UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D. C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2015

OR

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

For the transition period from to

NORTECH SYSTEMS INCORPORATED

Commission file number **0-13257**

State of Incorporation: **Minnesota**

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

Executive Offices: **7550 Meridian Circle N, Maple Grove, MN 55369**

Former Name. Former Address and Former Fiscal Year, if Changed Since Last Report: **1120**

Wayzata Blvd E., Suite 201, Wayzata, MN 55391

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulations S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer, and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large Accelerated Filer o	Accelerated Filer o
Non-accelerated Filer o	Smaller Reporting Company x

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

Number of shares of $.01 par value common stock outstanding at July 31, 2015 - 2,746,325

(The remainder of this page was intentionally left blank.)

Table of Contents

TABLE OF CONTENTS

Table of Contents

PART 1

ITEM 1. FINANCIAL STATEMENTS

NORTECH SYSTEMS INCORPORATED AND SUBSIDIARY

CONSOLIDATED BALANCE SHEETS

	June 30 2015 (Unaudited)	DECEMBER 31 2014
ASSETS		
Current Assets		
Cash	$ 68,783	$ 66,371
Accounts Receivable, Less Allowance for Uncollectible Accounts	16,656,851	17,367,668
Inventories	20,605,081	18,528,418
Prepaid Expenses	1,308,360	816,775
Income Taxes Receivable	842,106	465,236
Deferred Income Taxes	436,000	436,000
Total Current Assets	39,917,181	37,680,468
Property and Equipment, Net	11,042,807	10,888,717
Other Assets	114,481	117,127
Total Assets	$ 51,074,469	$ 48,686,312
LIABILITIES AND SHAREHOLDERS EQUITY		
Current Liabilities		
Current Maturities of Long-Term Debt	857,027	732,835
Accounts Payable	11,016,512	9,008,426
Accrued Payroll and Commissions	2,542,976	2,896,557
Other Accrued Liabilities	818,120	732,012
Total Current Liabilities	15,234,635	13,369,830
Long-Term Liabilities		
Line of Credit	8,471,042	7,998,184
Long-Term Debt, Net of Current Maturities	4,819,406	4,072,506
Deferred Income Taxes	149,000	149,000
Other Long-Term Liabilities	132,235	268,400
Total Long-Term Liabilities	13,571,683	12,488,090
Total Liabilities	28,806,318	25,857,920
Shareholders Equity		
Preferred Stock, $1 par value; 1,000,000 Shares Authorized: 250,000 Shares Issued and Outstanding	250,000	250,000
Common Stock - $0.01 par value; 9,000,000 Shares Authorized: 2,746,325 Shares Issued and Outstanding	27,463	27,430
Additional Paid-In Capital	15,762,035	15,751,160
Accumulated Other Comprehensive Loss	(62,936)	(62,936)
Retained Earnings	6,291,589	6,862,738
Total Shareholders Equity	22,268,151	22,828,392

Total Liabilities and Shareholders Equity	$	51,074,469	$	48,686,312

See Accompanying Condensed Notes to Consolidated Financial Statements

3

Table of Contents

NORTECH SYSTEMS INCORPORATED AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF OPERATIONS

(UNAUDITED)

	THREE MONTHS ENDED JUNE 30	
	2015	**2014**
Net Sales	$ 26,801,473	$ 27,408,467
Cost of Goods Sold	24,371,349	24,125,488
Gross Profit	2,430,124	3,282,979
Operating Expenses		
Selling Expenses	1,310,355	1,145,245
General and Administrative Expenses	1,603,129	1,790,557
Total Operating Expenses	2,913,484	2,935,802
Income (Loss) From Operations	(483,360)	347,177
Other Expense		
Interest Expense	(112,002)	(92,083)
Miscellaneous Expense, net		(23,393)
Total Other Expense	(112,002)	(115,476)
Income (Loss) Before Income Taxes	(595,362)	231,701
Income Tax Expense (Benefit)	(217,000)	(15,000)
Net Income (Loss)	$ (378,362)	$ 246,701
Earnings (Loss) Per Common Share:		
Basic	$ (0.14)	$ 0.09
Weighted Average Number of Common Shares Outstanding - Basic	2,746,325	2,742,992
Diluted	$ (0.14)	$ 0.09
Weighted Average Number of Common Shares Outstanding - Diluted	2,746,325	2,746,856

See Accompanying Condensed Notes to Consolidated Financial Statements

Table of Contents

NORTECH SYSTEMS INCORPORATED AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF OPERATIONS

(UNAUDITED)

	SIX MONTHS ENDED JUNE 30 2015	2014
Net Sales	$ 53,341,095	$ 53,557,609
Cost of Goods Sold	48,044,816	47,200,695
Gross Profit	5,296,279	6,356,914
Operating Expenses		
Selling Expenses	2,673,797	2,266,146
General and Administrative Expenses	3,307,443	3,507,370
Total Operating Expenses	5,981,240	5,773,516
Income (Loss) From Operations	(684,961)	583,398
Other Expense		
Interest Expense	(207,188)	(182,063)
Miscellaneous Expense, net		(33,477)
Total Other Expense	(207,188)	(215,540)
Income (Loss) Before Income Taxes	(892,149)	367,858
Income Tax Expense (Benefit)	(321,000)	35,000
Net Income (Loss)	$ (571,149)	$ 332,858
Earnings (Loss) Per Common Share:		
Basic	$ (0.21)	$ 0.12
Weighted Average Number of Common Shares Outstanding - Basic	2,745,183	2,742,992
Diluted	$ (0.21)	$ 0.12
Weighted Average Number of Common Shares Outstanding - Diluted	2,745,183	2,747,357

See Accompanying Condensed Notes to Consolidated Financial Statements

NORTECH SYSTEMS INCORPORATED AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF CASH FLOWS

(UNAUDITED)

	SIX MONTHS ENDED JUNE 30	
	2015	**2014**
Cash Flows From Operating Activities		
Net Income (Loss)	$ (571,149)	$ 332,858
Adjustments to Reconcile Net Income (Loss) to Net Cash Provided by (Used in) Operating Activities		
Depreciation	1,062,951	999,234
Amortization	2,646	2,646
Compensation on Stock-Based Awards	(669)	14,963
Compensation on Equity Appreciation Rights	(58,310)	
Loss on Disposal of Property and Equipment	1,129	1,150
Deferred Taxes		51,680
Changes in Operating Assets and Liabilities:Changes in Current Operating Items		
Accounts Receivable	710,817	869,595
Inventories	(2,076,663)	(1,963,079)
Prepaid Expenses	(491,585)	(76,768)
Income Taxes Receivable	(376,870)	(107,577)
Accounts Payable	1,998,289	1,641,621
Accrued Payroll and Commissions	(353,581)	(375,076)
Other Accrued Liabilities	16,225	(63,288)
Net Cash Provided by (Used in) Operating Activities	(136,770)	1,327,959
Cash Flows from Investing Activities		
Purchases of Property and Equipment	(1,214,489)	(1,128,141)
Net Cash Used in Investing Activities	(1,214,489)	(1,128,141)
Cash Flows from Financing Activities		
Borrowings on Line of Credit	56,462,817	54,795,076
Repayments on Line of Credit	(55,989,959)	(54,863,663)
Proceeds from Long-Term Debt	1,352,159	230,000
Principal Payments on Long-Term Debt	(427,752)	(361,231)
Debt Issuance Costs	(54,838)	
Excess Tax Benefit from Stock-Based Compensation	911	
Proceeds from Issuance of Common Stock	10,333	
Net Cash Provided by Financing Activities	1,353,671	(199,818)
Net Increase in Cash	2,412	
Cash - Beginning	66,371	
Cash - Ending	$ 68,783	$
Supplemental Disclosure of Cash Flow Information		
Cash Paid During the Period for Interest	$ 200,645	$ 181,981
Cash Paid During the Period for Income Taxes		237,615
Supplemental Noncash Investing and Financing Activities		
Capital Expenditures in Accounts Payable	19,604	25,866

See Accompanying Condensed Notes to Consolidated Financial Statements

6

Table of Contents

CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

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

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

Principles of Consolidation

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

Revenue Recognition

We recognize manufacturing revenue when we ship goods or the goods are received by our customer, when title has passed, all contractual obligations have been satisfied, the price is fixed or determinable and collection of the resulting receivable is reasonably assured. Generally, there are no formal substantive customer acceptance requirements or further obligations related to manufacturing services. If such requirements or obligations exist, then we recognize the related revenues at the time when such requirements are completed and the obligations are fulfilled. We also provide engineering services separate from the manufacture of a product. Revenue for engineering services is generally recognized upon completion of the engineering process. In addition, we have another separate source of revenue that comes from short-term repair services, which are recognized when the repairs are completed and the repaired products are shipped back to the customer. Our net sales for services were less than 5% of our total sales for all periods presented, and accordingly, are included in net sales in the consolidated statement of operations. Shipping and handling costs charged to our customers are included in net sales, while the corresponding shipping expenses are included in cost of goods sold.

Stock Options

Following is the status of all stock options outstanding as of June 30, 2015:

Table of Contents

	Shares		Weighted-Average Exercise Price Per Share	Weighted-Average Remaining Contractual Term (in years)		Aggregate Intrinsic Value
Outstanding - January 1, 2015	181,000	$	6.36			
Granted						
Exercised	(3,333)		3.20			
Cancelled	(37,917)		5.52			
Outstanding - June 30, 2015	139,750	$	6.66	2.49	$	18,400
Exercisable - June 30, 2015	134,917	$	6.78	2.31	$	12,842

The total intrinsic value of options exercised during the three and six months ended June 30, 2015 was $8,166. Cash received from options exercised during the three and six months ended June 30, 2015 was $10,333. There were no options exercised during the three and six months ended June 30, 2014. There were no stock options granted during the three and six months ended June 30, 2015 and 2014.

Total compensation expense (income) related to stock options for the three months ended June 30, 2015 and 2014 was $(4,338) and $7,482, respectively. Total compensation expense (income) related to stock options for the six months ended June 30, 2015 and 2014 was $(669) and $14,963, respectively. As of June 30, 2015, there was approximately $5,000 of unrecognized compensation related to unvested option awards that we expect to recognize over a weighted-average period of 0.62 years.

Equity Appreciation Rights Plan

In November 2010, the Board of Directors approved the adoption of the Nortech Systems Incorporated Equity Appreciation Rights Plan (the 2010 Plan). The total number of Equity Appreciation Right Units (Units) the Plan can issue shall not exceed an aggregate of 1,000,000 Units as amended and restated on March 11, 2015 and approved by the shareholders on May 6, 2015. The 2010 Plan provides that Units issued shall fully vest three years from the base date as defined in the agreement unless terminated earlier. Units give the holder a right to receive a cash payment equal to the appreciation in book value per share of common stock from the base date, as defined, to the redemption date. Unit redemption payments under this plan shall be paid in cash within 90 days after we determine the value as of the redemption date.

During the six months ended June 30, 2015, we granted 57,500 Units with a base date of January 1, 2015 and vesting dates through January 1, 2018.

Total compensation expense (income) related to the vested outstanding Units based on the estimated appreciation over their remaining terms was approximately $(46,000) and $38,000 for the three months ended June 30, 2015 and 2014, respectively and $(58,000) and $80,000 for the six months ended June 30, 2015 and 2014, respectively. The income for the three and six months ended June 30, 2015 was the result of a change in the assumption of the appreciation of book value per share of common stock.

As of June 30, 2015 and December 31, 2014, approximately $154,000 and $259,000 is accrued under this plan, respectively. As of June 30, 2015, approximately $78,000 of this balance is included in Other Accrued Liabilities and the remaining $76,000 balance was included in Other Long-term Liabilities. As of December 31, 2014, approximately $47,000 of this balance is included in Other Accrued Liabilites and the remaining $212,000 was included in Other Long-term Liabilities.

Earnings per Common Share

For the three and six months ended June 30, 2015, the effect of all stock options is antidilutive due to the net loss incurred and, therefore, were not included in the computation of per-share amounts. For the three and six months ended June 30, 2015, stock options of 123,750 and 126,375, respectively, were excluded because their inclusion would be antidilutive.

For both the three and six months ended June 30, 2014, 26,750 stock options were included in the computation of diluted per share amounts as their impact was dilutive. For the three and six months ended June 30, 2014, stock options of 189,250 and 169,250, respectively were excluded because their inclusion would be antidilutive.

Segment Reporting Information

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

Accounts Receivable and Allowance for Doubtful Accounts

We grant credit to customers in the normal course of business. Accounts receivable are unsecured and are presented net of an allowance for doubtful accounts. The allowance for doubtful accounts was $130,000 and $137,000 at June 30, 2015 and December 31, 2014, respectively. We determine our allowance by considering a number of factors, including the length of time accounts receivable are past due, our previous loss history, the customers current ability to pay their obligations to us, and the condition of the general economy and the industry as a whole. We write-off accounts receivable when they become uncollectible, and payments subsequently received on such receivables are credited to the allowance for uncollectible accounts.

Inventories

Inventories are stated at the lower of cost (first-in, first-out method) or market (based on the lower of replacement cost or net realizable value). Costs include material, labor, and overhead

Table of Contents

required in the warehousing and production of our products. Inventory reserves are maintained for the estimated value of the inventories that may have a lower value than stated or quantities in excess of future production needs.

Inventories are as follows:

		June 30 2015		December 31 2014
Raw Materials	$	14,686,768	$	12,745,623
Work in Process		3,654,868		3,653,670
Finished Goods		3,026,931		2,861,373
Reserve		(763,486)		(732,248)
Total	$	20,605,081	$	18,528,418

Impairment Analysis

We evaluate long-lived assets, primarily property and equipment, as well as the related depreciation periods, whenever current events or changes in circumstances indicate that the carrying amount of an asset or asset group may not be recoverable. Recoverability for assets to be held and used is based on our projection of the undiscounted future operating cash flows of the underlying assets. To the extent such projections indicate that future undiscounted cash flows are not sufficient to recover the carrying amounts of related assets, a charge might be required to reduce the carrying amount to equal estimated fair value.

Recent Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board issued Accounting Standards Update (ASU) 2014-09, *Revenue from Contracts with Customers (Topic 606)*. This standard outlines a single comprehensive model for companies to use in accounting for revenue arising from contracts with customers and supersedes most current revenue recognition guidance, including industry-specific guidance. The core principle of the revenue model is that revenue is recognized when a customer obtains control of a good or service. A customer obtains control when it has the ability to direct the use of and obtain the benefits from the good or service. Transfer of control is not the same as transfer of risks and rewards, as it is considered in current guidance. In the first quarter of 2015, the FASB approved a deferral of the effective date to January 1, 2018. Upon adoption in 2018, the company will record an adjustment to retained earnings as of the beginning of the year of initial application, which can be either the earliest comparative period presented, with all periods presented under the new rules, or January 1, 2018, without restating prior periods presented. Management has not yet determined which transition reporting option it will apply.

In April 2014, the FASB issued ASU No. 2015-03, *Interest Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Cost.* This ASU requires that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct

Table of Contents

deduction from the carrying amount of that debt liability, consistent with debt discounts. The recognition and measurement guidance for debt issuance costs is not affected by the new guidance. The updated standard will be effective for fiscal years beginning after December 15, 2015, and interim periods within those fiscal years. All entities have the option of adopting the new requirements as of an earlier date for financial statements that have not been previously issued. The guidance should be adopted on a retrospective basis, wherein the balance sheet of each individual period presented is adjusted to reflect the period-specific effects of applying the new guidance. The Company has adopted ASU 2015-03 and presented its debt issuance costs as a component of long term debt.

NOTE 2. CONCENTRATION OF CREDIT RISK AND MAJOR CUSTOMERS

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

Our largest customer, General Electric, has two divisions that collectively account for more than 10% of net sales for the three and six months ended June 30, 2015 and 2014:

	Three Months Ended June 30		**Six Months Ended June 30**	
	2015	**2014**	**2015**	**2014**
GE Healthcare	17%	24%	17%	24%
GE Transportation	8	6	8	5
Total General Electric	25%	30%	25%	29%

Combined accounts receivable from both divisions represented 18% and 19% of total accounts receivable at June 30, 2015 and December 31, 2014, respectively.

Export sales represented 13% and 14% of net sales for the three months ended June 30, 2015 and 2014, respectively. Export sales represented 12% and 13% of net sales for the six months ended June 30, 2015 and 2014, respectively.

NOTE 3. FINANCING ARRANGEMENTS

We have a credit agreement with Wells Fargo Bank (WFB) which was most recently amended on May 7, 2015 and provides for a line of credit arrangement of $15.0 million that expires, if not renewed, on May 31, 2018. The credit arrangement also has a $1.8 million real estate term note outstanding with a maturity date of March 31, 2027, an additional $1.7 million real estate term note outstanding that is due, if not renewed, on December 31, 2027, an equipment loan for $2.7 million and a new term loan facility of up to $1.0 million for capital expenditures, both with

Table of Contents

maturity dates of May 31, 2018. We incurred $54,838 of related costs and fees associated with the amended credit agreement. These fees were capitalized as a debt discount and are being amortized as interest expense over the term of the debt agreement. As of June 30, 2015, we have not borrowed against the $1.0 million capital term note.

Long-term debt at June 30, 2015 and December 31, 2014 consisted of the following:

	June 30 2015	December 31 2014
Real Estate Term Loan 1, interest at three month LIBOR + 2.75%, due in installments through March 31, 2027	$ 1,356,228	$ 1,415,461
Real Estate Term Loan 2, interest at three month LIBOR + 2.75%, due in installments through December 31, 2027	1,404,300	1,460,100
Equipment loan, interest at three month LIBOR + 2.75%, due January 31, 2016		102,917
Equipment loan, interest at three month LIBOR + 2.75%, due May 31, 2018		1,117,863
Equipment loan, interest at three month LIBOR + 2.75%, due May 31, 2018		349,000
Equipment loan, interest at three month LIBOR + 2.75%, due May 31, 2018	2,689,220	
Blue Earth Bond, which bears a variable interest rate, due in installments through June 30, 2021	280,000	360,000
Debt Issuance Costs	(53,315)	
Total debt	5,676,433	4,805,341
Less current maturities	857,027	732,835
Long-term debt	$ 4,819,406	$ 4,072,506

Under the credit agreement, both the line of credit and real estate term notes are subject to variations in the LIBOR rate. Our line of credit bears interest at three-month LIBOR + 2.25% (approximately 2.5% at June 30, 2015) while our real estate term notes bear interest at three-month LIBOR + 2.75% (approximately 3.0% at June 30, 2015). The weighted-average interest rate on our line of credit was 2.8% for the three and six months ended June 30, 2015. We had borrowing on our line of credit of $8,471,042 and $7,998,184 outstanding as of June 30, 2015 and December 31, 2014, respectively. The line of credit requires a lock box arrangement; however there are no acceleration clauses that would accelerate the maturity of our outstanding borrowings.

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

The availability under the line is subject to borrowing base requirements, and advances are at the discretion of the lender. At June 30, 2015, we have net unused availability under our line of credit of approximately $5.5 million. The line is secured by substantially all of our assets.

NOTE 4. INCOME TAXES

On a quarterly basis, we estimate what our effective tax rate will be for the full fiscal year and record a quarterly income tax provision based on the anticipated rate. As the year progresses, we

12

Table of Contents

refine our estimate based on the facts and circumstances, including discrete events, by each tax jurisdiction. Our effective tax rate for the three and six months ended June 30, 2015 was 36%. Our effective tax rate for the three and six months ended June 30, 2014 was (6%) and 10%, respectively. The lower effective tax rate for 2014 was the result of a favorable audit settlement with the Minnesota Department of Revenue which included the acceptance of our research and development credits of $100,000 which were previously reserved for as an uncertain position. The effective tax rate for the year ended December 31, 2015 is expected to be 36% compared to 8.4% for the year ended December 31, 2014. The decreased tax rate in 2014 was largely due to the result of the favorable audit settlement with the Minnesota Department of Revenue.

The differences between federal income taxes computed at the federal statutory rate and reported income taxes for the three and six months ended June 30, 2015 and 2014 are as follows: