

WINLAND ELECTRONICS INC
Form 10-Q
November 14, 2011

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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

For the Quarter Ended:

September 30, 2011

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 No.: 1-15637

WINLAND ELECTRONICS, INC.
(Name of registrant in its charter)

Minnesota
(State or other jurisdiction of incorporation or organization)

41-0992135
(IRS Employer Identification Number)

1950 Excel Drive, Mankato, Minnesota 56001
(Address of principal executive offices)

(507) 625-7231
(Issuer's telephone number)

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

Title of Each Class	Name of Exchange
Common Stock, \$.01 par value	American Stock Exchange
Preferred Stock Purchase Rights	American Stock Exchange

Securities registered pursuant to Section 12(g) of the Exchange Act: None

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Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the preceding 12 months (or for such shorter period that the registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a small reporting company. 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 Smaller Reporting Company

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

There were 3,701,630 shares of Common Stock, \$.01 par value, outstanding as of November 11, 2011.

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PART I – FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

WINLAND ELECTRONICS, INC.

CONDENSED BALANCE SHEETS
(In Thousands, Except Share Data)

ASSETS	September 30, 2011 (Unaudited)	December 31, 2010
Current Assets		
Cash and cash equivalents	\$ 1,598	\$ 318
Accounts receivable, less allowance for doubtful accounts of \$7 as of September 30, 2011 and \$10 as of December 31, 2010 (Note 3)	402	547
Receivable due from EMS asset sale (Note 8)	250	-
Refundable income taxes (Note 9)	-	277
Inventories (Note 5)	442	112
Prepaid expenses and other assets	71	87
Current assets of discontinued operations (Note 8)	157	4,649
Total current assets	2,920	5,990
Property and Equipment, at cost		
Property and equipment	313	3,750
Less accumulated depreciation and amortization	235	1,447
Net property and equipment	78	2,303
Assets held for sale, net (Note 11)	2,135	-
Property and equipment of discontinued operations, net (Note 8)	-	1,151
Total assets	\$ 5,133	\$ 9,444
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current Liabilities		
Revolving line-of-credit	\$ -	\$ 1,249
Current maturities of long-term debt	365	448
Accounts payable	473	381
Other short-term tax liabilities	-	68
Accrued liabilities:		
Compensation	135	410
Other	23	35
Current liabilities of discontinued operations (Note 8)	60	2,084
Total current liabilities	1,056	4,675
Long-Term Liabilities		
Deferred revenue	108	114
Long-term liabilities of discontinued operations (Note 8)	-	29
Total long-term liabilities	108	143
Total liabilities	1,164	4,818
Stockholders' Equity (Note 7)		

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Common stock, par value \$0.01 per share; authorized 20,000,000 shares; issued and outstanding 3,701,630 as of September 30, 2011 and 3,699,230 shares as of December 31, 2010	37	37
Additional paid-in capital	5,014	5,025
Accumulated deficit earnings	(1,082)	(436)
Total stockholders' equity	3,969	4,626
Total liabilities and stockholders' equity	\$5,133	\$9,444

See Notes to Financial Statements

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WINLAND ELECTRONICS, INC.

CONDENSED STATEMENTS OF OPERATIONS

(In Thousands, Except Share and Per Share Data)

(Unaudited)

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	2011	2010	2011	2010
Net sales (Note 3)	\$769	\$838	\$2,673	\$2,450
Cost of sales	501	442	1,801	1,395
Gross profit	268	396	872	1,055
Operating expenses:				
General and administrative	191	368	693	1,339
Sales and marketing	270	226	736	736
Research and development	103	-	150	-
	564	594	1,579	2,075
Operating loss	(296)	(198)	(707)	(1,020)
Other income (expenses):				
Interest expense	(6)	(19)	(45)	(31)
Other, net	2	(9)	17	(10)
	(4)	(38)	(28)	(78)
Loss from continuing operations before income taxes	(300)	(236)	(735)	(1,098)
Income tax benefit (expense) (Note 9)	-	89	(9)	87
Loss from continuing operations	(300)	(147)	(744)	(1,011)
Gain (loss) from discontinued operations, net of tax	-	(158)	98	(656)
Net loss	\$(300)	\$(305)	\$(646)	\$(1,667)
Loss per common share data:				
Basic and diluted	\$(0.08)	\$(0.08)	\$(0.17)	\$(0.45)
Loss from continuing operations per common share data:				
Basic and diluted	\$(0.08)	\$(0.04)	\$(0.20)	\$(0.27)
Gain (loss) from discontinued operations per common share data:				
Basic and diluted	\$-	\$(0.04)	\$0.03	\$(0.18)
Weighted-average number of common shares outstanding:				
Basic and diluted	3,701,630	3,699,230	3,700,848	3,690,911

See Notes to Financial Statements

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WINLAND ELECTRONICS, INC.

CONDENSED STATEMENTS OF CASH FLOWS

(In Thousands)

(Unaudited)

For the Nine Months
Ended September 30,
2011 2010

Cash Flows From Operating Activities

Net loss	\$(646	)	\$(1,667)
Adjustments to reconcile net loss to net cash used in operating activities:				
Depreciation and amortization	100		589	
Non-cash stock based compensation	(13	)	23	
Decrease in allowance for doubtful accounts	(3	)	(6)
Decrease in allowance for obsolete inventory	(20)	-	
Loss on disposal of equipment	-		56	
Decrease in deferred tax valuation allowance	-		(86)
Decrease in allowance for obsolete inventory held for discontinued operations	(112)	-	
Loss on sale of EMS business unit	14		-	
Changes in assets and liabilities:				
Accounts receivables	8		297	
Refundable income taxes	277		628	
Inventories	(310	)	(280)
Prepaid expenses and other assets	16		6	
Accounts payable	42		324	
Accrued expenses, including deferred revenue and other short and long term tax liabilities	(341	)	(39)
Net cash used in operating activities	(988	)	(155)

Cash Flows From Investing Activities

Purchases of property and equipment	(10	)	(31)
Proceeds from sale of property and equipment	-		7	
Sale of inventory from discontinued operations	2,795		-	
Cash from sale of EMS business unit, net of transaction costs	813		-	
Net cash provided by (used in) investing activities	3,598		(24)

Cash flows From Financing Activities

Net borrowings (payments) on revolving credit agreement	(1,249	)	581	
Net principal payments on long-term borrowings, including capital lease obligations	(83	)	(282)
Cash received from exercise of stock options	2		7	
Net cash provided by (used in) financing activities	(1,330	)	306	

Net increase in cash and cash equivalents

1,280 127

Cash and cash equivalents

Beginning	318		55	
Ending	\$1,598		\$182	

Supplemental Disclosures of Cash Flow Information

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Cash payments for interest	\$49	\$81
Cash receipts for income taxes	\$209	\$628
Non-cash reclassification of other tax liability from long-term to short-term	\$-	\$258
Non-cash investing activities		
Receivable recorded for sale of EMS Business unit	\$250	\$-
Accrued transaction costs for sale of EMS business unit	\$50	\$-

See Notes to Condensed Financial Statements

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Winland Electronics Inc.

Notes to Condensed Financial Statements

Note 1. Basis of Presentation

The accompanying unaudited condensed financial statements have been prepared by Winland Electronics, Inc. (the “Company” or “Winland”) in accordance with accounting principles generally accepted in the United States of America for the preparation of interim financial information and the instructions to Form 10-Q and Article 10 of Regulation S-X of the Securities and Exchange Commission (the “SEC”). Accordingly, they do not include all of the information and notes required by accounting principles generally accepted in the United States of America for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring adjustments) considered necessary for a fair presentation have been included. Financial results for the nine months ended September 30, 2011 are not necessarily indicative of the results that may be expected for the year ending December 31, 2011. The footnotes are in thousands unless noted.

The condensed balance sheet at December 31, 2010 has been derived from the audited financial statements as of that date but does not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statement presentation.

This financial information should be read in conjunction with the financial statements and notes included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2010.

Management is required to make certain estimates and assumptions which affect the amounts of assets, liabilities, revenue and expenses reported. Actual results could differ materially from these estimates and assumptions.

The Company evaluates events through the date the financial statements are filed for events requiring adjustment to or disclosure in the financial statements.

Discontinued Operations: Included in discontinued operations is Winland’s Electronic Manufacturing Services (EMS) operation. The sale of the EMS operations to a third party was completed on January 1, 2011 pursuant to the terms of an Asset Purchase Agreement dated November 15, 2010 (the “APA”). The transaction involved the sale of 100% of Winland’s EMS assets and assumptions of certain liabilities. The Company’s shareholders approved the sale on December 29, 2010.

The APA met the requirements of ASC 205-20 “Discontinued Operations” as being held for sale at December 31, 2010. Accordingly, the Company has restated the previously reported financial results to report the net results as a separate line in the statements of operations as “Loss from discontinued operations, net of tax” for all periods presented, and the assets and liabilities of EMS on the balance sheets have been separately classified as “Assets/Liabilities of discontinued operations”. In accordance with ASC 205-20-S99-3 “Allocation of Interest to Discontinued Operations”, the Company elected to not allocate interest expense to the discontinued operations where the debt is not directly attributed to or related to the discontinued operations. Notes to the financial statements have been revised to reflect only the results of continuing operations (see Notes 2 and 8).

Note 2. Segment Reporting

Accounting Standards Codification (“ASC”) 280, Segment Reporting, requires an enterprise to report segment information in the same way that management internally organizes its business for assessing performance and making decisions regarding the allocation of resources. The Company evaluates the performance of operating segments and

allocates resources based on profit and loss from operations.

For interim reporting periods in 2010, the Company had two reporting segments; EMS and Proprietary Products. As stated in Note 1, the Company sold the EMS segment effective January 1, 2011. Based on this, the financial information presented on the face of the financial statements represents one segment. See Note 8 for more information regarding the EMS segment and discontinued operations.

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Winland Electronics Inc.

Notes to Condensed Financial Statements

Note 3. Major Customers

The Company has one customer that accounted for 10 percent (10%) or more of net sales for the three and nine months ended September 30, 2011 and 2010 as follows:

Sales percentage:	For the Three Months Ended September 30,			
	2011		2010	
Customer A	43	%	51	%

Sales percentage:	For the Nine Months Ended September 30,			
	2011		2010	
Customer A	49	%	49	%

The Company had net receivables (as a percentage of total receivables) from the above customer as follows:

Accounts receivable percentage:	September 30,		December 31,	
	2011		2010	
Customer A	42	%	63	%

Note 4. Loss per Common Share

Loss per common share: Basic loss per common share is computed by dividing the net loss by the weighted-average number of common shares outstanding during the period. Diluted loss per common share is computed by dividing the net loss by the weighted-average number of common shares outstanding during the period, including potentially dilutive shares such as the options and warrants to purchase shares of common stock at various amounts per share (see Note 7). For the three and nine months ended September 30, 2011 and 2010, the diluted loss per share was the same as basic loss per share since the effects of options and warrants would have been anti-dilutive. The diluted share calculation excluded 190,000 weighted average shares for the three and nine months ended September 30, 2011 and 326,500 weighted average shares for the three and nine months ended September 30, 2010.

Note 5. Inventories

The components of inventories were as follows net of reserves:

	September 30,		December 31,	
	2011		2010	
Finished goods, net	\$	442	\$	112

Winland estimates excess, slow moving and obsolete reserves for inventory on a quarterly basis based upon order demand. Management's estimated valuation reserve for slow moving and obsolete finished goods inventories was \$14 at September 30, 2011 and \$34 at December 31, 2010.

Note 6. Allowance for Rework and Warranty Costs

Winland provides a limited warranty for its proprietary products for a period of one year, which requires Winland to repair or replace defective product at no cost to the customer or refund the purchase price. The reserve reflecting historical experience and potential warranty issues is determined based on specific experience factors including rate of return by item, average weeks outstanding from sale to return, average cost of repair and relation of repair cost to original sales price. Any specific known warranty issues are considered individually. These are analyzed to determine the probability and the amount of financial exposure, and a specific reserve is established. The allowance for rework and warranty costs was \$10 at September 30, 2011 and 2010.

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Winland Electronics Inc.

Notes to Condensed Financial Statements

Note 6. Allowance for Rework and Warranty Costs (Continued)

Changes in the Company's warranty liability were approximately as follows:

(\$ in thousands)	For the Three Months Ended September 30,	
	2011	2010
Balance, Beginning	\$ 10	\$ 8
Accruals for products sold	4	9
Expensing of specific warranty items	(4)	(9)
Change in estimate	-	2
Balance, Ending	\$ 10	\$ 10

	For the Nine Months Ended September 30,	
	2011	2010
Balance, Beginning	\$ 11	\$ 8
Accruals for products sold	13	13
Expensing of specific warranty items	(13)	(13)
Change in estimate	(1)	2
Balance, Ending	\$ 10	\$ 10

Note 7. Stock-Based Awards

For the three and nine months ended September 30, 2011, the Company granted 70,000 options which had weighted average grant date fair values of \$0.44 determined using an expected dividend yield of 0.0 percent, an expected stock volatility of 80.3%, a risk-free interest rate of 1.8% and expected option lives of 4.7 years. For the three and nine months ended September 30, 2010, the Company granted 22,000 options which had weighted average grant date fair values of \$0.59 determined using an expected dividend yield of 0.0 percent, an expected stock volatility of 82.8%, a risk-free interest rate of 2.4% and expected option lives of 5.0 years. For the nine months ended September 30, 2011, the Company recognized a net benefit of \$13 to compensation expense associated with stock based compensation awards which were cancelled on January 1, 2011 due to the separation of the Company's former chief executive officer and chief financial officer offset by compensation expense associated with options issued for the nine months ended September 30, 2011. For the nine months ended September 30, 2010, the Company recognized expense of \$23 related to compensation expense for stock based compensation awards.

At September 30, 2011, there was no unrecognized compensation cost related to share-based payments.

The following table summarizes information about stock options outstanding at September 30, 2011:

Range of Exercise Prices	Number of Shares	Options Outstanding		Options Exercisable	
		Weighted-Average Contractual Life Remaining (Years)	Weighted-Average Exercise Price	Number of Shares	Weighted-Average Exercise Price
0.448 - \$0.897	114,000	9.1	\$ 0.72	114,000	\$ 0.72
\$	22,000	6.6	1.74	22,000	1.74

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0.896 -					
\$1.792					
1.792 -					
\$2.240	5,500	6.3	2.23	5,500	2.23
2.240 -					
\$3.584	11,000	5.6	3.27	11,000	3.27
3.584 -					
\$4.032	24,000	0.9	3.62	24,000	3.62
4.032 -					
\$4.480	11,000	4.1	4.30	11,000	4.30
	187,500	7.1	\$ 1.62	187,500	\$ 1.62

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Winland Electronics Inc.

Notes to Condensed Financial Statements

Note 8. Discontinued Operations

On November 15, 2010, Winland entered into an Asset Purchase Agreement (the “APA”) with Nortech Systems, Incorporated (“Nortech”). Pursuant to the terms of the APA, Winland sold to Nortech the Company’s EMS business segment, which consisted of the design and manufacture of printed circuit board assemblies and higher level products sold mainly to original equipment manufacturer customers (the “Asset Sale”). The sale of the EMS business segment to Nortech was completed on January 1, 2011 pursuant to the terms of the APA and approved by the Company’s shareholders on December 29, 2010.

Aggregate consideration for the Asset Sale consisted of the following (not in thousands): (i) \$1,542,389 in cash, of which \$1,042,389 was paid at closing, \$250,000 was paid on July 1, 2011 and \$250,000 was paid on October 1, 2011, (ii) a minimum inventory consumption obligation of at least \$2,200,000 for 24 months after the closing of the Asset sale, and (ii) the assumption of substantially all of the liabilities of the EMS Business Segment. The terms of the APA and the amount of the consideration for the Asset Sale were negotiated by the Company and Nortech on an arms-length basis. The Asset Sale, net of transaction costs, resulted in a loss of approximately \$14,000. The Company recognized an additional gain of approximately \$112,000 during the nine months ended September 30, 2011, upon the sale of inventory to Nortech under the minimum purchase agreement for inventory that had previously been reserved.

Additionally, in connection with the Asset Sale, the Company entered into (i) a manufacturing agreement with Nortech, whereby Nortech will manufacture certain products for the Company related to the production of the Company’s proprietary monitoring devices, (ii) a lease agreement whereby the Company leased to Nortech, for six years, its office and manufacturing facility and improvements located at 1950 Excel Drive, Mankato Minnesota, 56001, and (iii) a sublease agreement with Nortech whereby Nortech subleased to the Company 1,000 square feet of the building that the Company leased to Nortech pursuant to the lease agreement, and (iv) non-compete agreements with the Company and certain key employees for a period of two-years. In May 2011, Winland amended the sub-lease agreement with Nortech increasing its leased space to 1,900 square feet of office space at \$5.25 per square foot.

Assets and liabilities of EMS segment (discontinued operations) were as follows:

(in thousands)	September 30, 2011	December 31, 2010
Accounts receivable, net	\$ -	\$ 1,752
Inventories, net	157	2,830
Other current assets	-	67
Current assets of discontinued operations	157	4,649
Property and equipment, net	-	1,151
Other assets of discontinued operations	-	1,151
Current maturities of long-term debt	\$ -	\$ 222
Accounts payable	50	1,772
Accrued compensation and other liabilities	10	90
Current liabilities of discontinued operations		