

SPECTRUM CONTROL INC
Form 10-K
February 11, 2010
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, 2009

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	Name of each exchange on which registered
Common Stock - No Par Value	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 whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of regulation S-T (Section 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files. Yes No .

Indicate by check mark 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, 2009, the aggregate market value of voting Common Stock held by non-affiliates of the registrant based on a closing price of \$8.22 was \$97,181,525. 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 29, 2010, the registrant had outstanding 12,712,865 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 12, 2010 are incorporated by reference into Part III of this Form 10-K.

Table of Contents**Table of Contents**

	Page
<u>PART I</u>	
Item 1. <u>Business</u>	3
Item 1A. <u>Risk Factors</u>	18
Item 1B. <u>Unresolved Staff Comments</u>	21
Item 2. <u>Properties</u>	22
Item 3. <u>Legal Proceedings</u>	23
Item 4. <u>Submission of Matters to a Vote of Security Holders</u>	23
<u>PART II</u>	
Item 5. <u>Market for Registrant's Common Stock, Related Stockholder Matters and Issuer Purchases of Equity Securities</u>	23
Item 6. <u>Selected Financial Data</u>	25
Item 7. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	26
Item 7A. <u>Quantitative and Qualitative Disclosures About Market Risk</u>	33
Item 8. <u>Financial Statements and Supplementary Data</u>	38
Item 9. <u>Changes in and Disagreements with Accountants on Accounting and Financial Disclosure</u>	66
Item 9A. <u>Controls and Procedures</u>	66
Item 9B. <u>Other Information</u>	67
<u>PART III</u>	
Item 10. <u>Directors and Executive Officers of the Registrant</u>	68
Item 11. <u>Executive Compensation</u>	69
Item 12. <u>Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters</u>	69
Item 13. <u>Certain Relationships and Related Transactions</u>	69
Item 14. <u>Principal Accountant Fees and Services</u>	69
<u>PART IV</u>	
Item 15. <u>Exhibits, Financial Statement Schedules, and Reports on Form 8-K</u>	70
<u>Signatures</u>	72
<u>Schedule</u>	73
<u>Exhibits</u>	74

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. Although our components and systems are used in many industries worldwide, our largest individual markets are military/defense and communications equipment which represented 61% and 16%, respectively, of our fiscal 2009 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: advanced specialty products (formerly referred to as signal and power integrity components); microwave components and systems; power management systems; and sensors and controls. Our Advanced Specialty Products Business designs and manufactures a broad range of products including antennas, specialty connectors, advanced ceramics, and electromagnetic interference ("EMI") filters and interconnects. Our Microwave Components and Systems Business designs and manufactures microwave filters and components, high power amplifiers, oscillators, synthesizers, switched filter banks, and related systems and integrated assemblies. The Power Management Systems Business designs and manufactures custom AC and DC power distribution units, power outlet strips, power monitoring equipment, 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 advanced specialty products. 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 product offerings. The Parent company's executive offices are located in Fairview.

Spectrum Control Technology, Inc. ("Spec Tech") is a wholly-owned subsidiary of the Parent company. Spec Tech designs and manufactures advanced ceramic products at its state-of-the-art ceramic facility in State College, Pennsylvania. In addition to producing specialty ceramic capacitors used in the Company's EMI filters, Spec Tech designs and manufactures other advanced ceramics including various ceramic-based antenna products and related assemblies.

Other wholly-owned 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") and Spectrum SEI Microwave, Inc. ("SEI") design and manufacture various radio frequency ("RF") and microwave products. These high-end components and integrated assemblies include amplifiers, frequency mixers, filters, microelectronics, and various types of oscillators (voltage control, dielectric resonator, and digitally tuned). Currently, Spec Microwave operates facilities in Philadelphia, Pennsylvania; Palm Bay, Florida; Marlborough and Worcester, Massachusetts; Auburn, New York; as well as a portion of our facility in State College, Pennsylvania. SEI's operating facility is located in Delmar, Delaware.

Edgar Filing: SPECTRUM CONTROL INC - Form 10-K

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

Table of Contents

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, principally acts as a distributor for the Company's advanced specialty 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 advanced specialty products, power management systems, and sensors and controls for various commercial customers.

RECENT DEVELOPMENTS

ACQUISITION

On November 30, 2009, we acquired substantially all of the assets and assumed certain liabilities of Micro Networks Corporation (Micro Networks). Micro Networks, with operations in Worcester, Massachusetts and Auburn, New York, designs and manufactures high-performance data conversion products, custom modules, and a broad line of filters, oscillators, and delay lines based on surface acoustic wave (SAW) technology. Micro Networks' products also include integrated microwave assemblies with hybrid circuit design, precision bulk acoustic wave delay lines and synthesizers. We believe that these products and related SAW technology, which are currently used predominantly in defense and aerospace applications, 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 Micro Networks' products.

The aggregate cash purchase price for Micro Networks was \$12.9 million. This purchase price was partially funded by borrowings of \$7.0 million under our domestic line of credit. We utilized our existing cash reserves to satisfy the balance of the purchase price.

STOCK BUYBACK PROGRAM

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, 2009, we did not repurchase any of our Common Stock. Since the inception of the stock repurchase program, 1,677,479 shares have been repurchased at a total cost of \$11.8 million.

MARKETS

MILITARY/DEFENSE

Military forces worldwide are dependent on sophisticated electronic equipment. Military aircraft, naval vessels, and fighting vehicles generally contain extensive communication equipment, electronic countermeasure equipment for defense against enemy weapons, smart weapons and munitions, and radar systems. We provide numerous custom microwave components and subsystems, power products, position sensors, and low pass EMI filters to major equipment manufacturers for installation into these systems. Our customers, in turn, sell their equipment to major defense manufacturers or directly to governments.

Table of Contents

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
- Joint Tactical Radio System (Extended Band Manpack, an accessory to the AN/PRC-148 JTRS Enhanced Multiband Inter/Intra Team Radio)
- Patriot Radar

Military/defense sales were approximately \$80.9 million in 2009 and \$62.5 million in 2008, or approximately 61% and 48% of our total sales, respectively. Demand for military/defense products may be impacted by numerous economic, technological and political factors. Accordingly, while we have 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

We provide a wide range of custom products for use in various communications equipment, including base stations, routers, servers, data storage, and WiMAX (Worldwide Interoperability for Microwave Access) systems. We design and manufacture products for both wireline and wireless applications. Wireless 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 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.

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. We provide discrete EMI filters, filtered interconnects, low phase noise amplifiers, and various power products to original equipment manufacturers (OEM s) of base station equipment. In addition, our 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.

Table of Contents

Approximately 16% of the Company's total revenue during fiscal year 2009 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 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 EMI filter products. Our State College facility, along with our extensive ceramic expertise, enables us to maintain short lead times for our EMI filter and interconnect 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 and microwave products, sensors, and power management systems. 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 under the requirements of the U.S. military quality system.

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

Table of Contents

Introducing New Advanced Specialty Product Lines. We are broadening our product lines to include specialty connectors, advanced ceramics, antennas, and related assemblies. In 2009, for example, we enhanced our capabilities to design and manufacture planar capacitors and internally machined connector shells. This now enables us to design and manufacture specialty connectors, including circular connectors. Circular connectors are used in numerous military/defense applications including falcon radios, movement tracking systems (MTS) for military vehicles, and communication systems for mine resistant ambush protected (MRAP) vehicles. In addition, we have recently developed numerous antenna products including loop antennas, wide beam aperture antennas, and wide bandwidth slot antennas. These specialty antennas have many commercial and military applications including asset tracking systems, down hole drilling, commercial satellites, and soldier wearable antennas. On an ongoing basis, our primary focus is on new higher-margin products to exploit the long-term expected growth in wireless devices and defense applications. Our customers increasingly look for greater capability to produce value-added systems integrating our existing advanced specialty 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. In 2009, we successfully introduced a ruggedized version of our AC SMART Start product. These multifunctional units direct and manage power to connected servers and networking equipment, while providing remote operational flexibility and control. Our newly developed ruggedized version is ideally suited for military applications. In recent years, we've also 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 Micro Networks, which expanded our microwave capabilities to include SAW-based technologies and products, we have made several other acquisitions in the past few years. In 2008, we acquired SatCon Electronics, Inc. (SatCon), a designer and manufacturer of 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, millimeterwave components, and a full line of thin and thick film circuits. We believe these products are a natural complement and extension of our Microwave Components and Systems Business. 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. 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.

With OEMs 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-effective 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.

Table of Contents

PRODUCTS

The Company's product offerings include various advanced specialty products, microwave components and systems, power management systems, and sensors and controls.

ADVANCED SPECIALTY PRODUCTS

Recently, we expanded our product capabilities for a wide range of sophisticated components and assemblies including antennas, unfiltered interconnects, cable assemblies, specialty ceramics, and film modules. These products have been added to our comprehensive line of EMI coaxial filters and filtered interconnects. Our advanced specialty products provide solutions for military and aerospace applications such as weapons guidance systems, missile defense, radios, secure communications, aircraft, and military vehicles. Communications equipment applications include base stations, switching equipment, GPS, and optical networks. In addition, our advanced specialty products are utilized within commercial aircraft, industrial controls, instrumentation, medical, consumer, and automotive markets.

Our current product offerings include the following:

ANTENNA ASSEMBLIES

- Patch antennas
- Microstrip antennas
- Slot antennas
- Arrays and assemblies

SPECIALTY CONNECTORS AND HARNESSING

- Circular connectors
- Audio connectors
- Glass sealed connectors
- Value added terminations, cables, and harnesses

EMI COAXIAL FILTERS AND INTERCONNECTS

- Resin and hermetically sealed filters
- Motor-line feed through filters
- High current and high voltage filters
- Miniature hermetically sealed and surface mount filters
- Filter plates and terminal blocks
- D-sub and combo filtered connectors
- Ribbon and datacomm connectors
- USB filtered and ESD protected connectors

POWER FILTERS AND FILM MODULES

- Commercial power filters
- Military and aerospace power filters
- Power entry modules
- Film feed through filters
- Film modules

ADVANCED CERAMICS

Structural ceramics
Capacitor arrays
Planar capacitors
Discoidal and tubular capacitors
Thick and thin film

During the year ended November 30, 2009, approximately 32% of our total consolidated revenue was generated from the sale of advanced specialty products.

Table of Contents

MICROWAVE COMPONENTS AND SYSTEMS

We design and manufacture a broad range of RF and microwave products. Currently, these products are predominately sold into military/defense markets for applications in communication jamming systems, radar systems, countermeasures, radio, electronic warfare, and weapons guidance systems. Wireless commercial applications for our microwave components and systems include base stations and towers, WiFi, HDTV and CATV, as well as medical imaging equipment.

Our current product offerings include the following:

RF AND MICROWAVE AMPLIFIERS

- Ultra low phase noise
- Medium power broadband models
- High reverse isolation AMPS
- High linearity designs

RF AND MICROWAVE MIXERS

- Broadband triple balanced models
- High isolation double balanced designs
- Multi-octave doublers
- High image suppression models

FREQUENCY CONTROL PRODUCTS

- Low phase noise voltage controlled oscillators
- High frequency dielectric resonator oscillators
- Multi-throw switches
- Low phase noise synthesizers

RF AND MICROWAVE FILTERS

- High selectivity cavity filters
- Low loss tubular filters
- Low profile lumped element designs
- Low cost ceramic filters
- Multi-channel switched filter banks

INTEGRATED RF AND MICROWAVE SOLUTIONS

- Integrated microwave assemblies
- High frequency receivers
- Microelectronic components

During the year ended November 30, 2009, approximately 45% of our total consolidated revenue was generated from the sale of microwave components and systems.

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 commercial markets for these systems include optical equipment, data centers, wireless base stations, and IT hubs. In addition, we offer a line of custom and standard power strips, and circuit protection systems for both AC and DC power applications. Military/defense is a growing market for our power management products with applications in mobile command platforms, simulators, radar systems, and ATE equipment.

Our current product offerings include the following:

AC POWER SOLUTIONS

Edgar Filing: SPECTRUM CONTROL INC - Form 10-K

Smart start switched power distribution units
AC Smart start power sequencers
Power entry panels with circuit protection
Specialty Hi-Rel power management systems
Monitored power strips
Single and three phase power strips

9

Table of Contents

DC POWER SOLUTIONS

Circuit breaker interface panels

Fuse interface panels

Data acquisition and monitoring modules

Specialty Hi-Rel power management systems

Smart start power sequencers

TACTICAL MILITARY VEHICLE AND TRANSIT CASE POWER SOLUTIONS

Smart start technology with sequencing for AC or DC

Transfer switches

Surge protection

Embedded battery charger

Integrated EMI filters

During the year ended November 30, 2009, approximately 8% of our total consolidated revenue was generated from the sale of power management systems.

SENSORS AND CONTROLS

We design and manufacture high reliability precision position sensors and transducers, as well as a broad line of temperature sensors and thermal products. Our precision position sensors and control products are based on several proprietary technologies, including a flush circuit conductive plastic element for long-term reliability. In addition, our new non-contact position sensors offer ultra-high precision and reliability. Our sensors and controls are used in numerous industries worldwide including military/defense, commercial aerospace, medical equipment, wind instruments, HVAC equipment, food service, and industrial automation.

Our current product offerings include the following:

POSITION SENSORS AND CONTROLS

Motorized potentiometers

Fadar and hollow shaft potentiometers

Element segments and wiper assemblies

ADVANCED THERMAL PRODUCTS

Temperature sensing probes and assemblies

Heater assemblies

Positive temperature coefficient (PTC) thermistors

Negative temperature coefficient (NTC) thermistors

During the year ended November 30, 2009, approximately 15% of our total consolidated 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: advanced specialty products, 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, 2009, 2008, and 2007, reportable segment information is as follows (in thousands):

	Advanced Specialty Products	Microwave Components and Systems	Power Management Systems	Sensors and Controls	Total
2009					
Revenue from unaffiliated customers	\$ 42,001	\$ 60,069	\$ 10,268	\$ 19,968	\$ 132,306
Depreciation and amortization expense	1,953	2,601	280	812	5,646
Segment income	5,332	10,021	2,758	3,448	21,559
Segment assets					
Tangible assets	20,125	25,482	2,743	7,541	55,891
Goodwill	14,243	23,046	-	7,706	44,995
Capital expenditures	1,030	2,326	99	298	3,753
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

Table of Contents

For the years ended November 30, 2009, 2008, and 2007, reconciliations of reportable segment information to the Company's consolidated financial statements are as follows (in thousands):

Depreciation and amortization expense	2009	2008	2007
Total depreciation and amortization expense for reportable segments	\$ 5,646	\$ 5,100	\$ 4,693
Unallocated amounts:			
Depreciation and amortization expense related to general and administrative activities	75	81	130
Consolidated depreciation and amortization expense	\$ 5,721	\$ 5,181	\$ 4,823
Income before provision for income taxes	2009	2008	2007
Total income for reportable segments	\$ 21,559	\$ 20,311	\$ 24,258
Unallocated amounts:			
General and administrative expense	(7,955)	(6,967)	(6,394)
Interest expense	(190)	(369)	(561)
Other income and (expense), net	(26)	505	255
Consolidated income before provision for income taxes	\$ 13,388	\$ 13,480	\$ 17,558
Assets	2009	2008	2007
Total assets for reportable segments	\$ 100,886	\$ 89,922	\$ 82,648
Unallocated amounts:			
Cash and cash equivalents	6,090	5,397	5,183
Accounts receivable	22,623	24,043	25,461
Other current assets	3,859	3,991	2,243
Other noncurrent assets	10,271	11,431	11,384
Total consolidated assets	\$ 143,729	\$ 134,784	\$ 126,919
Capital expenditures	2009	2008	2007
Total capital expenditures for reportable segments	\$ 3,753	\$ 4,456	\$ 5,787
Unallocated amounts:			
Capital expenditures related to general and administrative activities	199	26	23
Total consolidated capital expenditures	\$ 3,952	\$ 4,482	\$ 5,810

Table of Contents

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 2009, 2008, and 2007, is as follows (in thousands):

	United States	Mexico	China	Germany	All Other Countries	Total
2009						
Revenue from unaffiliated customers	\$ 110,612	\$ 658	\$ 2,111	\$ 2,535	\$ 16,390	\$ 132,306
Long-lived assets:						
Property, plant and equipment	25,164	116	1,086	17	-	26,383
2008						
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
2007						
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

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 2009 and 2008, the Company's largest single customer (a prime supplier to the military/defense industry) represented 8% and 4%, respectively, of total consolidated net sales. Sales to this major customer consisted of various advanced specialty products 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 advanced specialty products.

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 specialty ceramic components including tubular and discoidal capacitors. These specialty capacitors are primarily utilized in the manufacture of EMI filters and EMI interconnect products at the Company's facility in Fairview, Pennsylvania and its low-cost manufacturing center in Juarez, Mexico.

Our extensive machining capabilities are integral to our ability to deliver custom product solutions to our customers. We utilize six major machining centers, supported by three design and prototype satellite machining centers, to help us respond to our customers' design and timing requirements. Our primary machining centers are operated within our manufacturing facilities in State College, Pennsylvania; Grass Valley, California; Palm Bay, Florida; Juarez, Mexico; Qiao Tou Town, China; and Wesson, Mississippi. Our design and satellite machining centers are in our Delmar, Delaware; Columbia, Maryland; and Fairview, Pennsylvania manufacturing facilities. Within these facilities, we have more than 50 dedicated CNC machines. A complementary resource to our machining capability is our metal fabrication operations in Wesson, Mississippi.

The Company currently 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 advanced specialty products is currently performed at our facilities in Fairview and State College, Pennsylvania. Manufacturing of these products is conducted at our facilities in Juarez, Mexico; Qiao Tou Town, China; as well as our two Pennsylvania facilities. 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 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 effect 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.

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 2009, approximately 12% of the Company's consolidated sales were 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 2009, the Company sold its products to approximately 1,950 accounts. Sales of products to the Company's top ten customers represented 38.4% (\$50.8 million) of total consolidated net sales in 2009. The top ten customers primarily consist of military/defense prime contractors, original equipment manufacturers of communications equipment, and electronic product distributors. All of the Company's major customers are unaffiliated with Spectrum Control, Inc. and its subsidiaries.

Table of Contents

Shipments are made by common carrier. Most of the Company's advanced specialty products, 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 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.

BACKLOG

The Company's backlog, which consists of purchase orders by customers, totaled approximately \$73.2 million at November 30, 2009 and \$69.9 million at November 30, 2008. As part of our acquisition of Micro Networks in November of 2009, we assumed their sales order backlog of \$3.9 million. It is anticipated that approximately 90% of the Company's backlog as of November 30, 2009 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, 2009, the Company had a total of 1,399 employees, including 71 in sales, marketing and customer support; 164 in engineering, product development and technical support; 1,088 in manufacturing; and 76 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 current commercial value, if any, these patents and related licenses may have.

Table of Contents

ENVIRONMENTAL MATTERS

We own certain land and manufacturing facilities in State College, Pennsylvania. The property, which was acquired from Murata Electronics North America (Murata) in December 2005, 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.

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 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, 2009, remediation expenditures of \$1.9 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 \$1.0 million, which are anticipated to be incurred over the next six years, principally consist of: (a) continued operation and monitoring of the existing on-site groundwater extraction, treatment, and recharge system; (b) completion of soil investigations to determine the extent of potential soil contamination; (c) excavation and off-site disposal of soil containing contaminants above acceptable standards; and (d) 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, \$278,000 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.

Table of Contents

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.

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 Advanced Specialty Products Business include Amphenol Corporation; Conec Corporation; ITT Canon, an ITT Industries Company; CTS Corporation; 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, 2009 the Company employed 164 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 \$4.4 million in 2009, \$3.7 million in 2008, and \$3.5 million in 2007.

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 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 Business Conduct, 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 Company is exposed to certain risk factors that may affect future consolidated operating and financial results. The risks and uncertainties described below are not the only risks and uncertainties that we face. Additional risks and uncertainties not presently known to us or that are currently deemed immaterial may also impair our future business operations.

Current Worldwide Recession

The recent global economic downturn and credit crisis may have a significant negative impact on our business, financial condition, and future results of operations. Specific risk factors related to these overall economic and credit conditions include the following: customer or potential customers may reduce or delay their new product development and component procurement; key suppliers may become insolvent resulting in delays for our material purchases; vendors and other third parties may fail to perform their contractual obligations; customers may be unable to obtain credit to finance purchases of our products; and certain customers may become insolvent. These risk factors could reduce our product sales, increase our operating costs, impact our ability to manage inventory levels and collect customer receivables, lengthen our cash conversion cycle and increase our need for cash, which would ultimately decrease our profitability and negatively impact our financial condition.

Significance of Military and Defense Spending

Military aircraft, naval vessels, and certain military vehicles contain extensive communications systems, electronic countermeasure equipment for defense against enemy weapons, smart weapons and munitions, and radar systems. We provide advanced specialty products 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 fiscal year 2009, military/defense sales represented approximately 61% 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.

Volatile Communications Equipment Market

In fiscal year 2009, approximately 16% of our consolidated sales were to original equipment manufacturers of communications equipment, with a significant portion of these sales supporting wireless infrastructure equipment. 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.

Competitive Markets

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 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.

Table of Contents

Need for Continuous New Product Development

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.

Integrating Acquired Businesses

As part of our growth strategy, we expect to make strategic acquisitions which expand our technologies, product offerings, and customer base. Historically, our acquisitions have been integrated into our existing businesses. The acquisition and integration of businesses includes numerous risks, including the following: (1) potential exposure to unknown liabilities of the acquired companies; (2) higher than anticipated acquisition costs and expenses; (3) potential disruption to our ongoing business and diversion of management time and attention; (4) difficulties in adopting and maintaining uniform standards, controls, procedures, and policies; (5) loss of key employees and customers as a result of changes in management; and (6) possible dilution to our shareholders. We may not be successful in overcoming these risks or any other problems encountered in connection with any of our acquisitions. In addition, we may make a strategic acquisition knowing that the transaction may adversely affect our short-term profitability, perhaps because the acquisition candidate may be experiencing operating losses. We may believe that the benefits of acquiring such a company outweigh the operating losses the candidate is experiencing and the losses that we expect to experience before being able to make the acquisition candidate profitable. The completion of such an acquisition in the future would negatively affect our profitability and may cause a decline in our stock price. Future acquisitions may also require significant increases in our bank indebtedness, and related restrictive loan covenants, which may negatively impact our future operating performance and financial results.

Retaining and Attracting Technical Personnel

There is a continuing demand for qualified technical personnel. We believe that our future growth and success will depend upon our ability to attract, train and retain such personnel. Competition for personnel in our industry is intense and there are a limited number of persons, especially engineers, with knowledge of and experience in our technologies. Our design and development efforts depend on hiring and retaining qualified technical personnel. Although we currently experience relatively low rates of turnover for our technical personnel, the rate of turnover may increase in the future. An inability to attract or maintain a sufficient number of technical personnel could have a material adverse effect on our operating performance or on our ability to capitalize on market opportunities.

Protecting Intellectual Property Rights

Our success is dependent upon our proprietary technology. We do not currently have material patents. We rely principally on trade secret and copyright laws, certain employee and third-party non-disclosure agreements, as well as limited access to and distribution of proprietary information, in order to protect our technology. Trade secret laws afford us limited protection because they cannot be used to prevent third parties from reverse engineering and reproducing our products. Similarly, copyright laws afford us limited protection because copyright protection extends only to how an idea is expressed and does not protect the idea itself. Moreover, third parties could independently develop technologies that compete with our technologies. We cannot provide assurance that the obligations on the part of our employees and business partners to maintain the confidentiality of our proprietary technology will prevent disclosure of such information by our employees or third parties. Litigation may be necessary for us to defend against claims of infringement or protect our proprietary technology, which could result in substantial cost to us and diversion of our efforts. We cannot provide assurances that we would prevail in any such litigation. Our inability to protect our proprietary technology could have a material adverse effect on our business, financial condition and results of operations. Although we believe that our products and proprietary rights do not infringe on the patents and proprietary rights of third parties, we cannot provide assurance that infringement claims, regardless of merit, will not be asserted against us. In addition, effective copyright and trade secret protection of our proprietary technology may be unavailable or limited in certain foreign countries.

Table of Contents

International Sales and Operations

In fiscal year 2009, sales to international customers comprised approximately 16% of our net sales, and we expect our international business to continue to account for a significant part of our revenues. We currently maintain manufacturing facilities in Mexico and China. International sales and operations are subject to numerous risks including political and economic instability in foreign markets, currency exchange rate fluctuations, restrictive trade policies of foreign governments, inconsistent product regulation by foreign agencies or governments, imposition of product tariffs, and the costs of complying with a wide variety of export laws and regulatory requirements. For certain of our international products and system sales, we must obtain appropriate export licenses. Because of these various risks and uncertainties, we cannot provide assurance that we will be able to continue to compete successfully in international markets or that our international sales will be profitable.

Price Fluctuations for Precious Metals

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.

Price Pressures from our Customers

Many of our commercial customers are under continuous pressure to reduce costs and, therefore, we expect to continue to experience pressure from these customers to reduce the prices of the products that we sell to them. These customers frequently negotiate volume supply arrangements well in advance of delivery dates, requiring us to commit to price reductions before we can determine whether the assumed cost reductions or the negotiated supply volumes can be achieved. To offset declining average sales prices to these commercial customers, we believe that we must achieve manufacturing cost reductions and increase our sales volumes. If we are unable to offset declining average selling prices, our gross margins will decline, and this decline could materially harm our business, financial condition and operating results.

Environmental Issues

Our operations are subject to federal, state, local and foreign environmental laws and regulations. As a result, we may be involved from time to time in administrative or legal proceedings relating to environmental matters. We cannot provide assurance that the aggregate amount of future clean-up costs and other environmental liabilities will not be material. We cannot predict what environmental legislation or regulations will be enacted in the future, how existing or future laws or regulations will be administered or interpreted or what environmental conditions may be found to exist. Enactment of more stringent laws or regulations or more strict interpretations of existing laws and regulations may require us to make additional expenditures, some of which could be material.

Risks Related to our Securities

A number of factors could cause the market price of our Common Stock to fluctuate significantly, including: (1) our quarterly operating results or those of our competitors; (2) the public's reaction to our press releases, announcements, and our filings with the Securities and Exchange Commission; (3) changes in earnings estimates or recommendations by research analysts; (4) changes in general economic factors, financial markets, or pertinent industry-wide conditions; (5) natural disasters, terrorist attacks, or acts of war; and (6) other developments affecting us or our competitors. In addition, in recent years, the stock market has experienced extreme price and volume fluctuations. This volatility has had significant effect on the market price of securities issued by many companies for reasons unrelated to the operating performance of these companies.

Pennsylvania law and our charter documents may impede or discourage a takeover, which could cause the market price of our shares to decline. We are a Pennsylvania corporation and the anti-takeover provisions of Pennsylvania law impose various impediments to the ability of a third party to acquire control of us, even if a change in control would be beneficial to our existing shareholders. Our certificate of incorporation and bylaws provide, among other things, for board members to serve staggered three-year terms. Our incorporation under Pennsylvania law, the acceleration of the vesting of outstanding stock options upon a change in control, and certain provisions of our certificate of incorporation and bylaws could impede a merger, takeover, or other business combination involving us, or discourage a potential acquirer from making a tender offer for our Common Stock which, under certain circumstances, could reduce the market value of our Common Stock.

Table of Contents

Other Risks and Uncertainties

Our results of operations may be negatively affected in the future by a variety of other factors, including: (1) cancellation of existing sales order backlog; (2) unanticipated impairment of assets; (3) changes in product mix; (4) inability to timely increase production to meet some of our customer's increased demands; and (5) litigation involving antitrust, product warranty, product liability, and other issues.

Item 1B. Unresolved Staff Comments

None

Table of Contents**ITEM 2. PROPERTIES**

The Company's principal manufacturing and office facilities as of November 30, 2009 are as follows:

LOCATION	FUNCTION	APPROXIMATE SQUARE FEET OF FLOOR AREA	OWNERSHIP	PRINCIPAL BALANCE OUTSTANDING AT 11/30/09 ON RELATED MORTGAGE
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	\$ 545,000
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
23 North Division Street Auburn, NY	Manufacturing	21,000	Owned	N/A
324 Clark Street Worcester, MA	Manufacturing	63,000	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
Boulevard Zaragoza 2910	Manufacturing	55,000	Rented	N/A

Edgar Filing: SPECTRUM CONTROL INC - Form 10-K

Ciudad Juarez, Mexico

2 nd Industrial Area	Manufacturing	70,000	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	N/A
------------------	-------------------	--------	-------	-----

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, 2009.

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 2009 and 2008 are set forth below.

	High	Low
Fiscal 2009		
First quarter	\$ 7.52	\$ 4.15
Second quarter	8.22	4.99
Third quarter	10.25	7.50
Fourth quarter	9.90	8.19
	High	Low
Fiscal 2008		
First quarter	\$ 15.75	\$ 8.73
Second quarter	9.34	7.86
Third quarter	9.30	7.03
Fourth quarter	8.14	3.30

At January 29, 2010, the Company had 12,712,865 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.

The following table sets forth information as of November 30, 2009 with respect to compensation plans under which equity securities of the Company are authorized for issuance.

Plan Category	(I) Number of securities to be issued upon exercise of outstanding options	(II) Weighted-average exercise price of outstanding options	(III) Number of securities remaining available for future issuance under plans (excluding securities
---------------	---	--	---

listed in Column (I)

Equity compensation plans approved by security holders	1,062,100	\$6.86	1,312,552
Equity compensation plans not approved by security holders	-	-	-
Total	1,062,100	\$6.86	1,312,552

Table of Contents

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 2009, no shares were repurchased under this program. 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 2005 through 2009. The table assumes that \$100 was invested on December 1, 2004, in the Company's Common Stock and in each of the other indices.

	2004	2005	2006	2007	2008	2009
Spectrum	\$ 100	\$ 85	\$ 118	\$ 199	\$ 56	\$ 117
S&P 500	\$ 100	\$ 106	\$ 119	\$ 126	\$ 76	\$ 93
NASDAQ U.S.	\$ 100	\$ 108	\$ 117	\$ 127	\$ 75	\$ 83
NASDAQ Electronic Components Stock Index	\$ 100	\$ 106	\$ 115	\$ 125	\$ 65	\$ 98

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

	Years Ended November 30				
	(Amounts in Thousands, Except Per Share Data)				
	2009	2008	2007	2006	2005
Operations					
Net sales	\$ 132,306	\$ 130,694	\$ 136,539	\$ 125,672	\$ 98,354
Gross margin	34,360	32,762	36,363	28,780	25,775
Income from operations	13,604	13,344	17,864	9,314	7,134
Interest expense	190	369	561	545	110
Income before provision for income taxes	13,388	13,480	17,558	9,039	7,323
Net income	8,560	8,851	11,141	5,871	4,605
Earnings per common share:					
Basic	\$ 0.68	\$ 0.68	\$ 0.83	\$ 0.45	\$ 0.35
Diluted	\$ 0.67	\$ 0.67	\$ 0.81	\$ 0.44	\$ 0.35
Weighted average common shares outstanding:					
Basic	12,604	13,069	13,359	13,127	13,054
Diluted	12,739	13,189	13,798	13,381	13,160
Financial Position					
Working capital	\$ 47,240	\$ 42,590	\$ 43,277	\$ 31,808	\$ 39,470
Total assets	143,729	134,784	126,919	119,207	98,002
Long-term debt	480	545	1,031	1,131	1,426
Stockholders' equity	113,424	103,291	101,868	88,599	81,361

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 61% and 16%, respectively, of our fiscal 2009 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: advanced specialty products (formerly referred to as signal and power integrity components); microwave components and systems; power management systems; and sensors and controls. Our Advanced Specialty Products Business designs and manufactures a broad range of products including antennas, specialty connectors, advanced ceramics, and electromagnetic interference (EMI) filters and interconnects. Our Microwave Components and Systems Business designs and manufactures microwave filters and components, high power amplifiers, oscillators, synthesizers, switched filter banks, and related systems and integrated assemblies. The Power Management Systems Business designs and manufactures custom AC and DC power distribution units, power outlet strips, power monitoring equipment, 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 November 30, 2009, we acquired substantially all of the assets and assumed certain liabilities of Micro Networks Corporation (Micro Networks), a subsidiary of Integrated Device Technology, Inc. (Nasdaq: IDTI). Micro Networks, with operations in Worcester, Massachusetts and Auburn, New York, designs and manufactures high-performance data conversion products, custom modules, and a broad line of filters, oscillators, and delay lines based on surface acoustic wave (SAW) technology. These products, and related SAW technology, are used in numerous defense and aerospace applications. The aggregate cash purchase price for Micro Networks was \$12.9 million. This acquisition occurred after the close of business on the last day of our 2009 fiscal year and therefore no revenues, expenses, or customer orders have been recognized in our consolidated results of operations or related disclosures for the fiscal year ended November 30, 2009.

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.

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, 2009, 2008, and 2007 include the following amounts related to these acquired businesses (in thousands):

	2009	2008	2007
Micro Networks	\$ -	-	-
SatCon	11,664	2,289	-
EMF	2,356	2,007	3,164

For operating segment purposes, Micro Networks, SatCon and EMF are reported within our Microwave Components and Systems 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 contained elsewhere in this Annual Report. Readers are cautioned not to place undue reliance on these forward-looking statements.

Executive Summary

During fiscal 2009, our consolidated sales were \$132.3 million, an increase of \$1.6 million or 1.2% from fiscal 2008. This increase primarily reflects the following: (1) the impact from the first full year of SatCon product sales; (2) additional shipments for numerous military/defense programs including RCIED (Radio Controlled Improvised Explosive Devices) Jammer Systems, and (3) offset by soft market conditions for substantially all of our commercial markets. In 2009, our total sales to military/defense customers amounted to \$80.9 million, an increase of \$18.3 million or 29% from 2008. Sales to commercial customers were \$51.4 million in fiscal 2009, down from \$16.7 million or 25% from the prior year, primarily reflecting the impact of the global recession.

In fiscal 2009, our gross margin was \$34.4 million or 26.0% of sales, compared to \$32.8 million or 25.1% of sales in fiscal 2008. The increase in gross margin, as a percentage of sales, reflects reductions in material and direct labor costs from changes in sales mix and the impact of leveraging fixed manufacturing overhead with higher production volumes. Selling, general and administrative expense was \$20.8 million or 15.7% of sales in 2009, compared to \$19.4 million or 14.9% of sales in 2008. This increase primarily reflects additions to incentive-based compensation, legal settlement expenses, equity-based compensation, and employee relocation expenses.

Other nonoperating income, net of other expenses, decreased \$531,000 in fiscal 2009 compared to fiscal 2008. This decrease principally was driven by reductions in patent licensing fees and investment income.

Overall, we generated net income of \$8.6 million or 68 cents per share (67 cents diluted) in fiscal 2009, compared to net income of \$8.9 million or 68 cents per share (67 cents diluted) in fiscal 2008.

During the year ended November 30, 2009, net cash provided by operating activities amounted to \$19.0 million. This positive cash flow, along with our existing cash reserves, enabled us to expend \$4.0 million on capital equipment additions, repay \$3.5 million in bank indebtedness, as well as support the \$12.9 million aggregate cash purchase price for Micro Networks.

At November 30, 2009, our cash and cash equivalents were \$6.1 million, our current ratio was 3.42 to 1.00, and our total debt to equity was 0.27 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, 2009, 2008, and 2007:

	2009	2008	2007
Net sales	100.0%	100.0%	100.0%
Cost of products sold	74.0	74.9	73.4
Gross margin	26.0	25.1	26.6
Selling, general and administrative expense	15.7	14.9	13.5
Income from operations	10.3	10.2	13.1
Other income (expense)			
Interest expense	(0.2)	(0.3)	(0.4)
Other income and expense, net	-	0.4	0.2
Income before provision for income taxes	10.1	10.3	12.9
Provision for income taxes	3.6	3.5	4.7
Net income	6.5%	6.8%	8.2%

The following table sets forth our net sales by reportable operating segments for the years ended November 30, 2009, 2008, and 2007 (in thousands):

	2009	2008	2007
Advanced specialty products	\$ 42,001	\$ 52,060	\$ 60,713
Microwave components and systems	60,069	45,942	47,748
Power management systems	10,268	9,879	7,586
Sensors and controls	19,968	22,813	20,492
	\$ 132,306	\$ 130,694	\$ 136,539

2009 Compared to 2008*Net Sales*

Our consolidated net sales were \$132.3 million in fiscal 2009, an increase of \$1.6 million or 1.2% from fiscal 2008. This increase primarily reflects the impact of twelve months of SatCon product sales and increased shipment levels for numerous military/defense applications. Offsetting much of this sales growth in fiscal 2009 was the global recession and its impact throughout most of our commercial markets.

Sales of our microwave components and systems were \$60.1 million in fiscal 2009, an increase of \$14.1 million or 30.7% from fiscal 2008. SatCon product shipments increased in fiscal 2009 to \$11.7 million, up \$9.4 million from fiscal year 2008, representing SatCon's first full year of sales. In addition, shipments of microwave products used in numerous military/defense applications increased in fiscal 2009, including microwave components and assemblies used in RCIED Jammer Systems. These RCIED programs remain active, with orders and shipments for system upgrades expected to continue throughout fiscal 2010. Total customer orders received for our microwave components and systems were \$56.5 million in fiscal 2009, versus \$47.5 million in fiscal 2008.

Edgar Filing: SPECTRUM CONTROL INC - Form 10-K

Sales of our advanced specialty products were \$42.0 million in fiscal 2009, down \$10.1 million or 19.3% from a year ago. In 2009, sales of these products to customers in our commercial markets were down by approximately \$11.7 million. The soft commercial sales were partially offset by an increase of \$1.6 million of shipments in support of various military/defense programs. Total customer orders received for this business segment totaled \$49.1 million in fiscal 2009, compared to \$55.9 million in fiscal 2008.

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

For our sensors and controls, sales for fiscal 2009 were \$20.0 million, down \$2.8 million or 12.5% from a year ago. Shipments of these products used in military/defense applications (including aircraft cockpit controls and fin actuators, fighting vehicles, and smart weapons) increased \$1.1 million in 2009, while product shipments into commercial markets decreased by \$3.9 million. In fiscal 2009, demand for our temperature sensors and thermal products (which are used in various commercial food service applications, refrigeration, and HVAC equipment) was particularly soft. Customer orders received for our sensors and controls amounted to \$15.8 million in fiscal 2009, compared to \$26.6 million in fiscal 2008.

For our power management systems, sales for fiscal 2009 were \$10.3 million and customer orders received amounted to \$10.8 million, up 3.9% and 2.7% from a year ago, respectively. In fiscal 2009, shipments for these products were particularly strong in electronic data storage and applications for our AC power strip products.

Total customer orders received in fiscal 2009 amounted to \$132.2 million, a decrease of \$8.4 million from the preceding year. At November 30, 2009, our sales order backlog was \$73.2 million, up \$3.3 million from the end of fiscal 2008. This increase reflects \$3.9 million of sales order backlog assumed as part of our acquisition of Micro Networks.

Overall, average selling prices remained relatively stable in 2009 for all of our major product lines.

Gross Margin

In fiscal 2009, our gross margin was \$34.4 million or 26.0% of sales, compared to \$32.8 million or 25.1% of sales in fiscal 2008. The increase in gross margin, as a percentage of sales, principally reflects changes in sales mix and better absorption of fixed manufacturing overhead with higher production volumes.

Total material costs amounted to \$30.9 million or 23.3% of sales in fiscal 2009, versus \$30.8 million or 23.5% of sales in the preceding year. Direct labor costs were \$16.2 million or 12.3% of sales in 2009, compared to \$16.8 million or 12.8% of sales in 2008. The decreases in direct material and direct labor costs, as a percentage of sales, were driven primarily by changes in sales mix. Manufacturing overhead costs amounted to \$50.9 million or 38.4% of sales in 2009, versus \$50.4 million or 38.6% of sales in the preceding year. In fiscal 2009, the increase in manufacturing overhead primarily reflects additional costs for employee health insurance, which was partially offset by numerous cost reduction programs.

At November 30, 2009, we had a total workforce of 1,399 employees, including 73 Micro Networks employees, which represents a reduction of 7.7% 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 2009, selling expense amounted to \$11.4 million or 8.6% of sales, compared to \$10.8 million or 8.3% of sales in fiscal 2008. The increase in selling expense, as a percentage of sales, primarily reflects an increase to our effective sales commission rate from changes in sales mix. Aggregate general and administrative expense was \$9.4 million in 2009, versus \$8.6 million in 2008. The increase in general and administrative expense includes \$463,000 of additional incentive-based compensation expense, \$300,000 of expenses resulting from a legal settlement, as well as several other operating expense increases from additional business activity.

Interest Expense

With lower interest rates and reduced short-term borrowings, our interest expense decreased in the current year. Total interest expense in fiscal 2009 was \$190,000, a decrease of \$179,000 from fiscal 2008. During the year ended November 30, 2009, weighted average borrowings under our domestic line of credit amounted to \$3.8 million, with an average interest rate of 2.04%. During the year ended November 30, 2008, weighted average borrowings under the domestic line of credit were \$4.9 million, with an average interest rate of 3.95%.

Other Income and Expense

We hold certain 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

Edgar Filing: SPECTRUM CONTROL INC - Form 10-K

in 2008. No license fees or royalty income were earned or received in 2009. In addition, with substantially all of the PML-related patents having expired or about to expire, we believe that the PML licenses that we have granted have little or no remaining commercial value.

Table of Contents

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

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 \$60,000 in 2009 and \$13,000 in 2008 were recognized and included in nonoperating income and expense.

We realized interest income of \$34,000 in 2009 and \$178,000 in 2008 from temporary cash investments. The decrease in 2009 interest income primarily reflects reductions in money market interest rates.

Income Taxes

Our effective income tax rate was 36.1% in 2009 and 34.3% in 2008, compared to an applicable federal and state statutory income tax rate of approximately 40.0%. For the years ended November 30, 2009 and 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.

At November 30, 2009, 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, 2009.

2008 Compared to 2007

Net Sales

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 advanced specialty products were \$52.1 million in fiscal 2008, down \$8.7 million or 14.3% from the preceding year. 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. 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.

Sales and customer order rates for our other two business segments increased during fiscal 2008. 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 the preceding year, 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.

Table of Contents

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

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 the preceding fiscal year.

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 2008. 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

In 2008, other income and expense consists of PML license and royalty fee income of \$340,000, interest income from short-term investments of \$178,000, and net losses on foreign currency transactions of \$13,000. In 2007, other income and expense reflects \$93,000 of PML license and royalty fee income, \$168,000 of interest income, and net losses on foreign currency transactions of \$6,000.

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. 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.

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, 2009, \$7.0 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, 2009, 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 \$1.5 million (Euro 1.0 million). At November 30, 2009, 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 2009, our net working capital and current ratio increased slightly, primarily reflecting reduced borrowings under our domestic line of credit and increased inventories from our acquisition of Micro Networks. At November 30, 2009 and 2008, net working capital was \$47.2 million and \$42.6 million, respectively. At November 30, 2009, our current assets were 3.42 times current liabilities, compared to 2.98 at the end of fiscal 2008. Our net working capital was \$43.3 million at November 30, 2007 and our current ratio was 3.87 to 1.00 at the end of fiscal 2007. The reduction in our working capital and current ratio in 2008 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.

In fiscal year 2009, we expended \$4.0 million for capital additions and improvements, including \$2.3 million in our Microwave Components and Systems Business to increase manufacturing capabilities and efficiencies. The remainder of our 2009 capital expenditures principally consists of normal replacements and enhancements of manufacturing equipment. Our capital expenditures for property, plant and equipment were \$4.4 million in 2008, including \$1.9 million in our Microwave Components and Systems Business and \$1.4 million in our Advanced Specialty Products Business. These capital expenditures primarily relate to production capacity and other manufacturing enhancements. 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.

We conduct our operations in numerous locations, including a leased facility in Marlborough, Massachusetts (the Marlborough Facility) and an owned facility in Wesson, Mississippi (the Wesson Facility). In 2009, the Marlborough Facility sustained wind damage to its roof which, in turn, resulted in water damage to certain machinery, equipment, and leasehold improvements. Also in 2009, a small outbuilding at the Wesson Facility sustained a fire, destroying the outbuilding and certain plating equipment contained inside. Upon the settlement of all related insurance claims, we received insurance recoveries of \$1.2 million for the fixed assets damaged or destroyed by these involuntary conversions.

At November 30, 2009, we had not entered into any material commitments for additional capital expenditures. We currently expect our aggregate capital expenditures in fiscal 2010 to approximate our fiscal 2009 levels.

In November 2009, we acquired substantially all of the assets and assumed certain liabilities of Micro Networks. The aggregate cash purchase price for Micro Networks was \$12.9 million, which was primarily funded by borrowings under our domestic line of credit. 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.

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, 2009, we did not repurchase any of our Common Stock. In 2008, we repurchased 1,001,479 shares at an aggregate cost of \$8.2 million. No shares were

Edgar Filing: SPECTRUM CONTROL INC - Form 10-K

repurchased in fiscal 2007. 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 \$4.4 million in 2009, \$3.7 million in 2008, and \$3.5 million in 2007. We expect to continue our investment in research and development in 2010, 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, 2009, 2008, and 2007 amounted to \$3.5 million, \$6.8 million, and \$3.5 million, respectively. As a result of certain temporary differences and 2009 prepayments, we expect cash outlays for income taxes to be less than income tax expense for fiscal 2010.

As of November 30, 2009, our obligations and firm commitments are as follows (in thousands):

Contractual obligations	Total	Payments Due by Period					
		2010	2011	2012	2013	2014	Thereafter
Long-term debt	\$ 545	\$ 65	\$ 70	\$ 75	\$ 80	\$ 80	\$ 175
Operating leases	2,294	1,329	422	383	144	16	-

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 2010, 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 \$19.0 million in 2009, compared to \$9.8 million in 2008. This increase in operating cash flow primarily reflects improved accounts receivable and inventory turnover rates, as well as other reductions in working capital requirements. In 2008, our 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.

At November 30, 2009, goodwill represented 31.3% of our total assets and 39.7% of our stockholders' equity. In addition to a total of \$10.5 million of goodwill recognized in connection with our recent acquisitions of Micro Networks, SatCon, and EMF, another \$34.5 million of goodwill was realized in earlier acquisitions. In accordance with current accounting guidance, 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, 2009, 2008, and 2007.

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, 2009, we did not have any forward currency exchange contracts outstanding. For each of the three years ended November 30, 2009, currency exchange rate gains and losses were not material to the consolidated financial statements.

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, 2009, no interest rate swap agreements were outstanding.

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

We own certain land and manufacturing facilities in State College, Pennsylvania. The property, which was acquired from Murata Electronics North America (Murata) in December 2005, 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, 2009, remediation expenditures of \$1.9 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 \$1.0 million, which are anticipated to be incurred over the next six years, principally consist of: (a) continued operation and monitoring of the existing on-site groundwater extraction, treatment, and recharge system; (b) completion of soil investigations to determine the extent of potential soil contamination; (c) excavation and off-site disposal of soil containing contaminants above acceptable standards; and (d) 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, \$278,000 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.

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.

Table of Contents**Management's Discussion and Analysis of Financial Condition and Results of Operations (Continued)****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*ASC 805-10, Business Combinations*

In December 2007, the Financial Accounting Standards Board (FASB) issued ASC 805-10, *Business Combinations* . The objective of this new accounting guidance 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 price; 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. ASC 805-10 changes the accounting treatment for certain specific items, including acquisition-related costs and restructuring costs associated with the acquisition. This new accounting guidance 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, we believe ASC 805-10 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.

ASC 350-30-35, Intangibles Other Than Goodwill - Subsequent Remeasurements

In April 2008, the FASB issued ASC 350-30-35, *Intangibles Other Than Goodwill - Subsequent Remeasurements* , which amends the list of factors an entity should consider in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset. These provisions apply to intangible assets that are acquired individually or with a group of assets and intangible assets acquired in both business combinations and asset acquisitions. Furthermore, these provisions remove the provision that requires an entity to consider whether the renewal or extension can be accomplished without substantial cost or material modifications of the existing terms and conditions associated with the asset. Instead, these provisions require that an entity consider its own experience in renewing similar arrangements. An entity would consider market participant assumptions regarding renewal if no such relevant experience exists. This new accounting guidance is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2008 (the Company's 2010 fiscal year). We do not expect the adoption of this new accounting guidance to have a material impact on our consolidated financial condition, results of operations, and cash flow.

ASC 805-20-25, Business Combinations - Recognition of Identifiable Assets and Liabilities and Any Noncontrolling Interests

In April 2009, the FASB issued ASC 805-20-25, *Business Combinations - Recognition of Identifiable Assets and Liabilities and Any Noncontrolling Interests* , which applies to all assets acquired and liabilities assumed in a business combination that arise from contingencies that would be within the scope of ASC 450, *Contingencies* , if not acquired or assumed in a business combination, except for assets or liabilities arising from contingencies that are subject to specific guidance in ASC 805-10, *Business Combinations* . These provisions require an acquirer to recognize at fair value, at the acquisition date, an asset acquired or a liability assumed in a business combination that arises from a contingency if the acquisition-date fair value of that asset or liability can be determined during the measurement period. If the acquisition-date fair value cannot be determined during the measurement period, the asset or liability shall be recognized at the acquisition date if it is probable that the asset existed or that a liability has been incurred at the acquisition date and the amount of the asset or liability can be reasonably estimated. These provisions are effective for assets or liabilities arising from contingencies in 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 that this new accounting guidance 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)***ASC 855-10, Subsequent Events*

In May 2009, the FASB issued ASC 855-10, *Subsequent Events*. The objective of these provisions are to establish general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. The provisions discuss two types of subsequent events: (1) events that provide additional evidence about conditions that existed at the date of the balance sheet, and is recognized in the financial statements and (2) events that provide evidence about conditions that did not exist at the date of the balance sheet but arose after the balance sheet date but before financial statements are issued or are available to be issued, and not recognized at the balance sheet date. An entity shall also disclose the date through which subsequent events have been evaluated, as well as whether that date is the date the financial statements were issued or the date the financial statements were available to be issued. The requirements are effective for interim and annual financial periods ending after June 15, 2009. The requirements did not have a material impact on our consolidated financial statements. We evaluated our November 30, 2009 consolidated financial statements for subsequent events through February 11, 2010, the date the consolidated financial statements were issued. We are not aware of any subsequent events which would require recognition or disclosure in our consolidated financial statements.

ASU 2009-01, The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles

In June 2009, the FASB issued ASU 2009-01, *The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles* (ASU 2009-01), which amends FAS No. 168, *The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles* (FAS No. 168). FAS No. 168 identified the sources of accounting principles and the framework for selecting the principles used in preparing the financial statements that are presented in conformity with generally accepted accounting principles (GAAP). It arranged these sources of GAAP in a hierarchy for users to apply accordingly. With ASU 2009-01 in effect, all of its content carry the same level of authority, effectively superseding FAS No. 168. Thus, the GAAP hierarchy has been modified to include only two levels of GAAP: authoritative and nonauthoritative. ASU 2009-01 is effective for financial statements issued for interim and annual periods ending after September 15, 2009. The provisions of ASU 2009-01 did not have a material impact on our consolidated financial statements.

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 consolidated 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, 2009, our allowance for doubtful accounts was \$815,000 or approximately 3.5% 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 2010. 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, 2009, we had recorded inventory reserves in the aggregate amount of \$991,000 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.

Goodwill represents the excess of the purchase price over the fair value of identifiable net assets acquired in a business combination. Goodwill is assigned to specific reporting units, which we have identified as our operating segments, and is tested for impairment at least annually, or more frequently upon the occurrence of an event or when circumstances indicate that a reporting unit's carrying amount is greater than its fair value. 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. Goodwill is tested for impairment using the two-step approach, in accordance with Accounting Standards Codification (ASC) No. 350, *Intangibles—Goodwill and Other*. The determination of an impairment requires the valuation of the respective reporting unit, which we estimate using the discounted cash flow model and market approach.

Table of Contents

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

The discounted cash flow model involves many assumptions, including forecasted operating results and discount rates. Inherent in the forecasted operating results are certain assumptions regarding revenue growth rates, projected cost saving initiatives, and projected long-term growth rates in the determination of terminal values. We perform our goodwill impairment testing as of September 1 of each year. For each of the fiscal years presented herein, no impairments were identified. No reporting units were deemed to be at risk of failing Step 1 of the goodwill impairment test under ASC No. 350.

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 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>	39
<u>Consolidated Balance Sheets as of November 30, 2009 and 2008</u>	40
<u>Consolidated Statements of Income for the years ended November 30, 2009, 2008, and 2007</u>	41
<u>Consolidated Statements of Stockholders' Equity for the years ended November 30, 2009, 2008, and 2007</u>	42
<u>Consolidated Statements of Cash Flows for the years ended November 30, 2009, 2008, and 2007</u>	43
<u>Notes to Consolidated Financial Statements</u>	44-65

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, 2009 and 2008, and the related consolidated statements of income, stockholders' equity, and cash flows for each of the three years in the period ended November 30, 2009. 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, 2009 and 2008, and the consolidated results of their operations and their cash flows for each of the three years in the period ended November 30, 2009, 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, 2009, 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, 2010, expressed an unqualified opinion thereon.

/S/ ERNST & YOUNG LLP

Pittsburgh, Pennsylvania

February 11, 2010

Table of Contents**SPECTRUM CONTROL, INC. AND SUBSIDIARIES****CONSOLIDATED BALANCE SHEETS****NOVEMBER 30, 2009 AND 2008****(Dollar Amounts in Thousands)**

	2009	2008
Assets		
Current assets		
Cash and cash equivalents	\$ 6,090	\$ 5,397
Accounts receivable, less allowances of \$815 in 2009 and \$933 in 2008	22,623	24,043
Inventories, net	34,223	30,638
Deferred income taxes	1,425	1,684
Prepaid expenses and other current assets	2,434	2,307
Total current assets	66,795	64,069
Property, plant and equipment, net	26,383	27,250
Other assets		
Goodwill	44,995	36,811
Other noncurrent assets	5,556	6,654
Total other assets	50,551	43,465
Total assets	\$ 143,729	\$ 134,784
Liabilities and Stockholders Equity		
Current liabilities		
Short-term debt	\$ 7,000	\$ 10,000
Accounts payable	7,124	6,541
Income taxes payable	-	36
Accrued liabilities	5,366	4,415
Current portion of long-term debt	65	487
Total current liabilities	19,555	21,479
Long-term debt	480	545
Other liabilities	728	978
Deferred income taxes	9,542	8,491
Stockholders equity		
Common stock, no par value, authorized 25,000,000 shares, issued 14,343,335 shares in 2009 and 14,248,772 shares in 2008	48,919	47,830
Retained earnings	75,164	66,604
Treasury stock, 1,677,479 shares in 2009 and 2008, at cost	(11,788)	(11,788)
Accumulated other comprehensive income	1,129	645
Total stockholders equity	113,424	103,291

Edgar Filing: SPECTRUM CONTROL INC - Form 10-K

Total liabilities and stockholders' equity	\$ 143,729	\$ 134,784
--	------------	------------

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, 2009, 2008, AND 2007****(Amounts in Thousands Except Per Share Data)**

	2009	2008	2007
Net sales	\$ 132,306	\$ 130,694	\$ 136,539
Cost of products sold	97,946	97,932	100,176
Gross margin	34,360	32,762	36,363
Selling, general and administrative expense	20,756	19,418	18,499
Income from operations	13,604	13,344	17,864
Other income (expense):			
Interest expense	(190)	(369)	(561)
Other income and expense, net	(26)	505	255
	(216)	136	(306)
Income before provision for income taxes	13,388	13,480	17,558
Provision for income taxes	4,828	4,629	6,417
Net income	\$ 8,560	\$ 8,851	\$ 11,141
Earnings per common share:			
Basic	\$ 0.68	\$ 0.68	\$ 0.83
Diluted	\$ 0.67	\$ 0.67	\$ 0.81
Weighted average common shares outstanding:			
Basic	12,604	13,069	13,359
Diluted	12,739	13,189	13,798

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, 2009, 2008, AND 2007****(Dollar Amounts in Thousands)**

	Common Stock		Retained	Treasury	Accumulated Other Comprehensive Income (Loss)	Total Stockholders' Equity
	Shares	Amount	Earnings	Stock		
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)
Purchase of common stock, held in treasury	-	-	-	(8,160)	-	(8,160)
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
Net income	-	-	8,560	-	-	8,560
Foreign currency translation adjustments	-	-	-	-	484	484
Comprehensive income	-	-	-	-	-	9,044
Issuance of common stock upon exercise of employee stock options	123,634	865	-	-	-	865
Purchase and retirement of common stock	(29,071)	(265)	-	-	-	(265)
Tax benefits from exercise of stock options	-	42	-	-	-	42
Equity-based compensation	-	447	-	-	-	447
Balance - November 30, 2009	14,343,335	\$ 48,919	\$ 75,164	\$ (11,788)	\$ 1,129	\$ 113,424

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, 2009, 2008, AND 2007****(Dollar Amounts in Thousands)**

	2009	2008	2007
Cash Flows From Operating Activities:			
Net income	\$ 8,560	\$ 8,851	\$ 11,141
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation	4,944	4,447	3,925
Amortization	777	734	898
Deferred income taxes	1,310	557	693
Equity-based compensation	447	264	29
Tax benefits from exercise of stock options	(42)	(102)	(356)
Gain on insurance recoveries	(528)	-	-
Non-cash insurance recoveries	(250)	(479)	(743)
Changes in assets and liabilities, excluding effects of business acquisitions:			
Accounts receivable	2,668	2,810	(2,156)
Inventories	10	(3,290)	(3,270)
Prepaid expenses and other assets	272	(958)	1,522
Accounts payable and accrued liabilities	867	(3,009)	1,906
Net cash provided by operating activities	19,035	9,825	13,589
Cash Flows From Investing Activities:			
Payments for acquired businesses, net of cash received	(12,938)	(5,587)	(2,365)
Insurance proceeds related to property, plant and equipment	1,180	-	1,748
Purchase of property, plant and equipment	(3,952)	(4,440)	(5,810)
Net cash used in investing activities	(15,710)	(10,027)	(6,427)
Cash Flows From Financing Activities:			
Net proceeds (repayment) of short-term borrowings	(3,000)	8,000	(7,000)
Repayment of long-term debt	(487)	(99)	(295)
Net proceeds from issuance of common stock	600	514	1,204
Purchase of common stock	-	(8,160)	-
Tax benefits from exercise of stock options	42	102	356
Net cash provided by (used in) financing activities	(2,845)	357	(5,735)
Effect of exchange rate changes on cash	213	59	255
Net increase in cash and cash equivalents	693	214	1,682
Cash and cash equivalents, beginning of year	5,397	5,183	3,501
Cash and cash equivalents, end of year	\$ 6,090	\$ 5,397	\$ 5,183

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, 2009

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: Advanced Specialty Products; 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. These contracts are considered derivatives and are recognized on the consolidated balance sheet at fair value. Derivatives that are not considered effective hedges are adjusted to fair value through the consolidated income statement. 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. For work-in-process and finished goods inventories, standard cost includes an allocation of manufacturing overhead based on normal production rates and capacity.

Property, Plant and Equipment

Edgar Filing: SPECTRUM CONTROL INC - Form 10-K

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.

Table of Contents

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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 consolidated 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 consolidated 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 \$824,000 in 2009, \$786,000 in 2008, and \$781,000 in 2007.

Research and Development

Research and development costs are expensed as incurred. Research and development expense amounted to \$4,425,000 in 2009, \$3,743,000 in 2008, and \$3,477,000 in 2007.

Equity - Based Compensation

For employee services received in exchange for equity awards (including employee stock options), the Company measures the related compensation 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, 2009, 2008, and 2007, equity-based compensation expense (related solely to stock options) was as follows (in thousands):

	2009	2008	2007
Equity-based compensation expense	\$ 447	\$ 264	\$ 29

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 years ended November 30, 2009 and 2008, options to purchase 297,000 shares and 380,500 shares, respectively, of the Company's Common Stock were granted with the following weighted average assumptions:

	2009	2008
Expected volatility	46.90%	33.10%
Risk-free interest rate	1.72%	2.75%
Expected dividend yield	0.00%	0.00%
Expected option life in years	5.00	5.00
Fair value per share	\$ 2.52	\$ 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, no incremental compensation cost is being recognized for the modification of the original options.

No options were granted by the Company during the fiscal year ended November 30, 2007.

At November 30, 2009, the total future equity-based compensation expense related to nonvested options is expected to be recognized as follows (in thousands):

2010	\$ 479
2011	479
2012	215
2013	32
2014	-
	\$ 1,205

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.

Reclassifications

Edgar Filing: SPECTRUM CONTROL INC - Form 10-K

In the accompanying consolidated statements of cash flows, certain amounts for prior years have been reclassified to conform with the current year presentation.

Table of Contents**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Recent Accounting Pronouncements***ASC 805-10, Business Combinations*

In December 2007, the Financial Accounting Standards Board (FASB) issued ASC 805-10, *Business Combinations* . The objective of this new accounting guidance 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 price; 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. ASC 805-10 changes the accounting treatment for certain specific items, including acquisition-related costs and restructuring costs associated with the acquisition. This new accounting guidance 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 ASC 805-10 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.

ASC 350-30-35, Intangibles Other Than Goodwill Subsequent Remeasurements

In April 2008, the FASB issued ASC 350-30-35, *Intangibles Other Than Goodwill Subsequent Remeasurements* , which amends the list of factors an entity should consider in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset. These provisions apply to intangible assets that are acquired individually or with a group of assets and intangible assets acquired in both business combinations and asset acquisitions. Furthermore, these provisions remove the provision that requires an entity to consider whether the renewal or extension can be accomplished without substantial cost or material modifications of the existing terms and conditions associated with the asset. Instead, these provisions require that an entity consider its own experience in renewing similar arrangements. An entity would consider market participant assumptions regarding renewal if no such relevant experience exists. This new accounting guidance 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 does not expect the adoption of this new accounting guidance to have a material impact on its consolidated financial condition, results of operations, and cash flow.

ASC 805-20-25, Business Combinations Recognition of Identifiable Assets and Liabilities and Any Noncontrolling Interests

In April 2009, the FASB issued ASC 805-20-25, *Business Combinations Recognition of Identifiable Assets and Liabilities and Any Noncontrolling Interests* , which applies to all assets acquired and liabilities assumed in a business combination that arise from contingencies that would be within the scope of ASC 450, *Contingencies* , if not acquired or assumed in a business combination, except for assets or liabilities arising from contingencies that are subject to specific guidance in ASC 805-10, *Business Combinations* . These provisions require an acquirer to recognize at fair value, at the acquisition date, an asset acquired or a liability assumed in a business combination that arises from a contingency if the acquisition-date fair value of that asset or liability can be determined during the measurement period. If the acquisition-date fair value cannot be determined during the measurement period, the asset or liability shall be recognized at the acquisition date if it is probable that the asset existed or that a liability has been incurred at the acquisition date and the amount of the asset or liability can be reasonably estimated. These provisions are effective for assets or liabilities arising from contingencies in 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, the Company believes that this new accounting guidance 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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)***ASC 855-10, Subsequent Events*

In May 2009, the FASB issued ASC 855-10, *Subsequent Events*. The objective of these provisions are to establish general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. The provisions discuss two types of subsequent events: (1) events that provide additional evidence about conditions that existed at the date of the balance sheet, and is recognized in the financial statements and (2) events that provide evidence about conditions that did not exist at the date of the balance sheet but arose after the balance sheet date but before financial statements are issued or are available to be issued, and not recognized at the balance sheet date. An entity shall also disclose the date through which subsequent events have been evaluated, as well as whether that date is the date the financial statements were issued or the date the financial statements were available to be issued. The requirements are effective for interim and annual financial periods ending after June 15, 2009. The requirements did not have a material impact on the Company's consolidated financial statements. The Company evaluated its November 30, 2009 consolidated financial statements for subsequent events through February 11, 2010, the date the consolidated financial statements were issued. The Company is not aware of any subsequent events which would require recognition or disclosure in its consolidated financial statements.

ASU 2009-01, The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles

In June 2009, the FASB issued ASU 2009-01, *The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles* (ASU 2009-01), which amends FAS No. 168, *The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles* (FAS No. 168). FAS No. 168 identified the sources of accounting principles and the framework for selecting the principles used in preparing the financial statements that are presented in conformity with generally accepted accounting principles (GAAP). It arranged these sources of GAAP in a hierarchy for users to apply accordingly. With ASU 2009-01 in effect, all of its content carry the same level of authority, effectively superseding FAS No. 168. Thus, the GAAP hierarchy has been modified to include only two levels of GAAP: authoritative and nonauthoritative. ASU 2009-01 is effective for financial statements issued for interim and annual periods ending after September 15, 2009. The provisions of ASU 2009-01 did not have a material impact on the Company's consolidated financial statements.

2. Acquisitions

On November 30, 2009, the Company acquired substantially all of the assets and assumed certain liabilities of Micro Networks Corporation (Micro Networks). Micro Networks, with operations in Worcester, Massachusetts and Auburn, New York, designs and manufactures high-performance data conversion products, custom modules, and a broad line of filters, oscillators, and delay lines based on surface acoustic wave (SAW) technology. Micro Networks' products also include integrated microwave assemblies with hybrid circuit design, precision bulk acoustic wave delay lines and synthesizers. The Company believes that these products and related SAW technology, which are currently used predominantly in defense and aerospace applications, 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 Micro Networks' products. These factors contributed to a purchase price resulting in the recognition of goodwill.

The aggregate cash purchase price for Micro Networks was \$12,938,000. The purchase price will be allocated to the assets acquired and liabilities assumed based upon their respective fair market values. Land and building values will be determined by independent appraisal. Machinery and equipment values will be determined by reference to undepreciated cost as of the date of acquisition, which the Company believes approximates fair value. The fair market values of identifiable intangible assets will be 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 will be recognized as goodwill. The aggregate cash purchase price, which includes legal fees and other costs directly related to the acquisition of \$139,000, was partially funded by borrowings of \$7,000,000 under the Company's domestic line of credit. The Company utilized its existing cash reserves to satisfy the balance of the purchase price.

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

A preliminary allocation of the purchase price to the Micro Networks assets acquired and liabilities assumed is as follows (in thousands):

Accounts receivable	\$ 1,027
Inventories	3,533
Prepaid expenses and other current assets	19
Land	83
Building	517
Machinery and equipment	172
Accounts payable	(311)
Accrued liabilities	(286)
Goodwill	8,184
	\$ 12,938

The Company expects a final allocation of the Micro Networks purchase price to be completed in the first six months of fiscal year 2010, upon receipt and review of all relevant and necessary information. The goodwill acquired will be assigned to the Company's Microwave Components and Systems reportable operating segment. For tax purposes, the Company expects to amortize the acquired goodwill ratably over a 15 year period.

With the acquisition of Micro Networks occurring after the close of business on the last day of the Company's 2009 fiscal year, no Micro Networks revenues or expenses have been included in the accompanying consolidated statements of income. The following unaudited pro forma consolidated financial information for the years ended November 30, 2009 and 2008, has been prepared as if the Micro Networks acquisition had occurred on December 1, 2007 (in thousands, except per share data):

	2009	2008
Net sales	\$ 144,611	\$ 145,992
Net income	8,731	10,425
Earnings per common share:		
Basic	0.69	0.80
Diluted	0.69	0.79

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 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. The aggregate cash purchase price for SatCon was \$5,587,000, which was primarily funded by borrowings under the Company's domestic line of credit.

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

Edgar Filing: SPECTRUM CONTROL INC - Form 10-K

Earnings per common share:		
Basic	0.67	0.88
Diluted	0.67	0.85

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

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
Earnings per common share:		
Basic	0.84	0.46
Diluted	0.81	0.45

3. Inventories

Inventories by major classification are as follows:

	November 30	
	2009	2008
	(in thousands)	
Finished goods	\$ 5,548	\$ 3,464
Work-in-process	12,576	11,371
Raw materials	16,099	15,803
	\$ 34,223	\$ 30,638

At November 30, 2009 and 2008, inventories are presented net of inventory reserves of \$991,000 and \$1,705,000, respectively.

4. Property, Plant and Equipment

Property, plant and equipment consist of the following:

	November 30	
	2009	2008
	(in thousands)	
Land and improvements	\$ 2,362	\$ 2,276
Buildings and improvements	16,870	15,889
Machinery and equipment	45,045	42,358

Edgar Filing: SPECTRUM CONTROL INC - Form 10-K

	64,277	60,523
Less accumulated depreciation	37,894	33,273
	\$ 26,383	\$ 27,250

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

Changes in the carrying amount of goodwill for the years ended November 30, 2009 and 2008, in total and for each reportable segment, are summarized as follows (in thousands):

	2009	2008
Goodwill, beginning of year	\$ 36,811	\$ 35,669
Goodwill acquired	8,184	1,142
Goodwill, end of year	\$ 44,995	\$ 36,811

	Advanced Specialty Products	Microwave Components and Systems	Sensors and Controls
<u>2009</u>			
Goodwill, beginning of year	\$ 14,243	\$ 14,862	\$ 7,706
Goodwill acquired	-	8,184	-
Goodwill, end of year	\$ 14,243	\$ 23,046	\$ 7,706
<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

During the year ended November 30, 2009, the Company recorded \$8,184,000 of goodwill in connection with its acquisition of Micro Networks, based upon a preliminary allocation of the related purchase price. During the year ended November 30, 2008, the Company recorded \$1,142,000 of goodwill in connection with its acquisition of SatCon.

6. Other Noncurrent Assets

Other noncurrent assets consist of the following:

	November 30 2009	November 30 2008
	(in thousands)	
Amortizable assets:		
Customer-related intangibles	\$ 6,926	\$ 6,926
Patents and patent rights	325	306
Debt issuance costs	38	38
	7,289	7,270

Edgar Filing: SPECTRUM CONTROL INC - Form 10-K

Less accumulated amortization	3,959	3,198
	3,330	4,072
Other assets:		
Prepaid environmental liability insurance (see Note 10)	2,121	2,487
Deferred charges	105	95
Other noncurrent assets	\$ 5,556	\$ 6,654

For the years ended November 30, 2009 and 2008, the weighted average amortization period for customer-related intangibles was 8.0 years.

During each of the five years ending November 30, 2014, amortization expense is expected to approximate \$689,000, \$617,000, \$498,000, \$498,000, and \$418,000, respectively.

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

Short-term debt consists of the following:

	November 30 2009	November 30 2008 (in thousands)
Notes payable - domestic line of credit (1)	\$ 7,000	\$ 10,000
Notes payable - foreign line of credit (2)	-	-
	\$ 7,000	\$ 10,000

- (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, 2009, weighted average borrowings under the revolving line of credit amounted to \$3,808,000 with an average interest rate of 2.04% and maximum month-end borrowings of \$9,000,000. During the year ended November 30, 2008, weighted average borrowings were \$4,888,000 with an average interest rate of 3.95%, and maximum month-end borrowings of \$10,000,000. 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, 2009, 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 \$1,504,000 (Euro 1,000,000). During the years ended November 30, 2009 and 2008, 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 2009	November 30 2008 (in thousands)
Accrued salaries and wages	\$ 4,365	\$ 3,540
Accrued environmental remediation costs (see Note 10)	278	269
Accrued interest	67	121
Accrued other expenses	656	485
	\$ 5,366	\$ 4,415

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

Long-term debt consists of the following:

	November 30	
	2009	2008
	(in thousands)	
Industrial revenue bonds at an interest rate of 5.36% (1)	\$ 545	\$ 605
Mortgage note payable to bank at an interest rate of 8.50% (2)	-	427
Total	545	1,032
Less current portion	65	487
Long-term debt	\$ 480	\$ 545

- (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 was collateralized by certain land and building and required monthly principal payments of approximately \$3,000 through July 2009, with a final principal payment of \$400,000 made in August 2009.

The aggregate maturities of all long-term debt during each of the five years ending November 30, 2014, are \$65,000 in 2010, \$70,000 in 2011, \$75,000 in 2012, \$80,000 in 2013, and \$80,000 in 2014.

10. Other Liabilities

Other liabilities consist of the following:

	November 30	
	2009	2008
	(in thousands)	
Accrued environmental remediation costs	\$ 1,006	\$ 1,247
Less current portion	278	269
	\$ 728	\$ 978

The Company owns certain land and manufacturing facilities in State College, Pennsylvania. The property, which was acquired from Murata Electronics North America (Murata) in December 2005, 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.

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.

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

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, 2009, remediation expenditures of \$1,882,000 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 \$1,006,000 which are anticipated to be incurred over the next six years, principally consist of: (a) continued operation and monitoring of the existing on-site groundwater extraction, treatment, and recharge system; (b) completion of soil investigations to determine the extent of potential soil contamination; (c) excavation and off-site disposal of soil containing contaminants above acceptable standards; and (d) 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, \$278,000 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, 2009 and 2008, the Company did not have any material forward currency exchange contracts outstanding. Hedging ineffectiveness during the years ended November 30, 2009, 2008, and 2007 was not material to the consolidated financial statements.

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, 2009, no shares were repurchased under this program. 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.

Table of Contents**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****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, 2006	\$ 254
2007 Foreign currency translation adjustments	539
Balance November 30, 2007	793
2008 Foreign currency translation adjustments	(148)
Balance November 30, 2008	645
2009 Foreign currency translation adjustments	484
Balance November 30, 2009	\$ 1,129

14. Insurance Recoveries

The Company conducts its operations in numerous locations, including a leased facility in Marlborough, Massachusetts (the Marlborough Facility) and an owned facility in Wesson, Mississippi (the Wesson Facility). In January 2009, the Marlborough Facility sustained wind damage to its roof which, in turn, resulted in water damage to certain machinery, equipment, and leasehold improvements. Also in January 2009, a small outbuilding at the Wesson Facility sustained a fire, destroying the outbuilding and certain plating equipment contained inside. The aggregate book value of the assets damaged or destroyed by these two involuntary conversions amounted to \$652,000. In addition, the Company incurred costs of \$106,000 for various clean-up, repairs and related outside services. Upon the settlement of all related insurance claims, the Company received aggregate insurance recoveries of \$1,286,000. Accordingly, the Company recorded a net gain of \$528,000 representing the excess of the insurance recoveries over the carrying value of the assets destroyed and related costs incurred. This credit has been included in selling, general and administrative expense in the Company's consolidated statement of income for the year ended November 30, 2009.

15. Other Income and Expense

Other income and expense for the years ended November 30, 2009, 2008, and 2007, consist of the following (in thousands):

	2009	2008	2007
Patent licensing fees	\$ -	\$ 340	\$ 93
Investment income	34	178	168
Loss on foreign currency transactions	(60)	(13)	(6)

Table of Contents**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****16. Income Taxes**

For the years ended November 30, 2009, 2008, and 2007, income before income taxes consists of the following (in thousands):

	2009	2008	2007
U.S. operations	\$ 13,353	\$ 13,414	\$ 16,697
Foreign operations	35	66	861
	\$ 13,388	\$ 13,480	\$ 17,558

For the years ended November 30, 2009, 2008, and 2007, the provision for income taxes consists of the following (in thousands):

	2009	2008	2007
Current			
U.S. Federal	\$ 3,033	\$ 3,561	\$ 5,004
Foreign	(7)	(5)	112
State	492	514	608
Deferred			
U.S. Federal	1,208	603	617
State	102	(44)	76
	\$ 4,828	\$ 4,629	\$ 6,417

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, 2009, 2008, and 2007, consists of the following (in thousands):

	2009	2008	2007
Statutory federal income tax	\$ 4,686	\$ 4,718	\$ 6,145
State income taxes, net of federal tax effect	386	305	445
Research activities tax credit	(151)	(193)	-
Domestic production activities deduction	(175)	(186)	(95)
Foreign tax rates	(19)	(28)	(190)
Tax rate changes on existing temporary differences	-	-	127
Other items	101	13	(15)
	\$ 4,828	\$ 4,629	\$ 6,417

Excess 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, 2009, 2008, and 2007, these tax benefits and related credits to stockholders' equity amounted to \$42,000, \$102,000, and \$356,000, 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	
	2009	2008
	(in thousands)	
Deferred tax assets:		
Accrued compensation	\$ 638	\$ 602
Amortization of intangible assets	552	437
Inventory valuation	521	770
Allowance for doubtful accounts	284	327
Deferred tax assets	1,995	2,136
Deferred tax liabilities:		
Amortization of intangible assets	4,997	4,371
Depreciation of plant and equipment	2,898	2,488
Investment in subsidiaries	2,199	2,069
Other	18	15
Deferred tax liabilities	10,112	8,943
Net deferred tax liabilities	\$ (8,117)	\$ (6,807)
	November 30	
	2009	2008
	(in thousands)	
Net deferred tax assets:		
Current	\$ 1,425	\$ 1,684
Net deferred tax liabilities:		
Noncurrent	(9,542)	(8,491)
	\$ (8,117)	\$ (6,807)

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 recent 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, 2009, the aggregate undistributed earnings of the foreign subsidiaries amounted to \$4,597,000. 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

Edgar Filing: SPECTRUM CONTROL INC - Form 10-K

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, 2009 or 2008.

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 consolidated 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. The adoption of FIN 48, *Accounting for Uncertainty in Income Taxes*, 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 years ended November 30, 2009 and 2008, the Company had additional unrecognized tax benefits of \$50,000 and \$65,000, respectively, 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
Increases related to:	
Prior year tax positions	-
Current year tax positions	50
Balance at November 30, 2009	\$ 183

As of November 30, 2009 and 2008, the Company's unrecognized tax benefits of \$183,000 and \$133,000, 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 2005 to present, and the tax year 2002 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 2005 to the present.

17. Earnings Per Common Share

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

	2009	2008	2007
Numerator for basic and diluted earnings per common share (in thousands):			
Net income	\$ 8,560	\$ 8,851	\$ 11,141
Denominator for basic earnings per common share (in thousands):			
Weighted average shares outstanding	12,604	13,069	13,359
Denominator for diluted earnings per common share (in thousands):			
Weighted average shares outstanding	12,604	13,069	13,359
Effect of dilutive stock options	135	120	439
	12,739	13,189	13,798
Earnings per common share:			

Edgar Filing: SPECTRUM CONTROL INC - Form 10-K

Basic	\$ 0.68	\$ 0.68	\$ 0.83
Diluted	\$ 0.67	\$ 0.67	\$ 0.81

In 2009, options to purchase 105,500 shares of Common Stock, at a weighted average exercise price of \$9.25 per share, were outstanding but were not included in the computation of diluted earnings per share because their inclusion would be antidilutive. In 2008, options to purchase 1,103,734 shares of Common Stock, at a weighted average exercise price of \$7.48 per share, were similarly excluded.

Table of Contents**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****18. Supplemental Cash Flow Information**

Supplemental cash flow information for the years ended November 30, 2009, 2008, and 2007, consists of the following (in thousands):

	2009	2008	2007
Cash paid during the year for:			
Interest	\$ 244	\$ 357	\$ 603
Income taxes	3,488	6,759	3,548
Liabilities assumed in connection with:			
Business acquisitions	597	1,344	104

19. 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, 2009, options to purchase 1,312,552 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, 2009, 2008, and 2007, is as follows:

	Number of Shares Under Option	Per Share		Option Price Weighted Average	Aggregate
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
Granted during the year	297,000	5.75	6.43	5.91	1,757,000
Exercised during the year	(123,634)	6.31	7.60	7.00	(865,000)
Cancellations and forfeitures	(215,000)	8.00	8.68	8.66	(1,862,000)
Outstanding November 30, 2009	1,062,100	\$ 5.75	9.30	\$ 6.86	\$ 7,284,000
Exercisable:					
November 30, 2009	575,600	\$ 6.31	7.60	\$ 6.69	\$ 3,848,000

Edgar Filing: SPECTRUM CONTROL INC - Form 10-K

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

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

The following table summarizes significant ranges of outstanding and exercisable stock options at November 30, 2009:

Option Price Range		Number of Shares Under Option	
Per Share		Outstanding	Exercisable
\$5.75	6.00	225,000	-
6.01	7.00	470,000	398,000
7.01	8.00	177,600	177,600
8.01	9.00	94,000	-
9.01	9.30	95,500	-

At November 30, 2009, the weighted average remaining contractual life of outstanding options was 2.7 years. Except for the stock options granted during the years ended November 30, 2009 and 2008, all of the Company's outstanding options at November 30, 2009 are fully vested. Based upon a closing market price of \$8.74 per share for the Company's Common Stock on November 30, 2009, the aggregate intrinsic value of all outstanding options was \$2,052,000, including an aggregate intrinsic value of \$1,183,000 for all exercisable stock options. During the years ended November 30, 2009, 2008, and 2007, the aggregate intrinsic value of stock options exercised amounted to \$272,000, \$568,000, and \$2,143,000, respectively.

20. 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 \$635,000 in 2009, \$601,000 in 2008, and \$552,000 in 2007.

21. 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 60% of total accounts receivable at November 30, 2009 and 51% at November 30, 2008. At November 30, 2009 and 2008, approximately 17% and 18%, 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)****22. 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: advanced specialty products (formerly referred to as signal and power integrity components); microwave components and systems; power management systems; and sensors and controls. The Company's Advanced Specialty Products Business designs and manufactures a broad range of products including antennas, specialty connectors, advanced ceramics, and electromagnetic interference (EMI) filters and interconnects. Our Microwave Components and Systems Business designs and manufactures microwave filters and components, high power amplifiers, oscillators, synthesizers, switched filter banks, and related systems and integrated assemblies. The Power Management Systems Business designs and manufactures custom AC and DC power distribution units, power outlet strips, power monitoring equipment, 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.

For each period presented, the accounting policies and procedures used to determine segment income have been consistently applied. For the years ended November 30, 2009, 2008, and 2007, reportable segment information is as follows (in thousands):

	Advanced Specialty Products	Microwave Components and Systems	Power Management Systems	Sensors and Controls	Total
2009					
Revenue from unaffiliated customers	\$ 42,001	\$ 60,069	\$ 10,268	\$ 19,968	\$ 132,306
Depreciation and amortization expense	1,953	2,601	280	812	5,646
Segment income	5,332	10,021	2,758	3,448	21,559
Segment assets					
Tangible assets	20,125	25,482	2,743	7,541	55,891
Goodwill	14,243	23,046	-	7,706	44,995
Capital expenditures	1,030	2,326	99	298	3,753
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

Edgar Filing: SPECTRUM CONTROL INC - Form 10-K

Goodwill	14,243	13,720	-	7,706	35,669
Capital expenditures	1,999	1,524	372	1,892	5,787

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

For the years ended November 30, 2009, 2008, and 2007, reconciliations of reportable segment information to the Company's consolidated financial statements are as follows (in thousands):

Depreciation and amortization expense	2009	2008	2007
Total depreciation and amortization expense for reportable segments	\$ 5,646	\$ 5,100	\$ 4,693
Unallocated amounts:			
Depreciation and amortization expense related to general and administrative activities	75	81	130
Consolidated depreciation and amortization expense	\$ 5,721	\$ 5,181	\$ 4,823
Income before provision for income taxes	2009	2008	2007
Total income for reportable segments	\$ 21,559	\$ 20,311	\$ 24,258
Unallocated amounts:			
General and administrative expense	(7,955)	(6,967)	(6,394)
Interest expense	(190)	(369)	(561)
Other income and (expense), net	(26)	505	255
Consolidated income before provision for income taxes	\$ 13,388	\$ 13,480	\$ 17,558
Assets	2009	2008	2007
Total assets for reportable segments	\$ 100,886	\$ 89,922	\$ 82,648
Unallocated amounts:			
Cash and cash equivalents	6,090	5,397	5,183
Accounts receivable	22,623	24,043	25,461
Other current assets	3,859	3,991	2,243
Other noncurrent assets	10,271	11,431	11,384
Total consolidated assets	\$ 143,729	\$ 134,784	\$ 126,919
Capital expenditures	2009	2008	2007
Total capital expenditures for reportable segments	\$ 3,753	\$ 4,456	\$ 5,787
Unallocated amounts:			
Capital expenditures related to general and administrative activities	199	26	23
Total consolidated capital expenditures	\$ 3,952	\$ 4,482	\$ 5,810

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 2009, 2008, and 2007 is as follows (in thousands):

	United States	Mexico	China	Germany	All Other Countries	Total
2009						
Revenue from unaffiliated customers	\$ 110,612	\$ 658	\$ 2,111	\$ 2,535	\$ 16,390	\$ 132,306
Long-lived assets:						
Property, plant and equipment	25,164	116	1,086	17	-	26,383
2008						
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
2007						
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

In 2009 and 2008, the Company's largest single customer (a prime supplier to the military/defense industry) represented 8% and 4%, respectively, of total consolidated net sales. Sales to this major customer consisted of various advanced specialty products 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 advanced specialty products.

23. Quarterly Financial Data (Unaudited)

	Year Ended November 30, 2009			
	First	Second	Third	Fourth
	(in thousands, except per share data)			
Net sales	\$ 33,117	\$ 33,623	\$ 31,477	\$ 34,089
Gross margin	8,258	8,948	7,749	9,405
Net income	2,153	2,221	2,041	2,145
Earnings per common share:				
Basic	0.17	0.18	0.16	0.17
Diluted	0.17	0.18	0.16	0.17

	Year Ended November 30, 2008			
	First	Second	Third	Fourth
	(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

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.

Table of Contents**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****24. 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.

25. 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 2014. 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):

2010	\$ 1,329
2011	422
2012	383
2013	144
2014	16

\$ 2,294

Total rent expense under all operating leases amounted to \$2,270,000 in 2009, \$2,157,000 in 2008, and \$2,362,000 in 2007.

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, 2009. 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, 2009.

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, 2009, 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. and subsidiaries 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

Edgar Filing: SPECTRUM CONTROL INC - Form 10-K

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, 2009, 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, 2009 and 2008, and the related consolidated statements of income, stockholders' equity, and cash flows for each of the three years in the period ended November 30, 2009 of Spectrum Control, Inc. and subsidiaries and our report dated February 11, 2010, expressed an unqualified opinion thereon.

ERNST & YOUNG LLP

Pittsburgh, Pennsylvania

February 11, 2010

(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 2009.

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 12, 2010 (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, Mr. Bailey, and Mr. Ryan 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.

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

Name of Officer	Age	Position
John P. Freeman	55	Senior Vice President, Chief Financial Officer
Lawrence G. Howanitz	57	Senior Vice President, Advanced Specialty Products
Robert J. McKenna	56	Senior Vice President, New Business and Resource Development
Richard A. Southworth	67	President, Chief Executive Officer
James F. Toohey	75	Secretary
Brian F. Ward	50	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 Advanced Specialty Products.

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.

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

Edgar Filing: SPECTRUM CONTROL INC - Form 10-K

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 10 through 21 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 8 and 9 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 9 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 2010 on page 23 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	39
Consolidated Balance Sheets as of November 30, 2009 and 2008	40
Consolidated Statements of Income for the Years Ended November 30, 2009, 2008, and 2007	41
Consolidated Statements of Stockholders' Equity for the Years Ended November 30, 2009, 2008, and 2007	42
Consolidated Statements of Cash Flows for the Years Ended November 30, 2009, 2008, and 2007	43
Notes to Consolidated Financial Statements	44-65

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

Schedule II - Valuation and Qualifying Accounts	73
---	----

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	
Asset Purchase Agreement effective November 30, 2009, by and among Spectrum Control, Inc., Spectrum Microwave, Inc., Micro Networks Corporation, Creative Electric, Inc., MNC Worcester Corporation, and Integrated Device Technology, Inc., previously filed on November 30, 2009, as Exhibit 10.1 to Form 8-K, and incorporated herein by reference	
Subsidiaries of the Company (21.1)	74-75
Consent of Ernst & Young LLP (23.1)	76
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)	77
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)	78
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)	79

- (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 11, 2010

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 11, 2010
/s/ George J. Behringer	Director	February 11, 2010
/s/ James R. Foster	Principal Accounting Officer	February 11, 2010
/s/ John P. Freeman	Director, Chief Financial Officer	February 11, 2010
/s/ J. Thomas Gruenwald	Director	February 11, 2010
/s/ Charles S. Mahan, Jr.	Director	February 11, 2010
/s/ Gerald A. Ryan	Director	February 11, 2010
/s/ James F. Toohey	Director	February 11, 2010

Table of Contents

Spectrum Control, Inc. and Subsidiaries

Schedule II Valuation and Qualifying Accounts

For the Three Years Ended November 30, 2009

(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
Year ended November 30, 2007:				
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
Year ended November 30, 2008:				
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
Year ended November 30, 2009:				
Allowance for doubtful accounts	\$ 933	\$ (36)	\$ 82 (1)	\$ 815
Reserve for excess and slow-moving inventories	\$ 1,705	\$ 1,152	\$ 1,866 (2)	\$ 991

(1) Uncollectible accounts written off, net of recoveries

(2) Inventories physically scrapped