RELIABILITY INC
Form 10KSB
March 31, 2008

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-KSB

Annual Report Pursuant to Section 13 or 15 (d)

of the Securities Exchange Act of 1934

For the Fiscal Year Ended December 31, 2007	**Commission File Number 0-7092**

RELIABILITY INCORPORATED

(Exact name of registrant as specified in its charter)

TEXAS	**75-0868913**
(State or other jurisdiction	**(I.R.S. Employer**
of incorporation or organization)	**Identification Number)**

Post Office Box 218670

Houston, Texas **77218-8670**
(Address of principal executive offices) **(Zip Code)**

(281) 492-0550

(Registrant s telephone number, including area code)

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

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

Common Stock, no par value per share

(Title of class)

Indicate by check mark whether the issuer is not required to file reports pursuant to Section 13 or 15(d) of the Exchange Act.

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 twelve 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 ninety days. YES x 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-KSB or any amendment to this Form 10-KSB. ¨

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

State issuer s revenues for its most recent fiscal year: 0

State the aggregate market value of the voting and non-voting common equity held by non-affiliates; computed by reference to the price at which the common equity was last sold, or the average bid and asked price of such common equity, as of March 18, 2008: $506,877.

Number of shares outstanding of the issuer s Common Stock as of March 18, 2008: 6,335,965.

Documents Incorporated by Reference

None.

Transitional Small Business Disclosure Format (check one). YES ¨ NO x

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PART I

Item 1. *Description of Business*

THE COMPANY

Reliability Incorporated has principally been engaged in the design, manufacture, market and support of high performance equipment used to test and condition integrated circuits (Testing Products). Reliability also designed, manufactured and marketed a line of DC-DC power converters (Power Sources). Reliability and its subsidiary (collectively referred to as Reliability or the Company) also operated a service facility in Singapore that conditioned and tested integrated circuits as a service for others (Services).

During the past seven years, Reliability Incorporated and its subsidiaries (collectively referred to as Reliability or the Company) has sustained significant negative financial results, including substantial decreases in revenues, net income, backlog, and cash flows from operating activities that are generally attributable to operating losses. Due to the deterioration in its financial position, the Company has undergone significant restructuring to reduce its expenses and improve its liquidity, including: the closure of its Power Sources Costa Rica facility, significant downsizing of its domestic and international workforce, the sale of its Power Sources division, the closure of its Services division in Singapore, eliminated all research and development for test equipment, the sale of its Houston headquarters facility, and the closure of its Test Systems business. As a result of these actions, the Company significantly reduced its expenses, and generated some cash. However, based upon its current financial position, and an evaluation of the prospects for continuing to operate its historical business lines, the Company concluded that it should explore some other possibilities.

On April 1, 2007, Reliability completed the merger of its wholly owned subsidiary, Reliability-Medallion, Inc., a Florida corporation, into Medallion Electric Acquisition Corporation and the indirect acquisition, through Medallion Electric Acquisition Corporation, of Medallion Electric, Inc.

Medallion Electric Acquisition Corporation was incorporated under the laws of the State of Florida on December 8, 2006 to facilitate a merger between business entities and was considered to be a development stage company with no operations at March 31, 2007. On June 21, 2007, the Company changed the name of Medallion Electric Acquisition Corporation (MEAC) to Reliability Contractors of Florida, Inc. Reliability Contractors of Florida, Inc. is a wholly-owned subsidiary of Reliability.

Medallion Electric, Inc. (Medallion Electric or Medallion) was incorporated in the State of Florida in 1980. Medallion Electric is an electrical contracting company, located in Coral Springs, Florida, specializing in electrical contracting services to residential homebuilders, with its major assets consisting of contracts for services to be performed and accounts receivable. Medallion Electric became a wholly-owned subsidiary of Reliability Contractors of Florida, Inc. (collectively referred to as Reliability Florida or Electrical Contracting Services).

All of the funds used for the initial acquisition payment and the Company s transaction costs related to the merger and acquisition were paid out of the Company s cash on hand. The Company funded $750,000 to finance the acquisition. $100,000 of such funds was made available to Medallion Electric as working capital; $150,000 was used by MEAC to pay its transaction related expenses. The remaining $500,000 was used to make the initial payment to Mr. Ronald Masaracchio (Masaracchio), the only shareholder of Medallion Electric for 100% of the stock of Medallion Electric. The remainder of the purchase price consisted of two notes- one for $500,000 due in six months and one for $1.4 million due in six months. The Company secured the $500,000 note with the pledge of its real property in North Carolina; the $1.4 million note was secured with the assets of Medallion Electric.

The Company planned to pay the notes from the Company s working capital, funds generated by Electrical Contracting Services, additional debt and/or equity financing, and the sale of a part of its real estate located in North Carolina. However, in early September, 2007 it became apparent, the Company was not generating enough funds and had not been successful in raising debt or equity funds to meet all of the obligations which would be due on October 1, 2007. Therefore, the Reliability Board of Directors passed a resolution on September 25, 2007 that instructed management to enter into an agreement to sell Medallion Electric, Inc. back to the previous owner, Mr. Masaracchio.

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On October 12, 2007, the Company and its subsidiaries Reliability Contractors of Florida, Inc. and Medallion Electric, Inc. entered into a Settlement, Sale of Stock and Release Agreement (Agreement) with Mr. Masaracchio, pursuant to which Reliability Contractors sold back to Masaracchio the stock of Medallion effective October 1, 2007. The Company agreed to pay Mr. Masaracchio $325,000 upon the closing of the sale of part of the Company s North Carolina real estate, which was under a purchase and sale contract, and transfer 100% of the Medallion stock to Masaracchio. Masaracchio agreed to release all the liens against the Company s assets, cancel all the notes, and release the Company from any and all of its obligations to him. In addition to the $325,000, Reliability transferred to Masaracchio all the Medallion stock which held assets that were valued at approximately $1.7 million on Reliability s balance sheet and liabilities which were generated in the normal course of business at Medallion valued at approximately $529,000.

Upon the closing of the sale of a portion of Reliability s North Carolina real estate on October 26, 2007, Mr. Masaracchio received the $325,000, and the sale of Medallion Electric, the release of the liens, and cancellation of all the obligations was consummated. At the time of the sale, Masaracchio held two notes totaling $1.9 million, which were due October 1, 2007, and an earnout agreement which called for a minimum payment of $750,000 over three years. The notes were secured by the assets of Medallion and the North Carolina property owned by Reliability. The sale of Medallion back to Masaracchio included a release of all liability on the notes and the earnout agreement, assumption of all Medallion ordinary course of business debts and obligations, mutual releases between Reliability and Masaracchio, including a release of the security for the notes. The net proceeds from the sale of a part of the North Carolina real estate to Reliability, after the $325,000 payment and all other expenses of the sale, were $292,000. The Company retained the ownership of 10 acres of land in North Carolina.

Upon the sale of Medallion Electric and cancellation of related liabilities, the Company s largest remaining asset is the 10 acres of land in North Carolina.

The Company was incorporated under the laws of the State of Texas in 1953, but the principal business of the Company, as described in this report, started in 1971, but was closed down in 2007. The Company has two wholly owned subsidiary, Reliability Singapore, Pte Ltd, and Medallion Electric Acquisition Corporation, which are not operating. The accompanying financial statements for twelve month period ended December 31, 2007, have been prepared assuming the Company will continue as a going concern. However, upon the completion of the sale of Medallion Electric, the Company has no further operating activities. The accompanying financial statements do not include any adjustments to reflect the possible future effects on the recoverability and classification of assets or the amounts and classifications of liabilities that may result from the possible inability of the Company to continue as a going concern.

However, based upon its current financial position, and an evaluation of the prospects for continuing to operate, the Company has concluded that it should pursue one, or some combination, of the following courses of action: sell its remaining real estate holdings; invest in another line of business through a purchase or merger; make distributions to its shareholders of the proceeds of asset or business line sale, possibly through a corporate liquidation. There can be no assurances that the Company will be able to successfully complete any of these transactions or be able to maintain sufficient liquidity over a period of time that will allow it to carry out these actions, in which case the Company might be forced to liquidate or seek protection under the Federal bankruptcy statutes, or both.

The accompanying financial statements do not include any adjustments to reflect the possible future effects on the recoverability and classification of assets or the amounts and classifications of liabilities that may result from the possible inability of the Company to continue as a going concern.

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INDUSTRY OVERVIEW

Rapid technological advances resulting in evolving industry standards characterize the semiconductor industry. As the performance of semiconductors has increased and their physical size and cost per function have decreased, the demand for semiconductors has expanded not only in computer systems but also in telecommunications, automotive products, consumer goods and industrial automation and controls. The demand for smaller, faster, higher performance integrated circuits (ICs) continuously places new technical challenges and demands on semiconductor manufacturers and semiconductor equipment manufacturers to provide innovative new products and product enhancements to improve quality control and reduce manufacturing cost.

Under current semiconductor technology and manufacturing processes, manufacturers are unable to consistently produce batches of ICs that are completely free of defects that may cause the ICs to fail. An IC may be defective at the time it is produced or it may have a latent defect that eventually will cause it to fail. An IC with such a defect will almost always fail during the first 500-1000 hours of normal use. As a result, it has become customary to condition or burn-in ICs (i.e., to subject them, during a relatively short period of time, to controlled stresses which simulate the first several hundred hours of operation) to identify defects prior to delivery. Such conditioning subjects the ICs to maximum rated temperatures, voltages and electrical signals. Following burn-in, the ICs are tested to determine whether they function as designed.

PRODUCTS

During fiscal 2006, the Company had three operating segments based on its product and service offerings: Testing Products, Services and Power Sources. In March of 2006, the Company sold its Power Sources segment and in April of 2006 the Company commenced the closure of its Services segment. In March of 2007, the Company closed its Testing Products segment, and purchased Medallion Electric, Inc., an electrical contractor located in Florida, on April 1, 2007. On October 1, 2007, the Company sold Medallion Electric, Inc. back to its previous owner. As a result of these actions, all the Company s operating segments are reported as discontinued operations in the accompanying Financial Statements for each period presented. **See Note 3** of Notes to Consolidated Financial Statements for financial information regarding discontinued operations reporting.

TESTING PRODUCTS

The Company has been providing capital equipment to IC manufacturers and users to burn-in ICs since 1975 and to functionally test ICs during burn-in since 1980. The Company was one of the first to design, manufacture and market systems that utilize burn-in and test technology within the same product. From 1992 to 2001, the Division focused its research and development activities on equipment and related software that perform functional testing during burn-in of memory devices (i.e., DRAM, SRAM, SDRAM) and micrologic devices (i.e., microprocessors). This focus led to the development of two major product families: INTERSECT for performing functional and long cycle tests on large quantities of memory devices in parallel during the conditioning (burn-in) process; and CRITERIA® 18 designed for fine-line geometry micrologic devices (i.e.,microprocessors) that dissipate large amounts of heat.

From 2001 through August 2005, the Division s focus was on developing its newest generation burn-in and test system for medium and high power micrologic devices, the CRITERIA 20. During this period, the Division spent in excess of $5 million on the development of the Criteria 20. Despite actively marketing the Criteria 20 during this period, the Company was unable to secure an order for a Criteria 20 unit. As a result of the continued lack of demand for the product and the high level of expenditures necessary to continue to develop the product, the Company suspended research and development activities and significantly reduced its workforce in August 2005. Since that time, the business activity of the Testing Products Division has consisted of sales of spare parts for, and the refurbishment and upgrades to, existing, previous generation systems. The Company closed down the remaining part of its Testing Products segment in March of 2007.

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SERVICES

The Company has provided burn-in and other related services to its customers since 1971. The establishment or expansion of a service facility requires a large investment of capital. Although the Company and its customers have historically shared capital cost, the Company is primarily responsible for providing the building and equipment required, along with the personnel and management to operate the facility.

The Company operated a service facility in Singapore that used CRITERIA and INTERSECT systems to provide burn-in and burn-in test services for DRAM, SDRAM, SRAM, and microprocessors. The Company also used related equipment acquired from others to provide serial testing, laser-marking, and tape and reel services.

On April 18, 2006, the Company announced plans to close down its Services division located in Singapore. During the wind down of operations, the division has maintained a small number of employees to complete unfinished jobs, provide limited services for its customers while they seek alternative service providers, prepare equipment for sale and vacate the division s leased facility. The liquidation of the Company s former Services division was substantially complete as of December 31, 2006. The complete dissolution of this division is expected to be complete during the first half of 2008. The Company s former Services division is reported as discontinued operations in the accompanying Financial Statements for each period presented. **See Note 3** of the Notes to Consolidated Financial Statements for information regarding discontinued operations.

POWER SOURCES

The operating components of electronic equipment frequently have varying electrical requirements. Rather than provide power to each component separately, specialized power devices called DC-DC converters, or power sources, are used to convert direct current voltage into a higher or lower voltage. By using small DC-DC converters, electronic equipment can operate from a single output power supply yet provide different voltages to different operating components, allowing designers of electronic equipment to localize power requirements, increase modularity in the product design and expand equipment features without having to redefine power needs. The Company offered a wide range of DC-DC converters from 1 to 30 Watts targeting customers within the telecommunications, computer and other industries.

On March 14, 2006, the Company sold its Power Sources Division to Reliability Power, Inc., an unaffiliated third party. The Company s former Power Sources division is reported as discontinued operations in the accompanying Financial Statements for each period presented. **See Note 3** of the Notes to Consolidated Financial Statements for financial information regarding discontinued operations.

SALES AND MARKETING

The Company has historically maintained direct sales and service operations in the United States and Singapore as well as a network of distributors and sales representative in certain other key areas within the United States, Europe and Southeast Asia. Due to the sale of the Company s former Power Sources division, the closure of its Services division in Singapore and an evaluation of the prospects for continuing to operate its remaining business line, the Company no longer maintains direct sales or service operations.

RESEARCH AND DEVELOPMENT

The semiconductor industry s and the electronic equipment industry s demand for increasingly complex and sophisticated equipment requires innovation and accurate anticipation of changing needs and emerging technology trends. To avoid becoming technologically obsolete over time, the Company has historically committed a significant portion of its resources to research and development programs for new products and enhancements to existing products.

In August 2005, as a part of cost cutting measures, the Company suspended all research and development activities. As a result, the Company s research and development expenditures were nil in 2006 and 2007.

The Company has no present plans to resume research and development activities.

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INTELLECTUAL PROPERTY

The Company believes that rapidly changing technology in the electronics industry makes the Company s future success dependent on the quality of its products and its ability to adapt to the changing technological requirements more than upon the protection of any proprietary rights.

Although the Company believes that its intellectual property may have some value, no single item is, in itself, critical to the Company s business. Therefore, the Company has no plans to continue to protect its intellectual property through patents, copyrights, trade secrets, trademarks, and other means.

RAW MATERIALS AND INVENTORY

The Company discontinued its operating activities during 2007. Thus, the Company has no inventory and no plans to purchases any inventory.

CUSTOMERS AND COMPETITION

The Company no longer has a customer base nor does it remain in a competitive market.

EMPLOYEES

As of December 31, 2007, the Company no longer has any full time paid employees. The Company contracts any work that must be done. None of the Company s employees are represented by a labor union.

INTERNATIONAL OPERATIONS

The Company is domiciled in the United States and previously sold products to customers for delivery outside of the U.S. However, as discussed above, the Company discontinued its last foreign operation (Singapore) in 2006 and only has winding down activities remaining.

ENVIRONMENTAL MATTERS

The Company does not expect to be affected by zoning, environmental protection, or other similar laws or ordinances.

SEASONALITY

The Company no longer has any operating activities.

GOVERNMENTAL BUSINESS

The Company does not have any business with any governmental agencies.

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Item 2. ***Description of Properties***

In June 2006, the Company completed the sale of its former headquarters and principal administrative, engineering and manufacturing facility located in Park 10, an office and industrial park located on the west side of Houston, Texas. The Company relocated it headquarters to a 3,400 square foot leased facility, also located in Park 10, on the west side of Houston. The Company vacated this lease September 30, 2007.

The Company also owned a 43,500 square foot facility on a seventeen-acre tract of land in Durham, North Carolina. The Company sold approximately 7.5 acres and the 43,500 sq ft facility in October, 2007, for $675,000. Three Hundred Twenty-five Thousand ($325,000) of the proceeds from the sale was used as part of the payment made to the former owner of Medallion Electric, Inc. **See Note 4** of the Notes to the Consolidated Financial Statements**.** The Company s proceeds from the sale was a net of $292,000. The Company still owns the remaining 10 acres of land which it is actively marketing.

Item 3. ***Legal Proceedings.***

Not applicable.

Item 4. ***Submission of Matters to a Vote of Security Holders.***

Not applicable.

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PART II

Item 5. ***Market for Common Equity, Related Stockholder Matters and Small Business Issuer Purchases of Equity Securities.***
The Company s common stock trades in the over-the-counter bulletin board market under the symbol REAL. Prior to February 24, 2005, the Company s stock traded on Nasdaq, until no longer meeting its listing requirements. The high and low sale prices for 2006 and 2007 are set forth below.

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
2007				
High	$ .23	$ .30	$ .27	$ .14
Low	.17	.19	.10	.05
2006				
High	$ .29	$ .31	$ .28	$ .22
Low	.16	.18	.18	.18

The price information provided above was obtained from MSN.com and is based upon inter-dealer quotes without retail mark-ups, mark-down or commissions and may not necessarily reflect actual sale transactions.

The Company paid no cash dividends in 2007 or 2006 and had approximately 500 shareholders of record as of December 31, 2006, and 470 shareholders of record as of December 31, 2007, not counting the shareholders who hold the Company stock in street name.

The following table sets forth the number of shares of the Company s common stock reserved for issuance under the Company s equity compensation plans as of December 31, 2007:

	Number of securities to be issued upon exercise of outstanding options, warrants and rights	Weighted-average exercise price of outstanding options, warrants and rights	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))
Plan category	(a)	(b)	(c)
Equity compensation plans approved by security holders	370,000	$ 0.21	0
Equity compensation plans not approved by security holders			
Total	370,000	$ 0.21	0

Shares of Company stock were also used to fund the matching feature of the Employee Stock Savings Plan, which was terminated effective November 16, 2006. **See Note 7** to the Company s Consolidated Financial Statements for information concerning Employee Stock Savings Plan.

No shares of common stock were sold during 2006 or 2007 that were not registered under the Securities Act. All the shares issued under the agreement to purchase Medallion Electric in 2007 were returned to the Company. No shares of common stock were repurchased by the Company or any of its affiliates in 2006 or 2007.

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Item 6. ***Management s Discussion and Analysis or Plan of Operation.***
The following discussion and analysis of financial condition and results of operations of the Company should be read in conjunction with the Consolidated Financial Statements and related notes that appear in this document.

REVIEW OF SIGNIFICANT ACCOUNTING POLICIES

In response to a guidance document that was issued by the Securities and Exchange Commission, the Company completed a review of its significant accounting policies. The results of the review indicated that the accounting policies that the Company has adopted are appropriate for the operations of the Company and that the Company has correctly applied the accounting policies. **See Note 1** to the Company s Consolidated Financial Statements for information concerning significant accounting policies.

Management s discussion and analysis of its financial condition and results of operations is based on the Company s Consolidated Financial Statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires the Company to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses and the related disclosure of contingent assets and liabilities, if any exist. The Company evaluates its estimates on an on-going basis, including those related to inventories, investments, assets held for sale, intangible assets, income taxes, warranty obligations, bad debts, product returns, long-lived assets and contingencies, if any. The Company bases its estimates on historical experience and various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values and disclosure of amounts recorded or disclosed in the Consolidated Financial Statements of the Company.

FORWARD-LOOKING STATEMENTS

This Management s Discussion and Analysis or Plan of Operations and other parts of this report contain forward-looking statements that involve risks and uncertainties, as well as current expectations and assumptions. From time to time, the Company may publish forward-looking statements, including those that are contained in this report, relating to such matters as anticipated financial performance, business prospects, technological developments, new products, research and development activities and similar matters. The Private Securities Litigation Reform Act of 1995 provides a safe harbor for forward-looking statements. In order to comply with the terms of the safe harbor, the Company notes that a variety of factors could cause the Company s actual results and experience to differ materially from the anticipated results or other expectations expressed in the Company s forward-looking statements. The risks and uncertainties that may affect the operations, performance, development and results of the Company s business include, but are not limited to, its ability to maintain sufficient working capital, adverse changes in the economy, the ability to attract and maintain key personnel, the ability to sell its remaining real estate holdings or business line, its ability to identify or complete an acceptable merger or acquisition, and future results related to acquisition, merger or investment activities. The Company s actual results could differ materially from those anticipated in these forward-looking statements, including those set forth elsewhere in this report. The Company assumes no obligation to update any such forward-looking statements.

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ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

During the past seven years, Reliability Incorporated and its subsidiaries (collectively referred to as Reliability or the Company) has sustained significant negative financial results, including substantial decreases in revenues, net income, backlog, and cash flows from operating activities that are generally attributable to operating losses. Due to the deterioration in its financial position, the Company has undergone significant restructuring to reduce its expenses and improve its liquidity, including: the closure of its Power Sources Costa Rica facility, significant downsizing of its domestic and international workforce, the sale of its Power Sources division, the closure of its Services division in Singapore, eliminated all research and development for test equipment, the sale of its Houston headquarters facility, and the closure of its Test Systems business. As a result of these actions, the Company significantly reduced its expenses, and generated some cash. However, based upon its current financial position, and an evaluation of the prospects for continuing to operate its historical business lines, the Company concluded that it should explore some other possibilities.

On April 1, 2007, Reliability completed the merger of its wholly owned subsidiary, Reliability-Medallion, Inc., a Florida corporation, into Medallion Electric Acquisition Corporation and the indirect acquisition, through Medallion Electric Acquisition Corporation, of Medallion Electric, Inc.

Medallion Electric Acquisition Corporation was incorporated under the laws of the State of Florida to facilitate a merger between business entities and was considered to be a development stage company with no operations at March 31, 2007. On June 21, 2007, the Company changed the name of Medallion Electric Acquisition Corporation (MEAC) to Reliability Contractors of Florida, Inc. Reliability Contractors of Florida, Inc. is a wholly-owned subsidiary of Reliability.

Medallion Electric, Inc. (Medallion Electric or Medallion) was incorporated in the State of Florida in 1980. Medallion Electric is an electrical contracting company, located in Coral Springs, Florida, specializing in electrical contracting services to residential homebuilders, with its major assets consisting of contracts for services to be performed and accounts receivable. Medallion Electric is a wholly-owned subsidiary of Reliability Contractors of Florida, Inc. (collectively referred to as Reliability Florida or Electrical Contracting Services).

All of the funds used for the initial acquisition payment and the Company s transaction costs related to the merger and acquisition were paid out of the Company s cash on hand. The Company funded $750,000 to finance the acquisition. $100,000 of such funds was made available to Medallion Electric as working capital; $150,000 was used by MEAC to pay its transaction related expenses. The remaining $500,000 was used to make the initial payment to Mr. Ronald Masaracchio (Masaracchio), the only shareholder of Medallion Electric for 100% of the stock of Medallion Electric. The remainder of the purchase price consisted of two notes- one for $500,000 due in six months and one for $1.4 million due in six months. The Company secured the $500,000 note with the pledge of its real property in North Carolina; the $1.4 million note was secured with the assets of Medallion Electric.

The Company planned to pay the notes from the Company s working capital, funds generated by Electrical Contracting Services, additional debt and/or equity financing, and the sale of a part of its real estate located in North Carolina. However, in early September, 2007 it became apparent, the Company was not generating enough funds and had not been successful in raising debt or equity funds to meet all of the obligations which would be due on October 1, 2007. Therefore, the Reliability Board of Directors passed a resolution on September 25, 2007 that instructed management to enter into an agreement to sell Medallion Electric, Inc. back to the previous owner, Mr. Masaracchio.

On October 12, 2007, the Company and its subsidiaries Reliability Contractors of Florida, Inc. and Medallion Electric, Inc. entered into a Settlement, Sale of Stock and Release Agreement (Agreement) with Mr. Masaracchio, pursuant to which Reliability Contractors sold back to Masaracchio the stock of Medallion effective October 1, 2007. The Company agreed to pay Mr. Masaracchio $325,000 upon the closing of the sale of part of the Company s North Carolina real estate, which was under a purchase and sale contract, and transfer 100% of the Medallion stock to Masaracchio. Masaracchio agreed to release all the liens against the Company s assets, cancel all the notes, and release the Company from any and all of its obligations to him. In addition to the $325,000, Reliability transferred to Masaracchio all the Medallion stock which held assets that were valued at approximately $1.7 million on Reliability s balance sheet and liabilities which were generated in the normal course of business at Medallion valued at approximately $529,000.

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Upon the closing of the sale of a portion of Reliability s North Carolina real estate on October 26, 2007, Mr. Masaracchio received the $325,000, and the sale of Medallion Electric, the release of the liens, and cancellation of all the obligations was consummated. At the time of the sale, Masaracchio held two notes totaling $1.9 million, which were due October 1, 2007, and an earnout agreement which called for a minimum payment of $750,000 over three years. The notes were secured by the assets of Medallion and the North Carolina property owned by Reliability. The sale of Medallion back to Masaracchio included a release of all liability on the notes and the earnout agreement, assumption of all Medallion ordinary course of business debts and obligations, mutual releases between Reliability and Masaracchio, including a release of the security for the notes. The net proceeds from the sale of a part of the North Carolina real estate to Reliability, after the $325,000 payment and all other expenses of the sale, were $292,000. The Company retained the ownership of 10 acres of land in North Carolina.

Net cash used by operating activities for the year ended December 31, 2006 was $1,544,000, compared to $385,000 used by operations during 2007. The principal items contributing to the $385,000 useage of cash in 2006 was the net income of $1,583,000 from the gain on the sale of assets, primarily the sale of the Company s headquarters facility, which drove the net income for 2006 to $204,000. The principal items contributing to the net cash used by operations in 2007 was a net loss from continuing operations of $616,000.Changes in depreciation & amortization; inventory obsolescence provisions, and changes in operating assets and liabilities including decline in accounts receivable and decreases in prepaid expenses, accounts payable, and accrued liabilities almost offset each other.

In 2006 investing activities provided $4,616,000 as a result of net proceeds of, $3,866,000 on the sale of the Company s headquarters facility, $300,000 from the sale of the Company s former Power Sources segment, $242,000 from the sale of excess furniture and equipment, and $208,000 from the sale of investment securities. In 2007 the Acquisition of businesses, specifically Medallion Electric, reduced cash by $787,000.

Financing activities used $2,556,000 in 2006, primarily the result of the Company repaying all borrowing under its former credit agreement upon the sale of its headquarters facility in comparison to only $53,000 used in financing activities in 2007.

The Company was incorporated under the laws of the State of Texas in 1953, but the principal business of the Company, as described in this report, started in 1971, but was closed down in 2007. The Company has two wholly owned subsidiary, Reliability Singapore, Pte Ltd, and Medallion Electric Acquisition Corporation which are not operating. The accompanying financial statements for twelve month period ended December 31, 2007, have been prepared assuming the Company will continue as a going concern. However, upon the completion of the sale of Medallion Electric, the Company has no further operating activities. The accompanying financial statements do not include any adjustments to reflect the possible future effects on the recoverability and classification of assets or the amounts and classifications of liabilities that may result from the possible inability of the Company to continue as a going concern.

However, based upon its current financial position, and an evaluation of the prospects for continuing to operate, the Company has concluded that it should pursue one, or some combination, of the following courses of action: sell its remaining real estate holdings; invest in another line of business through a purchase or merger; make distributions to its shareholders of the proceeds of asset or business line sale, possibly through a corporate liquidation. There can be no assurances that the Company will be able to successfully complete any of these transactions or be able to maintain sufficient liquidity over a period of time that will allow it to carry out these actions, in which case the Company might be forced to liquidate or seek protection under the Federal bankruptcy statutes, or both.

The accompanying financial statements do not include any adjustments to reflect the possible future effects on the recoverability and classification of assets or the amounts and classifications of liabilities that may result from the possible inability of the Company to continue as a going concern.

Available sources of liquidity at December 31, 2007 include cash and cash equivalents of $32,000, and assets held for sale of $225,000. **See Note 4** to the Company s Consolidated Financial Statements for information regarding assets held for sale.

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RESULTS OF CONTINUING OPERATIONS

Net Revenues and Gross Profit

Revenues and gross profit for 2006 and 2007 from continuing operations are reported as zero for both years, as all operations were discontinued as of September 30, 2007 and the financial statements show all operations for 2006 and 2007 as discontinued operations. See **NOTE 3** of the Notes to the Consolidated Financial Statements.

Marketing, General and Administrative

Marketing, general and administrative (MG&A) expenses primarily consist of employee salaries and payroll related costs, insurance, rent, and legal, accounting and other professional services.

MG&A expenses decreased from $1,301,000 in 2006 to $483,000 in 2007. The reductions were primarily the result of a decrease in payroll related costs from $740,000 in 2006 to $384,000 in 2007 as the result of salary cuts and staff reductions. A reduction in rent of $48,000 and a $61,000 decrease in corporate compliance and professional fees further reduced the MG&A.

The reductions were partially offset by an impairment charge of $159,000 related to the North Carolina property which was carried as an Asset held for sale. **See Note 4** of the Notes to the Company s Consolidated Financial Statements**.**

Gain on the Sale of Assets

In June of 2006, the Company sold its Houston headquarters facility, previously reported as Asset Held for Sale. Net proceeds to the Company were $3.9 million. As a result of the sale, the Company repaid all borrowing under its credit agreements and recognized a gain on the sale of approximately $1.4 million. In addition, the Company recorded a gain of $88,000 on the sale of excess idle equipment and furnishings in its Houston facility and a $59,000 gain on the sale of securities.

In 2007 the Company recorded a gain of $3,000 on the sale of excess equipment and furnishings.

Interest Expense

Interest expense for 2006, as a result of borrowing under the Company s former credit agreements, was $170,000. The Company repaid all its credit agreement debt as of June 30, 2006, and paid no interest in 2007.

Loss from discontinued operations

The loss from discontinued operations increased from $382,000 in 2006 to $1,377,000 in 2007. The loss in 2006 was due to the loss on the closing of the Services segment. The $1,377,000 loss in 2007 was primarily due to a loss of $1,150,000 from the purchase and later sale of Medallion Electric, Inc during 2007. **See Note 3** to the Company s Consolidated Financial Statements for information regarding gains and losses from discontinued operations.

Provision for Income Taxes

The Company recorded no provision or benefit for income taxes in 2006 or 2007 due to its substantial cumulative operating losses. **See Note 5** to the Company s Consolidated Financial Statements for information regarding income taxes

OFF-BALANCE SHEET ARRANGEMENTS

None.

Item 7. ***Financial Statements.***

The financial statements of the Company and the related report of the Company s independent registered public accounting firm thereon are included in this report and are referenced as pages F-1 to F-16.

Item 8. ***Changes in and Disagreements with Accountants on Accounting and Financial Disclosure.***

None

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Item 8A. ***Controls and Procedures.***

(a) Evaluation of Disclosure Controls and Procedures. Our management, with the participation of our Chief Executive Officer (CEO), evaluated the effectiveness of our disclosure controls and procedures as of the end of the period covered by this report. Based on that evaluation, our CEO concluded that our disclosure controls and procedures as of the end of the period covered by this report were effective such that the information required to be disclosed by us in reports filed under the Securities Exchange Act of 1934 is (i) recorded, processed, summarized and reported within the time periods specified in the SEC s rules and forms and (ii) accumulated and communicated to our management, including our CEO, as appropriate to allow timely decisions regarding disclosure. A controls system cannot provide absolute assurance, however, that the objectives of the controls system are met, and no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within a company have been detected.

Management s Annual Report on Internal Control over Financial Reporting. Our management is responsible for establishing and maintaining adequate internal control over financial reporting (as defined in Rule 13a-15(f) under the Exchange Act). Our 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 of accounting principles generally accepted in the United States.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Therefore, even those systems determined to be effective can provide only reasonable assurance of achieving their control objectives.

Our management, with the participation of the CEO, evaluated the effectiveness of the Company s internal control over financial reporting as of December 31, 2007. In making this assessment, our management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in Internal Control Integrated Framework. Based on this evaluation, our management, with the participation of the President, concluded that, as of December 31, 2007, our internal control over financial reporting was effective.

(b) *Changes in Internal Control over Financial Reporting.* There were no changes in the Company s internal controls over financial reporting, known to the chief executive officer that occurred during the period covered by this report that has materially affected, or is reasonably likely to materially affect, the Company s internal control over financial reporting.

Item 8B. ***Other Information***

Not applicable.

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PART III

Item 9. ***Directors and Executive Officers, Promoters and Control Persons; Compliance with Section 16(a) of the Exchange Act.***
Directors of the Company at December 31, 2007 were as follows:

Name	Director since	Age	Other positions and offices presently held with the Company (and other principal occupation, if different)
Larry Edwards	1995	66	Chairman of the Board of Directors, President and Chief Executive Officer
Thomas L. Langford	1980	66	(Group Vice President, Consolidated Contractors International Co. S.A.L.)
Philip Uhrhan	1997	58	(Retired)
C. Lee Cooke, Jr	2004	63	(President, Chief Executive Officer, Habitek International, d/b/a U.S. Medical Systems, Inc.)
David C. Kurland	2007	47	Chief Counsel, Sunco, Inc.

Mr. Edwards has been President and Chief Executive Officer of the Company since 1993 and has been a Director and Chairman of the Board of Directors since 1995. From 1990 to 1993, he served as President and Chief Operating Officer of the Company. Mr. Edwards joined the Company in 1977 as Manager of Engineering, Planning and Manufacturing Systems, and subsequently held the positions of Vice President Operations, Corporate Vice President Systems, and Executive Vice President Systems.

Mr. Langford has been a Director of the Company since 1980. Mr. Langford s principal occupation has been that of Group Vice President of Consolidated Contractors International Co. S.A.L., an engineering and construction company, since February 2001. He was Executive Vice President of Stone and Webster, Inc., a professional engineering, construction and consulting company, from 1997 to July 2000. In June 2000, Stone and Webster, Inc. filed a Chapter 11 Bankruptcy, and Mr. Langford served, from July 2000 until January 2001 as President and Chief Restructuring Officer of the Debtor in Possession of Stone and Webster. From 1991 until 1996, Mr. Langford was President of Parsons Corporation, an engineering and construction company.

Mr. Uhrhan has been a Director of the Company since 1997. Mr. Uhrhan is retired. He served as Vice President Finance of Solvay America, Inc., a chemical and pharmaceuticals company, from 1996 until February of 2007. Mr. Uhrhan was a Partner with Ernst & Young LLP for more than five years prior to his employment by Solvay America, Inc.

Mr. C. Lee Cooke, Jr. has been a director of the Company since July 2004. Since 1991, he has been President and Chief Executive Officer of Habitek International, Inc. d/b/a U.S. Medical Systems, Inc., a biomedical company. He served as Chairman of the Board, Chief Executive Officer and President of Sharps Compliance Corp. from March 1992 until July 1998. Mr. Cooke served as Chairman of the Board for Tanisys Technology, Inc. (Tanisys), a developer and marketer of semi-conductor testing equipment from February 2002 until February 2003 and served as Chief Executive Officer from March 2002 until February 2003. Mr. Cooke serves as an advisory director to the Staubach Group, CTLLC, a real estate representative company. Mr. Cooke also serves on the board of two other private companies. Mr. Cooke was President and Chief Executive Officer of CUville, Inc., d/b/a Good2CU.com, from 1999 until 2000. Mr. Cooke served as Chief Executive of The Greater Austin Chamber of Commerce from 1983 to 1987. From 1972 to 1983, Mr. Cooke also served in various management roles with Texas Instruments. From 1988 to 1991 he served in the elected position of Mayor of Austin, Texas. Mr. Cooke has served as director of New Century Equity Holdings Corp. (New Century), a publicly-held holding company focused on high growth companies since 1996.

Mr. David C. Kurland has been a Director of the Company since April, 2007. Since 2001, Mr. Kurland has served as Chief Counsel with Sunco, Inc. (R&M), a major refining and chemical company, where he is responsible for regulatory and corporate compliance matters. From 1992 to 2001, Mr. Kurland was Chief Counsel at Rohm and Haas. From 1989 to 1992, he practiced law with a mid-size law firm in Philadelphia, Pennsylvania.

Directors serve a one-year term and hold office until their successors are elected by the shareholders, unless they shall sooner resign.

The Company has an Audit Committee comprised of its four independent directors, Messrs. Langford, Uhrhan, Kurland, and Cooke. The Board has determined that the Company has two audit committee financial experts, as defined by the Securities and Exchange Commission, serving on its audit committee. Mr. Uhrhan, Chairman of the committee, and Mr. Langford qualify as financial experts and both are independent, as independence for audit committee members is defined by the Securities and Exchange Commission.

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Executive officers of the Company as of December 31, 2007 were as follows:

Name	Age	Officer of Reliability Incorporated Since	Position Currently Held with Reliability Incorporated
Larry Edwards	66	1981	Chairman of the Board of Directors, President and Chief Executive Officer

Mr. Edwards has been President and Chief Executive Officer of the Company since 1993 and became a Director and Chairman of the Board of Directors in 1995. Mr. Edwards has been employed by the Company in various capacities since 1977.

Mr. James Harwell was appointed Executive Vice President and Chief Operating Officer in July 2003. From November 2002 until July 2003 and from August 2006 to November, 2007, he also served as Executive Vice President and Acting Chief Financial Officer. Mr. Harwell was employed by the Company in various capacities since 1979. Mr. Harwell resigned from the Company in November, 2007.

The Company has a code of ethics that applies to all directors, officers and employees, including its principal executive officer and principal financial officer (who is also its principal accounting officer).

The Company intends to post on its website any amendments to, or waivers from its code of ethics promptly following any such amendment or waiver. No amendments or waivers were granted in 2006 or 2007.

Item 10. ***Executive Compensation.***
Summary compensation table

The following table provides information as to the compensation paid by the Company to its executive officers during fiscal years 2007 and 2006.

			Annual compensation		
(a)	**(b)**	**(c)**	**(f)**	**(i)**	**(j)**
Name and principal position	**Year**	**Salary**	**Option Awards**	**All other Compensation**	**Total**
Larry Edwards	2007	$ 77,972	$ 0	$ 105,952	$ 183,924
President, Chairman of the Board and Chief Executive Officer	2006	$ 117,685	$ 24,000	$ 2,158	$ 143,843
James M. Harwell	2007	$ 95,860	$ 0	$ 61,545	$ 157,405
Executive Vice President and Acting Chief Financial Officer	2006	$ 103,872	$ 12,000	$ 1,598	$ 117,470

Mr. Harwell resigned from the Company in November, 2007.

The Company has no employment contracts, long-term compensation plans, awards, defined benefit plans, stock appreciation rights or option plans except for the Amended and Restated 1997 Stock Option Plan. The Company has termination of employment or change in control agreements with its executive officers consisting of one weeks base pay for each year of service plus two weeks base pay. The Company paid $105,952 to Mr. Edwards and $61,545 to Mr. Harwell upon stopping to pay all salaries, which is shown in column (i) for 2007.

In addition to base salary, the Company has an incentive bonus plan which applies to the CEO, all executive officers, directors and all salaried employees of the Company. The incentive plan has three components:

1. a quantitative measure of the Company s performance based on income before income tax; and

2. a qualitative measure of each individual s performance during the year; and

3. a target incentive which is a quantitative percent of base salary.

The Company was not profitable during 2006 or 2007; therefore, no bonuses were paid. As a result column (d) is intentionally omitted in the compensation table above.

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Under the Company s Amended and Restated 1997 Stock Option Plan (Option Plan), which expired in 2006, stock option grants were available for officers, directors, and key employees. The objective of the Option Plan was to promote the interest of the Company by providing an ownership incentive to officers, directors, and key employees, to reward outstanding performance, and to encourage continued employment. The Board of Directors, which acted as the Plan Administrator, determined to whom options were granted, the type of options, the number of shares covered by such options and the option vesting schedule. All options were issued at market value on the date of the grant and generally had a ten-year contractual term with graded vesting.

The amounts shown in column (f) represent the grant date fair value estimate of options granted during the last two completed fiscal years to the named individuals. **See Note 8** to the Company s Consolidated Financial Statements for information concerning the Stock Options.

The Company sponsored an Employee Stock Savings Plan (the Plan), until November 16, 2006, when the Plan was terminated. The Plan allowed all U.S. employees, who had been employed for six months, to contribute up to 100% of defined compensation to the Plan. The Company matched employee contributions at a rate equal to 50% of the employee s contributions, but limited to 2% of the employee s defined compensation. In addition, the Company contributed an amount equal to 1% of defined compensation to all plan participants. The Plan also provided for the Company to make additional voluntary profit sharing contributions based on the consolidated profits of the Company. The Company did not make any additional voluntary profit sharing contribution in 2007, 2006 or 2005. **See Note 7** to the Company s Consolidated Financial Statements for information regarding the Employee Stock Savings Plan.

The amounts shown in column (i) for 2006 represent the Company s matching contributions to the Employee Stock Savings Plan for the benefit of the named individuals. There were no payments in 2007.

Outstanding equity awards

The following table discloses information regarding all option awards, to executive officers, to purchase the Company s Common Stock as of December 31, 2007.

	Option Awards			
Name	**Number of Securities Underlying Unexercised Options**			**Option**
	# Exercisable	**# Unexercisable (1)**	**Exercise Price**	**Expiration Date**
(a)	**(b)**	**(c)**	**(e)**	**(f)**
Larry Edwards:	200,000		$ .21	7/19/2016
James Harwell:	100,000		$ .21	7/19/2016

(1) All issued options are vested and became exercisable on January 20, 2007.

Director Compensation

The following table provides information as to the compensation paid by the Company to each of its non-employee directors during fiscal year 2007.

Name	**Fees Earned or Paid in Cash**	**Option Awards**