiaries	2,069	1,914
Other	15	11
Deferred tax liabilities	8,943	7,952
Net deferred tax liabilities	\$ (6,807)	\$ (6,250)
	November 30	
	2008	2007
	(in thousands)	
<b>Net deferred tax assets:</b>		
Current	\$ 1,684	\$ 1,332
<b>Net deferred tax liabilities:</b>		
Noncurrent	(8,491)	(7,582)
	\$ (6,807)	\$ (6,250)

For computing deferred tax assets and liabilities, the Company revised its estimated effective U.S. federal income tax rate from 34% to 35% in fiscal 2007. This increase in tax rate reflects the Company's current level of taxable income and management's projections for future profitability. The impact of this tax rate change was to increase the Company's income tax expense by \$127,000 for the year ended November 30, 2007.

The Company has not recorded deferred income taxes on the remaining undistributed earnings of its foreign subsidiaries because of management's intent to indefinitely reinvest such earnings. At November 30, 2008, the aggregate undistributed earnings of the foreign subsidiaries amounted to \$4,549,000. Upon distribution of these earnings in the form of dividends or otherwise, the Company may be subject to U.S. income taxes and foreign withholding taxes. It is not practical, however, to estimate the amount of taxes that may be payable on the eventual remittance of these earnings.

In assessing the realizability of deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the periods in which the temporary differences become deductible. Management considers the scheduled reversal of deferred tax liabilities, projected future taxable income, and tax planning strategies in making this assessment. Based upon the level of historical taxable income and projections for future taxable income, management believes it is more likely than not the Company will realize the benefits of the deferred tax assets. Accordingly, no deferred tax asset valuation allowance was recorded at November 30, 2008 or 2007.

As discussed in Note 1, the Company has adopted Financial Accounting Standards Board ( FASB ) Interpretation No. 48, Accounting for Uncertainty in Income Taxes an Interpretation of FASB Statement No. 109 ( FIN 48 ). The adoption of FIN 48, effective December 1, 2007, did not give rise to any cumulative effect adjustment to retained earnings or any reclassification of the Company s income tax assets and liabilities. Upon adoption, the Company had unrecognized tax benefits of \$68,000 related to certain state income tax matters. During the year ended November 30, 2008, the Company had additional unrecognized tax benefits of \$65,000 related to certain U.S. tax credits.

**Table of Contents****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

A reconciliation of beginning and ending unrecognized tax benefits is as follows (in thousands):

Balance at December 1, 2007	\$ 68
Increases related to:	
Prior year tax positions	-
Current year tax positions	65
 Balance at November 30, 2008	 \$ 133

As of November 30, 2008 and December 1, 2007, the Company's unrecognized tax benefits of \$133,000 and \$68,000, respectively, would affect the Company's effective tax rate if recognized.

The Company's practice is to recognize interest and penalties related to income tax matters as income tax expense. For each of the years presented herein, there were no significant amounts accrued or charged to expense for tax-related interest and penalties.

Although no income tax examinations are currently in process, the Company is subject to possible income tax examinations for its U.S. federal income tax returns filed for the tax years 2004 to present, and the tax year 2001 to present for most state income tax returns. International tax statutes may vary widely regarding the tax years subject to examination, but generally range from 2004 to the present.

**16. Earnings Per Common Share**

The following table sets forth the computation of basic and diluted earnings per common share:

	2008	2007	2006
Numerator for basic and diluted earnings per common share (in thousands):			
Net income	\$ 8,851	\$ 11,141	\$ 5,871
Denominator for basic earnings per common share (in thousands):			
Weighted average shares outstanding	13,069	13,359	13,127
Denominator for diluted earnings per common share (in thousands):			
Weighted average shares outstanding	13,069	13,359	13,127
Effect of dilutive stock options	120	439	254
	13,189	13,798	13,381
Earnings per common share:			
Basic	\$ 0.68	\$ 0.83	\$ 0.45

Edgar Filing: SPECTRUM CONTROL INC - Form 10-K

Diluted	\$ 0.67	\$ 0.81	\$ 0.44
---------	---------	---------	---------

In 2008, options to purchase 1,103,734 shares of Common Stock, at a weighted average exercise price of \$7.48 per share, were outstanding but were not included in the computation of diluted earnings per share because their inclusion would be antidilutive.



**Table of Contents****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****17. Supplemental Cash Flow Information**

Supplemental cash flow information for the years ended November 30, 2008, 2007, and 2006, consists of the following (in thousands):

	2008	2007	2006
Cash paid during the year for:			
Interest	\$ 357	\$ 603	\$ 446
Income taxes	6,759	3,548	2,284
Liabilities assumed in connection with:			
Purchase of land and buildings	-	-	2,888
Business acquisitions	1,344	104	758

**18. Common Stock Options**

The Company has two plans that provide for granting to officers, directors, employees and advisors options to purchase shares of the Company's Common Stock. Under the plans, option prices are not less than the market price of the Company's Common Stock on the date of the grant. The options become exercisable at varying dates and generally expire five years from the date of grant. At November 30, 2008, options to purchase 1,205,983 shares of Common Stock were available for grant under the Company's stock option plans.

A summary of the Company's stock option activity for the years ended November 30, 2008, 2007, and 2006 is as follows:

	Number of Shares Under Option	Per Share	Option Price Weighted Average	Aggregate	
Outstanding November 30, 2005	1,721,951	\$ 5.05	10.06	\$ 6.87	\$ 11,834,000
Granted during the year	-	-	-	-	-
Exercised during the year	(186,467)	5.05	7.00	5.75	(1,073,000)
Cancellations and forfeitures	(157,950)	5.25	10.06	9.06	(1,430,000)
Outstanding November 30, 2006	1,377,534	5.05	8.68	6.77	9,331,000
Granted during the year	-	-	-	-	-
Exercised during the year	(308,167)	5.05	8.68	6.24	(1,922,000)
Cancellations and forfeitures	(3,400)	5.25	6.05	5.52	(19,000)
Outstanding November 30, 2007	1,065,967	5.05	8.68	6.93	7,390,000
Granted during the year	380,500	8.38	15.00	11.94	4,545,000
Exercised during the year	(151,733)	5.05	8.68	5.38	(816,000)
Cancellations and forfeitures	(191,000)		15.00	15.00	(2,865,000)
Outstanding November 30, 2008	1,103,734	\$ 6.31	9.30	\$ 7.48	\$ 8,254,000

Edgar Filing: SPECTRUM CONTROL INC - Form 10-K

Exercisable:

November 30, 2008	656,598	\$ 6.31	8.68	\$ 7.37	\$ 4,840,000
November 30, 2007	483,031	\$ 5.05	8.68	\$ 6.83	\$ 3,300,000
November 30, 2006	382,935	\$ 5.05	8.68	\$ 6.34	\$ 2,426,000

**Table of Contents****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The following table summarizes significant ranges of outstanding and exercisable stock options at November 30, 2008:

Option Price Range		Number of Shares Under Option	
Per Share		Outstanding	Exercisable
\$6.31	7.00	461,000	291,332
7.01	8.00	242,234	154,266
8.01	9.00	305,000	211,000
9.01	9.30	95,500	-

At November 30, 2008, the weighted average remaining contractual life of outstanding options was 2.3 years. Except for the stock options granted during the year ended November 30, 2008, all of the Company's outstanding options at November 30, 2008 are fully vested. Based upon a closing market price of \$4.17 per share for the Company's Common Stock on November 30, 2008, none of the Company's outstanding stock options as of November 30, 2008 had any intrinsic value. During the years ended November 30, 2008, 2007 and 2006, the aggregate intrinsic value of stock options exercised amounted to \$568,000, \$2,143,000, and \$576,000, respectively.

**19. Employee Savings Plan**

The Company has a savings plan, available to substantially all U.S. employees, which permits participants to make contributions by salary reduction pursuant to Section 401(k) of the Internal Revenue Code. The Company matches employee contributions up to a maximum of 2.5% of compensation and may, at its discretion, make additional contributions to the plan. The Company's aggregate contribution to the plan was \$601,000 in 2008, \$552,000 in 2007, and \$493,000 in 2006.

**20. Concentration of Credit Risk**

Financial instruments which potentially subject the Company to a concentration of credit risk principally consist of cash equivalents, forward currency exchange contracts, and trade receivables.

The Company places its temporary cash investments with high credit quality financial institutions which invest primarily in U.S. Government instruments, commercial paper of prime quality, certificates of deposit, and guaranteed bankers' acceptances. The Company has never experienced any material losses on its temporary cash investments.

The Company is exposed to credit loss in the event of nonperformance by counterparties on foreign exchange contracts used in hedging activities. The counterparties to the Company's forward currency exchange contracts are major financial institutions and the Company has never experienced nonperformance by any of its counterparties.

Although its products are used in many industries, the Company's largest individual markets are military/defense and communications equipment. Accounts receivable from military/defense customers represented approximately 51% of total accounts receivable at November 30, 2008 and 49% at November 30, 2007. At November 30, 2008 and 2007, approximately 18% and 20%, respectively, of the Company's accounts receivable were from customers in the communications equipment industry. To reduce credit risk, the Company performs ongoing credit evaluations of its customers, but does not generally require advance payments or collateral. The Company maintains a provision for potential credit losses based upon the expected collectibility of all accounts receivable.



**Table of Contents**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**21. Reportable Operating Segments**

The Company designs, develops and manufactures custom electronic components and systems. Although it provides a wide range of products to many industries worldwide, the Company's largest markets are military/defense, communications, and medical/industrial equipment.

The Company's current operations are conducted in four reportable segments: signal and power integrity components; microwave components and systems; power management systems; and sensors and controls. The Company's Signal and Power Integrity Components Business designs and manufactures a broad range of products including coaxial filters, filtered connectors, power filters, antennas, and various specialty ceramic components. Our Microwave Components and Systems Business designs and manufactures radio frequency and microwave filters, amplifiers, mixers, oscillators, and related systems and integrated assemblies. The Power Management Systems Business designs and manufactures custom AC and DC power distribution units, power outlet strips, and our Smart Start power management systems. Our Sensors and Controls Business designs and manufactures rotary and linear positioning sensors, temperature sensing probes, thermistors, resistance temperature detector sensors, and related assemblies. The reportable segments are each managed separately because they manufacture and sell distinct products with different production processes.

The Company evaluates performance and allocates resources to its reportable segments based upon numerous factors, including segment income before income taxes. The accounting policies of the reportable segments are the same as those utilized in the preparation of the Company's consolidated financial statements. However, substantially all of the Company's general and administrative expenses, and nonoperating expenses, are not allocated to the Company's reportable operating segments and, accordingly, these expenses are not deducted in arriving at segment income. Segment reportable assets are comprised of certain tangible assets (property, plant, equipment, and inventories) and goodwill.

**Table of Contents****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

For each period presented, the accounting policies and procedures used to determine segment income have been consistently applied. For the years ended November 30, 2008, 2007, and 2006, reportable segment information is as follows (in thousands):

	Signal and Power Integrity Components	Microwave Components and Systems	Power Management Systems	Sensors and Controls	Total
<b><u>2008</u></b>					
Revenue from unaffiliated customers	\$ 52,060	\$ 45,942	\$ 9,879	\$ 22,813	\$ 130,694
Depreciation and amortization expense	1,990	1,977	258	875	5,100
Segment income	9,343	5,492	1,705	3,771	20,311
<b>Segment assets</b>					
Tangible assets	21,966	21,052	2,854	7,239	53,111
Goodwill	14,243	14,862	-	7,706	36,811
Capital expenditures	1,367	1,938	432	719	4,456
<b><u>2007</u></b>					
Revenue from unaffiliated customers	60,713	47,748	7,586	20,492	136,539
Depreciation and amortization expense	1,924	2,041	205	523	4,693
Segment income	11,314	8,791	1,338	2,815	24,258
<b>Segment assets</b>					
Tangible assets	22,030	16,100	2,903	5,946	46,979
Goodwill	14,243	13,720	-	7,706	35,669
Capital expenditures	1,999	1,524	372	1,892	5,787
<b><u>2006</u></b>					
Revenue from unaffiliated customers	58,472	48,716	6,657	11,827	125,672
Depreciation and amortization expense	1,739	1,709	109	330	3,887
Segment income	3,754	9,511	2,012	1,407	16,684
<b>Segment assets</b>					
Tangible assets	21,986	14,076	1,190	3,921	41,173
Goodwill	14,243	12,559	-	7,706	34,508
Capital expenditures	6,337	1,189	749	256	8,531

**Table of Contents****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

For the years ended November 30, 2008, 2007, and 2006, reconciliations of reportable segment information to the Company's consolidated financial statements are as follows (in thousands):

<b>Depreciation and amortization expense</b>	<b>2008</b>	<b>2007</b>	<b>2006</b>
Total depreciation and amortization expense for reportable segments	\$ 5,100	\$ 4,693	\$ 3,887
Unallocated amounts:			
Depreciation and amortization expense related to general and administrative activities	81	130	224
Consolidated depreciation and amortization expense	\$ 5,181	\$ 4,823	\$ 4,111
<b>Income before provision for income taxes</b>	<b>2008</b>	<b>2007</b>	<b>2006</b>
Total income for reportable segments	\$ 20,311	\$ 24,258	\$ 16,684
Unallocated amounts:			
General and administrative expense	(6,967)	(6,394)	(7,370)
Interest expense	(369)	(561)	(545)
Other income, net of other expense	505	255	270
Consolidated income before provision for income taxes	\$ 13,480	\$ 17,558	\$ 9,039
<b>Assets</b>	<b>2008</b>	<b>2007</b>	<b>2006</b>
Total assets for reportable segments	\$ 89,922	\$ 82,648	\$ 75,681
Unallocated amounts:			
Cash and cash equivalents	5,397	5,183	3,501
Accounts receivable	24,043	25,461	22,676
Other current assets	3,991	2,243	4,531
Other noncurrent assets	11,431	11,384	12,818
Total consolidated assets	\$ 134,784	\$ 126,919	\$ 119,207
<b>Capital expenditures</b>	<b>2008</b>	<b>2007</b>	<b>2006</b>
Total capital expenditures for reportable segments	\$ 4,456	\$ 5,787	\$ 8,531
Unallocated amounts:			
Capital expenditures related to general and administrative activities	26	23	23
Total consolidated capital expenditures	\$ 4,482	\$ 5,810	\$ 8,554

**Table of Contents****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The Company has operations in the United States, Mexico, China and Germany. Sales are attributed to individual countries based on the location of the customer. The geographic distribution of sales and long-lived assets for 2008, 2007, and 2006 is as follows (in thousands):

	United States	Mexico	China	Germany	All Other Countries	Total
<b>2008</b>						
Revenue from unaffiliated customers	\$ 101,891	\$ 1,122	\$ 3,652	\$ 4,231	\$ 19,798	\$ 130,694
Long-lived assets:						
Property, plant and equipment	25,599	71	1,558	22	-	27,250
<b>2007</b>						
Revenue from unaffiliated customers	107,740	735	5,398	5,726	16,940	136,539
Long-lived assets:						
Property, plant and equipment	24,607	95	1,445	30	-	26,177
<b>2006</b>						
Revenue from unaffiliated customers	99,403	1,376	3,710	5,327	15,856	125,672
Long-lived assets:						
Property, plant and equipment	22,682	93	1,434	27	-	24,236

In 2008, the Company's largest single customer ( a prime supplier to the military/defense industry ) represented 4% of total consolidated net sales. Sales to this major customer consisted of various signal, power and microwave components and systems.

In 2007, sales to the Company's largest single customer (a distributor of electronic components) represented 5% of the Company's total consolidated net sales. Sales to this major customer principally consisted of signal and power integrity components.

In 2006, sales to the Company's largest single customer (a prime supplier to the military/defense industry) represented 7% of the Company's total consolidated net sales. Sales to this major customer primarily consisted of microwave components and systems.



**Table of Contents****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****22. Quarterly Financial Data (Unaudited)**

	<b>Year Ended November 30, 2008</b>			
	<b>First</b>	<b>Second</b>	<b>Third</b>	<b>Fourth</b>
	(in thousands, except per share data)			
Net sales	\$ 31,154	\$ 32,574	\$ 33,124	\$ 33,842
Gross margin	6,851	8,080	8,592	9,239
Net income	1,789	2,176	2,354	2,532
Earnings per common share:				
Basic	0.13	0.16	0.18	0.20
Diluted	0.13	0.16	0.18	0.20

	<b>Year Ended November 30, 2007</b>			
	<b>First</b>	<b>Second</b>	<b>Third</b>	<b>Fourth</b>
	(in thousands, except per share data)			
Net sales	\$ 32,887	\$ 33,558	\$ 35,418	\$ 34,676
Gross margin	7,802	9,133	10,098	9,330
Net income	2,119	2,750	3,081	3,191
Earnings per common share:				
Basic	0.16	0.21	0.23	0.24
Diluted	0.16	0.20	0.22	0.23

Earnings per common share are computed independently for each of the quarters presented. Therefore, the sum of the quarterly earnings per share may not equal the total computed for the year.

**23. Contingencies**

The Company is subject to certain legal proceedings and claims arising in the ordinary course of business. In the opinion of management, the amount of any ultimate liability with respect to these actions will not materially affect the Company's consolidated financial position, results of operations, or cash flows.

**24. Operating Leases**

The Company has entered into several operating lease agreements, primarily relating to certain manufacturing facilities, computer equipment, and sales offices. These leases are noncancelable and expire on various dates through 2013. Leases that expire generally are expected to be renewed or replaced by other leases. Future minimum rental payments for all operating leases having initial or remaining noncancelable terms in excess of one year are as follow (in thousands):

2009	\$ 1,396
2010	1,304
2011	389
2012	321
2013	107

\$ 3,517

Total rent expense under all operating leases amounted to \$2,157,000 in 2008, \$2,362,000 in 2007, and \$2,237,000 in 2006.

---

**Table of Contents**

**ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE**

None

**ITEM 9A. Controls and Procedures**

*(a) Evaluation of Disclosure Controls and Procedures*

The Company's management, with the participation of the Company's Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of the Company's disclosure controls and procedures as of November 30, 2008. Based on that evaluation, the Company's Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures were effective to ensure that information required to be disclosed by the Company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the Commission's rules and forms.

*(b) Management's Annual Report on Internal Controls Over Financial Reporting*

Management of Spectrum Control, Inc. is responsible for establishing and maintaining an adequate system of internal control over financial reporting. This system is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with accounting principles generally accepted in the United States of America.

The Company's internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the Company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the Company are being made only in accordance with authorizations of management and directors of the Company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the Company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, a system of internal control over financial reporting can provide only reasonable assurance and may not prevent or detect misstatements. Further, because of changes in conditions, effectiveness of internal controls over financial reporting may vary over time. Our system contains self-monitoring mechanisms, and actions are taken to correct deficiencies as they are identified.

Management conducted an evaluation of the effectiveness of the system of internal control over financial reporting based on the framework in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Based on this evaluation, management concluded that the Company's system of internal control over financial reporting was effective as of November 30, 2008.

The effectiveness of the Company's internal control over financial reporting has been audited by Ernst & Young LLP, an independent registered public accounting firm, as stated in their report which is included herein.

*(d) Report of Independent Registered Public Accounting Firm*

The Board of Directors and Shareholders

Spectrum Control, Inc.

We have audited Spectrum Control, Inc. and subsidiaries' internal control over financial reporting as of November 30, 2008, based on criteria established in Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). Spectrum Control, Inc.'s management is responsible for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, as stated in their report which is included herein. Our responsibility is to express an opinion on the company's internal control over financial

reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

**Table of Contents**

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, Spectrum Control, Inc. and subsidiaries maintained, in all material respects, effective internal control over financial reporting as of November 30, 2008, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Spectrum Control, Inc. and subsidiaries as of November 30, 2008 and 2007, and the related consolidated statements of income, stockholders' equity, and cash flows for each of the three years in the period ended November 30, 2008 of Spectrum Control, Inc. and our report dated February 11, 2009, expressed an unqualified opinion thereon.

ERNST & YOUNG LLP

Pittsburgh, Pennsylvania

February 11, 2009

*(e) Changes in Internal Control Over Financial Reporting*

There were no material changes in the Company's internal control over financial reporting during the fourth quarter of fiscal 2008.

**ITEM 9B. Other Information**

None

**Table of Contents****PART III****ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT**

The information set forth under "Election of Directors" and "Directors of the Company" on pages 4 and 5 of the registrant's Proxy Statement for the annual meeting of shareholders to be held April 6, 2009 (the "Proxy Statement") is incorporated herein by reference.

Current members of the Company's Audit Committee are: George J. Behringer, Chairman; Bernard C. Bailey; and Gerald A. Ryan. All of the committee members are independent directors. The Company has determined that Mr. Behringer and Mr. Bailey are financial experts, as that term has been defined by the Securities and Exchange Commission.

The Company has adopted a Code of Ethics and Business Conduct that applies to all of its directors, officers (including its chief executive officer, chief financial officer, chief accounting officer, controller and any person performing similar functions) and employees. The Code of Ethics and Business Conduct is available on the Company's website at [www.spectrumcontrol.com](http://www.spectrumcontrol.com).

The following information is provided with respect to the executive officers of the Company:

<b>Name of Officer</b>	<b>Age</b>	<b>Position</b>
John P. Freeman	54	Senior Vice President, Chief Financial Officer
Lawrence G. Howanitz	56	Senior Vice President, Signal and Power Integrity Products
Robert J. McKenna	55	Senior Vice President, New Business and Resource Development
Richard A. Southworth	66	President, Chief Executive Officer
James F. Toohey	74	Secretary
Brian F. Ward	49	Senior Vice President, Sensors and Controls

Mr. Freeman is a graduate of Gannon University in Accounting and is a Certified Public Accountant and Certified Management Accountant. He joined the Company in 1988 as Controller. Prior to that time, he was a principal in a public accounting firm. In 1990, he was named Vice President and Chief Financial Officer. In December of 2000, he was named Senior Vice President.

Mr. Howanitz is a graduate of Pennsylvania State University with a bachelors degree in Business Administration. Since joining the Company in 1984, he has held several management positions including General Manager of the Company's Interconnect Products Division, Vice President of the Company's Signal Integrity Products Group, and Senior Vice President of Signal and Power Integrity Products. In his current position, Mr. Howanitz is responsible for the Company's EMI filter, components and power integrity products business.

Mr. McKenna is a graduate of Gannon University with a bachelors degree in General Science. Since joining the Company in 1991, he has held several positions including Business Unit Leader and Distribution Sales Manager. In 2002, Mr. McKenna was named Vice President of New Business and Resource Development. In 2004, he was named Senior Vice President.

Mr. Southworth is a graduate of Gannon University in Mechanical Engineering and Mathematics. He joined the Company in 1991 as Vice President and General Manager. Prior to joining the Company, Mr. Southworth held executive positions with National Water Specialties, Philips Components, Murata Electronics North America, and Erie Technological Products. In 1997, Mr. Southworth was named President and Chief Executive Officer.

## Edgar Filing: SPECTRUM CONTROL INC - Form 10-K

Mr. Toohey is a graduate of Gannon University and Dickinson School of Law and is a practicing member of the Erie County Bar Association. He is a member of the law firm of Quinn, Buseck, Leemhuis, Toohey & Kroto, Inc., general counsel to the Company, and has been a Director and Secretary of the Company since its organization.

Mr. Ward is a Marketing graduate of Franklin Pearce College of Business. He joined the Company in 1994 as Director of Marketing and in 1997 was named Vice President of Sales and Marketing. In December of 2000, he was named Senior Vice President. In his current position, Mr. Ward is responsible for the Company's sensors and controls business. Prior to joining the Company, Mr. Ward held managerial positions in Engineering and Marketing with Clarostat Manufacturing Co. and Oak Grigsby, Inc.

All executive officers are elected by the Board of Directors and serve at the discretion of the Board.

**Table of Contents**

**ITEM 11. EXECUTIVE COMPENSATION**

The information set forth under Executive Compensation and Compensation Discussion and Analysis on pages 9 through 20 of the Proxy Statement is incorporated herein by reference.

**ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS**

The information set forth under Securities Ownership on pages 7 and 8 of the Proxy Statement is incorporated herein by reference.

**ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS**

The information set forth under Certain Relationships and Related Transactions on page 8 of the Proxy Statement is incorporated herein by reference.

**ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES**

The information set forth under Appointment of the Company's Auditors for the Fiscal Year 2009 on page 21 of the Proxy Statement is incorporated herein by reference.



**Table of Contents**

**PART IV**

**ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES, AND REPORTS ON FORM 8-K**

(a) Financial Statements and Schedules

- (1) Financial Statements - The following consolidated financial statements of Spectrum Control, Inc. and subsidiaries are included in Part II, Item 8:

	Page No.
Report of Independent Registered Public Accounting Firm	36
Consolidated Balance Sheets as of November 30, 2008 and 2007	37
Consolidated Statements of Income for the Years Ended November 30, 2008, 2007, and 2006	38
Consolidated Statements of Stockholders' Equity for the Years Ended November 30, 2008, 2007, and 2006	39
Consolidated Statements of Cash Flows for the Years Ended November 30, 2008, 2007, and 2006	40
Notes to Consolidated Financial Statements	41-63

- (2) Financial Statement Schedules - The following financial statement schedule is submitted herewith for the periods indicated therein.

Schedule II - Valuation and Qualifying Accounts	71
---	----

All other schedules are not submitted because they are not required or are not applicable, or the required information is shown in the consolidated financial statements or notes thereto. Columns omitted from the schedule filed have been omitted because the information is not applicable.

**Table of Contents**

(3) Exhibits - The following is the index to exhibits for Spectrum Control, Inc. and subsidiaries.

Description of Exhibit	Page No.
Articles of Incorporation of the Company, as amended, previously filed on February 25, 1981, as Exhibit 3.1 to Form S-1 registration and incorporated herein by reference	
By-laws of the Company, as amended, previously filed on February 25, 1981, as Exhibit 3.2 to Form S-1 registration and incorporated herein by reference	
Stock Option Plan of 1995, previously filed under Form S-8 on January 22, 1996, and incorporated herein by reference	
1996 Non-Employee Directors' Stock Option Plan, previously filed under Form S-8 on July 16, 1996, and incorporated herein by reference	
Asset Purchase Agreement dated October 15, 2004, by and between Spectrum Control, Inc. and REMEC Inc., previously filed on October 15, 2004, as Exhibit 2.1 to Form 8-K, and incorporated herein by reference	
Asset Purchase Agreement dated February 11, 2005, by and among Spectrum Microwave, Inc., Amplifonix, Inc., R. Lake Associates and Dr. Arthur Riben, previously filed on February 11, 2005, as Exhibit 10.1 to Form 8-K, and incorporated herein by reference	
Subsidiaries of the Company (21.1)	72-73
Consent of Ernst & Young LLP (23.1)	74
Certification of Chief Executive Officer pursuant to Rule 13a-14(a) and Rule 15d-14(a) of the Securities Exchange Act, as amended (31.1)	75
Certification of Chief Financial Officer pursuant to Rule 13a-14(a) and Rule 15d-14(a) of the Securities Exchange Act, as amended (31.2)	76
Certification of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (32.1)	77

(b) Reports on Form 8-K  
None

**Table of Contents**

**SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) 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.

Spectrum Control, Inc.

February 12, 2009 By: /s/ Richard A. Southworth  
Richard A. Southworth

President and Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

/s/ Bernard C. Bailey	Director	February 12, 2009
/s/ George J. Behringer	Director	February 12, 2009
/s/ John P. Freeman	Director, Chief Financial Officer, and Principal Accounting Officer	February 12, 2009
/s/ J. Thomas Gruenwald	Director	February 12, 2009
/s/ Melvin Kutchin	Director	February 12, 2009
/s/ Gerald A. Ryan	Director	February 12, 2009
/s/ James F. Toohey	Director	February 12, 2009

**Table of Contents**

Spectrum Control, Inc. and Subsidiaries  
 Schedule II Valuation and Qualifying Accounts  
 For the Three Years Ended November 30, 2008  
 (Amounts in Thousands)

Column A	Column B	Column C	Column D	Column E
Description	Balance at Beginning of Year	Additions Charged to (Credited Against) Costs and Expenses	Deductions	Balance at End of Year
<b>Year ended November 30, 2006:</b>				
Allowance for doubtful accounts	\$ 1,032	\$ 266	\$ 447 (1)	\$ 851
Reserve for excess and slow- moving inventories	\$ 2,510	\$ 1,005	\$ 2,174 (2)	\$ 1,341
<b>Year ended November 30, 2007:</b>				
Allowance for doubtful accounts	\$ 851	\$ (89)	\$ (209) (1)	\$ 971
Reserve for excess and slow- moving inventories	\$ 1,341	\$ 1,303	\$ 1,416 (2)	\$ 1,228
<b>Year ended November 30, 2008</b>				
Allowance for doubtful accounts	\$ 971	\$ 212	\$ 250 (1)	\$ 933
Reserve for excess and slow- moving inventories	\$ 1,228	\$ 1,506	\$ 1,029 (2)	\$ 1,705

(1) Uncollectible accounts written off, net of recoveries

(2) Inventories physically scrapped