

RICHARDSON ELECTRONICS LTD/DE  
Form 10-K  
July 29, 2016

**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**WASHINGTON, DC 20549**

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**FORM 10-K**

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

**For the fiscal year ended May 28, 2016**

**OR**

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

**For the transition period from \_\_\_\_\_ to**

**Commission File Number: 0-12906**

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**(Exact name of registrant as specified in its charter)**

**Delaware** **36-2096643**  
**(State or other jurisdiction of incorporation or organization) (I.R.S. Employer Identification No.)**

**40W267 Keslinger Road, P.O. Box 393, LaFox, Illinois 60147-0393**

**(Address of principal executive offices)**

**Registrant's telephone number, including area code: (630) 208-2200**

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

<b>Title of each class</b>	<b>Common stock, \$0.05 Par Value</b>
<b>Name of each exchange of which registered</b>	<b>NASDAQ Global Select Market</b>

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

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Indicate by check mark whether the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes      No

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

Yes      No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (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 has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months or for such shorter period that the registrant was required to submit and post such files).      Yes      No

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

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

Large Accelerated Filer	Accelerated Filer
Non-Accelerated Filer (Do not check if a smaller reporting company)	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

The aggregate market value of the registrant's common stock held by non-affiliates of the registrant as of November 28, 2015, was approximately \$61.0 million.

As of July 25, 2016, there were outstanding 10,702,932 shares of Common Stock, \$0.05 par value and 2,140,631 shares of Class B Common Stock, \$0.05 par value, which are convertible into Common Stock of the registrant on a one-for-one basis.

**DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the registrant's Proxy Statement for the Annual Meeting of Stockholders scheduled to be held October 4, 2016, which will be filed pursuant to Regulation 14A, are incorporated by reference in Part III of this report. Except as specifically incorporated herein by reference, the abovementioned Proxy Statement is not deemed filed as part of this report.

**TABLE OF CONTENTS**

	<u>Page</u>
<b><u>Part I</u></b>	
Item 1. <u>Business</u>	3
Item 1A. <u>Risk Factors</u>	7
Item 1B. <u>Unresolved Staff Comments</u>	11
Item 2. <u>Properties</u>	12
Item 3. <u>Legal Proceedings</u>	13
<b><u>Part II</u></b>	
Item 5. <u>Market for Registrant’s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities</u>	14
Item 6. <u>Selected Financial Data</u>	16
Item 7. <u>Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>	17
Item 7A. <u>Quantitative and Qualitative Disclosures About Market Risk</u>	28
Item 8. <u>Financial Statements and Supplementary Data</u>	29
Item 9A. <u>Controls and Procedures</u>	58
Item 9B. <u>Other Information</u>	59
<b><u>Part III</u></b>	
Item 10. <u>Directors, Executive Officers and Corporate Governance</u>	60
Item 11. <u>Executive Compensation</u>	60
Item 12. <u>Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters</u>	60
Item 13. <u>Certain Relationships and Related Transactions, and Director Independence</u>	60
Item 14. <u>Principal Accountant Fees and Services</u>	60
<b><u>Part IV</u></b>	
Item 15. <u>Exhibits and Financial Statement Schedules</u>	61
<u>Signatures</u>	62
<u>Exhibit Index</u>	63

## **Forward Looking Statements**

Certain statements in this report may constitute “forward-looking” statements within the meaning of the Private Securities Litigation Reform Act of 1995. The terms “may”, “should”, “could”, “anticipate”, “believe”, “continues”, “estimate”, “expect”, “intend”, “objective”, “plan”, “potential”, “project”, and similar expressions are intended to identify forward-looking statements. These statements are not guarantees of future performance and involve risks, uncertainties, and assumptions that are difficult to predict. These statements are based on management’s current expectations, intentions, or beliefs and are subject to a number of factors, assumptions, and uncertainties that could cause actual results to differ materially from those described in the forward-looking statements. Factors that could cause or contribute to such differences or that might otherwise impact the business include the risk factors set forth in Item 1A of this Form 10-K. We undertake no obligation to update any such factor or to publicly announce the results of any revisions to any forward-looking statements contained herein whether as a result of new information, future events, or otherwise.

In addition, while we do, from time to time, communicate with securities analysts, it is against our policy to disclose to them any material non-public information, or other confidential commercial information. Accordingly, stockholders should not assume that we agree with any statement or report issued by any analyst irrespective of the content of the statement or report. Thus, to the extent that reports issued by securities analysts contain any projections, forecasts, or opinions, such reports are not our responsibility.

## **PART I**

### **ITEM 1. Business**

#### ***General***

Richardson Electronics, Ltd. is a leading global provider of engineered solutions, power grid and microwave tubes and related consumables; power conversion and RF and microwave components; high value displays, flat panel detector solutions and replacement parts for diagnostic imaging equipment; and customized display solutions. We serve customers in the alternative energy, healthcare, aviation, broadcast, communications, industrial, marine, medical, military, scientific and semiconductor markets. The Company’s strategy is to provide specialized technical expertise and “engineered solutions” based on our core engineering and manufacturing capabilities. The Company provides solutions and adds value through design-in support, systems integration, prototype design and manufacturing, testing, logistics, and aftermarket technical service and repair through its global infrastructure.

Our products include electron tubes and related components, microwave generators, subsystems used in semiconductor manufacturing, and visual technology solutions. These products are used to control, switch or amplify electrical power signals, or are used as display devices in a variety of industrial, commercial, medical, and communication applications.

During the first quarter of fiscal 2015, we created a new strategic business unit called Richardson Healthcare (“Healthcare”). As hospitals remain under pressure to reduce costs while serving a much larger customer base, there is a growing demand for independent sources of high-value replacement parts for diagnostic imaging. Having access to parts that are tested and in stock enables hospitals to terminate expensive service contracts with the Original Equipment Manufacturers (“OEM”) and instead use third party service providers or in-house technicians. With our global infrastructure, technical sales team, and experience servicing the healthcare market, we are well positioned to take advantage of this market opportunity. Over time, our plan is to expand our position from being the leader in power grid tubes to a key player in the high-growth, high-profile healthcare industry.

Our fiscal year 2016 began on May 31, 2015, and ended on May 28, 2016. Unless otherwise noted, all references in this document to a particular year shall mean our fiscal year.

## ***Geography***

We currently have operations in the following major geographic regions: North America, Asia/Pacific, Europe, and Latin America.

Selected financial data attributable to each segment and geographic region for fiscal 2016, 2015, and 2014 is set forth in Note 11 “Segment and Geographic Information” of the notes to our consolidated financial statements in Part II, Item 8 of this Annual Report on Form 10-K.

We have three operating and reportable segments, which we define as follows:

### ***Power and Microwave Technologies Group***

Power and Microwave Technologies Group (“PMT”), launched in July 2015, combines Electron Device Group’s (“EDG”) core engineered solutions, power grid and microwave tube business with new RF and power technologies. As a manufacturer and authorized distributor, PMT’s strategy is to provide specialized technical expertise and engineered solutions based on our core engineering and manufacturing capabilities. We provide solutions and add value through design-in support, systems integration, prototype design and manufacturing, testing, logistics, and aftermarket technical service and repair—all through our existing global infrastructure. PMT’s focus is on products for power, RF and microwave applications for customers in alternative energy, aviation, broadcast, communications, industrial, marine, medical, military, scientific, and semiconductor markets. PMT focuses on various applications including broadcast transmission, CO2 laser cutting, diagnostic imaging, dielectric and induction heating, high energy transfer, high voltage switching, plasma, power conversion, radar, and radiation oncology. PMT also offers its customers technical services for both microwave and industrial equipment.

PMT represents leading manufacturers of electron tubes and components used in semiconductor manufacturing equipment and industrial power applications. Among the suppliers they support are Amperex, CPI, Draloric, Eimac, General Electric, Hitachi, Jennings, L3, MaCom, National, NJRC, Thales, Toshiba, and Vishay.

PMT’s inventory levels reflect our commitment to maintain an inventory of a broad range of products for customers who are buying products for replacement of components used in critical equipment. PMT also sells a number of products representing trailing edge technology. While the market for these trailing edge technology products is declining, PMT is increasing its market share. PMT often buys products it knows it can sell ahead of any supplier

price increases. As manufacturers for these products exit the business, PMT has the option to purchase a substantial portion of their remaining inventory.

PMT has distribution agreements with many of its suppliers; most of these agreements provide exclusive distribution rights which often include global responsibility. The agreements are typically long term, and usually contain provisions permitting termination by either party if there are significant breaches which are not cured within a reasonable period of time. Although some of these agreements allow PMT to return inventory periodically, others do not, in which case PMT may have obsolete inventory that they cannot return to the supplier.

PMT's suppliers provide warranty coverage for the products and allow return of defective products, including those returned to PMT by its customers. For information regarding the warranty reserves, see Note 3 "Significant Accounting Policies" of the notes to our consolidated financial statements in Part II, Item 8 of this Annual Report on Form 10-K.

In addition to third party products, we sell proprietary products principally under certain trade names we own including: *Amperex*®, *Cetron*®, and *National*®. Our proprietary products include thyratrons and rectifiers, power tubes, ignitrons, magnetrons, phototubes, microwave generators, and liquid crystal display monitors. The materials used in the manufacturing process consist of glass bulbs and tubing, nickel, stainless steel and other metals, plastic and metal bases, ceramics, and a wide variety of fabricated metal components. These materials are generally readily available, but some components may require long lead times for production, and some materials are subject to shortages or price fluctuations based on supply and demand.



### *Canvys*

Canvys provides customized display solutions serving the corporate enterprise, financial, healthcare, industrial, and medical original equipment manufacturers (“OEM”) markets. Our engineers design, manufacture, source, and support a full spectrum of solutions to match the needs of our customers. We offer custom display solutions that include touch screens, protective panels, custom enclosures, specialized cabinet finishes, and application specific software packages. Our volume commitments are much lower than those of the large display manufacturers, making us the ideal choice for companies with very specific design requirements. We partner with both private label manufacturing companies and leading branded hardware vendors to offer the high quality liquid crystal displays, mounting devices, and customized computing platforms.

We have long-standing relationships with key component and finished goods manufacturers including 3M, LG, NEC Displays, and several key Asian display manufacturers that manufacture products to our specifications. We believe supplier relationships, combined with our engineering design and manufacturing capabilities and private label partnerships, allow us to maintain a well-balanced and technologically advanced offering of customer specific display solutions.

### *Healthcare*

Healthcare, included in Canvys prior to fiscal year 2015, manufactures, distributes and services high value replacement parts for the healthcare market including hospitals, medical centers, independent service organizations, and multi-vendor service providers. Products include power grid tubes, hydrogen thyratrons, klystrons, magnetrons; Image Systems medical displays and workstations for picture archiving and communication systems (“PACS”); visual solutions for operating rooms/surgical environments; digital radiography solutions including replacement flat panel detectors and upgrades; and additional replacement components currently under development for the diagnostic imaging service market. Through a combination of newly developed products and partnerships, service offerings, and training programs, we believe we can help our customers improve efficiency and deliver better clinical outcomes while lowering the cost of healthcare delivery.

### *Sales and Product Management*

As of the end of fiscal 2016, we employed 179 sales and product management personnel worldwide. In addition, we have authorized representatives, who are not our employees, selling our products primarily in regions where we do not have a direct sales presence.

We offer various credit terms to qualifying customers as well as cash in advance and credit card terms. We establish credit limits for each customer and routinely review delinquent and aging accounts.

### ***Distribution***

We maintain approximately 110,700 part numbers in our product inventory database and we estimate that more than 90% of orders received by 6:00 p.m. local time are shipped complete the same day if product is in stock. Customers can access our products on our web sites, [www.rell.com](http://www.rell.com), [www.rellhealthcare.com](http://www.rellhealthcare.com), [www.canvys.com](http://www.canvys.com), and [www.rellaser.com](http://www.rellaser.com), through electronic data interchange, or by telephone. Customer orders are processed by our regional sales offices and supported primarily by one of our distribution facilities in LaFox, Illinois; Amsterdam, Netherlands; Marlborough, Massachusetts; Plymouth, Minnesota; Donaueschingen, Germany; or Singapore, Singapore. We also have satellite warehouses in Sao Paulo, Brazil; Shanghai, China; Bangkok, Thailand; and Hook, United Kingdom. Our data processing network provides on-line, real-time interconnection of all sales offices and central distribution operations, 24 hours per day, seven days per week. Information on stock availability, pricing in local currency, cross-reference information, customers, and market analyses are obtainable throughout the entire distribution network.

### ***International Sales***

During fiscal 2016, approximately 54% of our sales were made outside the U.S. We continue to pursue new international sales to further expand our geographic reach.

### ***Employees***

As of May 28, 2016, we employed 373 full-time individuals. Of these, 241 were located in the United States and 132 were located internationally. The worldwide employee base included 179 in sales and product management and an additional 194 employees in distribution support, administrative positions, and value-add and manufacturing. All of our employees are non-union, and we consider our relationships with our employees to be good.

### ***Website Access to SEC Reports***

We maintain an Internet website at [www.rell.com](http://www.rell.com). Our Annual Report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities and Exchange Act of 1934 are accessible through our website, free of charge, as soon as reasonably practicable after these reports are filed electronically with the Securities and Exchange Commission. Interactive Data Files pursuant to Rule 405 of Regulation S-T, of these filing dates, formatted in Extensible Business Reporting Language (“XBRL”) are accessible as well. To access these reports, go to our website at [www.rell.com](http://www.rell.com). The foregoing information regarding our website is provided for convenience and the content of our website is not deemed to be incorporated by reference in this report filed with the Securities and Exchange Commission.

## **ITEM 1A. Risk Factors**

Investors should consider carefully the following risk factors in addition to the other information included and incorporated by reference in this Annual Report on Form 10-K that we believe are applicable to our businesses and the industries in which we operate. While we believe we have identified the key risk factors affecting our businesses, there may be additional risks and uncertainties that are not presently known or that are not currently believed to be significant that may adversely affect our results of operations.

### ***We may not achieve our plan for sales growth and margin targets.***

We have established both margin and expense targets to grow our sales with new and existing customers. If we do not achieve our growth objectives, the complexity of our global infrastructure makes it difficult to leverage our fixed cost structure to align with the size of our operations. Factors that could have a significant effect on our ability to achieve these goals include the following:

- Failure to achieve our sales and margin growth objectives in our product lines and business units;
- Failure to identify, consummate and successfully integrate acquisitions;
- Declining gross margin reflecting competitive pricing pressures or product mix; and,
- Limitations on our ability to leverage our support-function cost structure while maintaining an adequate structure to achieve our growth objectives.

### ***We have historically incurred significant charges for inventory obsolescence, and may incur similar charges in the future.***

We maintain significant inventories in an effort to ensure that customers have a reliable source of supply. Our products generally support industrial machinery that is powered by tube technology. As technology evolves and this capital equipment is replaced, the market for our products potentially declines. In addition, the market for many of our other products is characterized by rapid change resulting from the development of new technologies, evolving industry standards, frequent new product introductions by some of our suppliers and changing end-user demand, which can contribute to the decline in value or obsolescence of our inventory. We do not have many long-term supply contracts with our customers. If we fail to anticipate the changing needs of our customers or we fail to accurately forecast customer demand, our customers may not place orders with us, and we may accumulate significant inventories of products which we may be unable to sell or return to our vendors. This may result in a decline in the

value of our inventory.

***We face competitive pressures that could have a material adverse effect on our business.***

Our overall competitive position depends on a number of factors including price, engineering capability, vendor representation, product diversity, lead times and the level of customer service. There are very few vacuum tube competitors in the markets we serve. There are also a limited number of Chinese manufacturers whose ability to produce vacuum tubes has progressed over the past several years. The most significant competitive risk comes from technical obsolescence. Canvys faces many competitors in the markets we serve. Increased competition may result in price reductions, reduced margins, or a loss of market share, any of which could materially and adversely affect our business, operating results, and financial condition. As we expand our business and pursue our growth initiatives, we may encounter increased competition from current and/or new competitors. Our failure to maintain and enhance our competitive position could have a material adverse effect on our business.

***A single stockholder has voting control over us.***

As of July 25, 2016, Edward J. Richardson, our Chairman, Chief Executive Officer and President, beneficially owned approximately 99% of the outstanding shares of our Class B common stock, representing approximately 66% of the voting power of the outstanding common stock. This share ownership permits Mr. Richardson to exert control over the outcome of stockholder votes, including votes concerning the election of directors, by-law amendments, possible mergers, corporate control contests, and other significant corporate transactions.

*We are dependent on a limited number of vendors to supply us with essential products.*

Our principal products are capacitors, vacuum tubes and related products, microwave generators, and high voltage power supplies. The products we supply are currently produced by a relatively small number of manufacturers. One of our suppliers represents 11% of our total sales volume. Our success depends, in large part, on maintaining current vendor relationships and developing new relationships. To the extent that our significant suppliers are unwilling or unable to continue to do business with us, or extend lead times, or limit supplies due to capacity constraints, or other factors, there could be a material adverse effect on our business.

*International operations represent a significant percentage of our business and present a variety of risks which could impact our results.*

Because we source and sell our products worldwide, our business is subject to risks associated with doing business internationally. These risks include the costs and difficulties of managing foreign entities, limitations on the repatriation and investment of funds, cultural differences that affect customer preferences and business practices, unstable political or economic conditions, trade protection measures and import or export licensing requirements, and changes in tax laws.

We also face exposure to fluctuations in foreign currency exchange rates because we conduct business outside of the United States. Price increases caused by currency exchange rate fluctuations may make our products less competitive or may have an adverse effect on our margins. Our international revenues and expenses generally are derived from sales and operations in currencies other than the U.S. dollar. Accordingly, when the U.S. dollar strengthens in relation to the base currencies of the countries in which we sell our products, our U.S. dollar reported net revenue and income will decrease. We currently do not engage in any currency hedging transactions. We cannot predict whether foreign currency exchange risks inherent in doing business in foreign countries will have a material adverse effect on our operations and financial results in the future.

*Repatriation of cash held by our foreign subsidiaries to fund U.S. operations or strategic opportunities may be restricted or may subject us to a significant tax liability.*

As of May 28, 2016, \$52.7 million of cash, cash equivalents was held by our foreign subsidiaries. Some of these subsidiaries are located in jurisdictions which require foreign government approval before a cash repatriation can occur. In addition, under current tax law, repatriation of this cash may trigger significant adverse tax consequences in the U.S.

If the cash generated by our domestic operations is not sufficient to fund our domestic operations and our broader corporate initiatives, such as stock repurchases, dividends, acquisitions, and other strategic opportunities, we may need to raise additional funds through public or private debt or equity financings, or we may need to obtain new credit facilities to the extent we are unable to, or choose not to, repatriate our overseas cash. Such additional financing may not be available on terms favorable to us, or at all, and any new equity financings or offerings would dilute our current stockholders' ownership interests in us. Furthermore, lenders may not agree to extend us new, additional or continuing credit. In any such case, our business, operating results or financial condition could be adversely impacted.

### ***BREXIT/Europe***

In a non-binding referendum on the United Kingdom's membership in the European Union in June 2016, a majority of those who voted approved the United Kingdom's withdrawal from the European Union. Any withdrawal by the United Kingdom from the European Union ("Brexit") would occur after, or possibly concurrently with, a process of negotiation regarding the future terms of the United Kingdom's relationship with the European Union, which could result in the United Kingdom losing access to certain aspects of the single EU market and the global trade deals negotiated by the European Union on behalf of its members. The Brexit vote and the perceptions as to the impact of the withdrawal of the United Kingdom may adversely affect business activity, political stability and economic conditions in the United Kingdom, the European Union and elsewhere. Any of these developments, or the perception that any of these developments are likely to occur, could have a material adverse effect on economic growth or business activity in the United Kingdom, the Eurozone, or the European Union, and could result in the relocation of businesses, cause business interruptions, lead to economic recession or depression, and impact the stability of the financial markets, availability of credit, political systems or financial institutions and the financial and monetary system. Given that we conduct a substantial portion of our business in the European Union, these developments could have a material adverse effect on our business, financial position, liquidity and results of operations. The uncertainty concerning the timing and terms of the exit could also have a negative impact on the growth of the European economy and cause greater volatility in all of the global currencies that we currently use to transact business.

***We rely heavily on information technology systems which, if not properly functioning, could materially adversely affect our business.***

We rely on our information technology systems to process, analyze, and manage data to facilitate the purchase, manufacture, and distribution of our products, as well as to receive, process, bill, and ship orders on a timely basis. A significant disruption or failure in the design, operation, security or support of our information technology systems could significantly disrupt our business.

Our information technology systems may be subject to cyber attacks, security breaches or computer hacking. Experienced computer programmers and hackers may be able to penetrate our security controls and misappropriate or compromise sensitive personal, proprietary or confidential information, create system disruptions or cause shutdowns. They also may be able to develop and deploy viruses, worms and other malicious software programs that attack our systems or otherwise exploit any security vulnerabilities. Our systems and the data stored on those systems may also be vulnerable to security incidents or security attacks, acts of vandalism or theft, coordinated attacks by activist entities, misplaced or lost data, human errors, or other similar events that could negatively affect our systems and its data, as well as the data of our business partners. Further, third parties, such as hosted solution providers, that provide services to us, could also be a source of security risk in the event of a failure of their own security systems and infrastructure.

The costs to mitigate or address security threats and vulnerabilities before or after a cyber incident could be significant. Our remediation efforts may not be successful and could result in interruptions, delays or cessation of service, and loss of existing or potential suppliers or customers. In addition, breaches of our security measures and the unauthorized dissemination of sensitive personal, proprietary or confidential information about us, our business partners or other third parties could expose us to significant potential liability and reputational harm. As threats related to cyber attacks develop and grow, we may also find it necessary to make further investments to protect our data and infrastructure, which may impact our profitability. As a global enterprise, we could also be negatively impacted by existing and proposed laws and regulations, as well as government policies and practices related to cybersecurity, privacy, data localization and data protection.

***Our products may be found to be defective or our services performed may result in equipment or product damage and, as a result, warranty and/or product liability claims may be asserted against us.***

Many of our components are sold at prices that are significantly lower than the cost of the equipment or other goods in which they are incorporated. Since a defect or failure in a product could give rise to failures in the equipment that incorporates them, we may face claims for damages that are disproportionate to the revenues and profits we receive from the components involved in the claims. While we typically have provisions in our agreements with our suppliers that hold the supplier accountable for defective products, and we and our suppliers generally exclude consequential



damages in our standard terms and conditions, our ability to avoid such liabilities may be limited as a result of various factors, including the inability to exclude such damages due to the laws of some of the countries where we do business. Our business could be adversely affected as a result of a significant quality or performance issues in the components sold by us if we are required to pay for the damages. Although we have product liability insurance, such insurance is limited in coverage and amount.

***Substantial defaults by our customers on our accounts receivable or the loss of significant customers could have a significant negative impact on our business.***

We extend credit to our customers. The failure of a significant customer or a significant group of customers to timely pay all amounts due could have a material adverse effect on our financial condition and results of operations. The extension of credit involves considerable judgment and is based on management's evaluation of factors which include such things as a customer's financial condition, payment history, and the availability of collateral to secure customers' receivables.

***Failure to successfully implement our growth initiatives, or failure to realize the benefits expected from these initiatives if implemented, may create ongoing operating losses or otherwise adversely affect our business, operating results and financial condition.***

Our growth strategy focuses on expanding our healthcare and our power conversion businesses. On June 15, 2015, we acquired certain assets, including inventory, receivables, fixed assets, and certain other assets, of International Medical Equipment and Services, Inc. (“IMES”), for a purchase price of \$12.2 million. In July 2015, we launched Power and Microwave Technologies Group (“PMT”), which combines our core engineered solutions, power grid and microwave tube business with new RF and power technologies. We may be unable to implement our growth initiatives or reach profitability in the near future or at all, due to many factors, including factors outside of our control. If our investments in these growth initiatives do not yield anticipated returns for any reason, our business, operating results and financial condition may be adversely affected.

***We may not be successful in identifying, consummating and integrating future acquisitions.***

As part of our growth strategy, our intent is to acquire additional businesses or assets. We may not be able to identify attractive acquisition candidates or complete the acquisition of identified candidates at favorable prices and upon advantageous terms. Also, acquisitions are accompanied by risks, such as potential exposure to unknown liabilities and the possible loss of key employees and customers of the acquired business. In addition, we may not obtain the expected benefits or cost savings from acquisitions. Acquisitions are subject to risks associated with financing the acquisition, and integrating the operations, personnel and systems of the acquired businesses. If any of these risks materialize, they may result in disruptions to our business and the diversion of management time and attention, which could increase the costs of operating our existing or acquired businesses or negate the expected benefits of the acquisitions.

***Economic weakness and uncertainty could adversely affect our revenues and gross margins.***

Our revenues and gross profit margins depend significantly on global economic conditions, the demand for our products and services and the financial condition of our customers. Economic weakness and uncertainty have in the past resulted, and may result in the future, in decreased revenues and gross profit margins. Economic weakness and uncertainty also make it more difficult for us to forecast overall supply and demand with a great deal of confidence.

Our operating results during fiscal 2016 reflect an increase in our net loss. There can be no assurance that we will experience a recovery in the near future; nor is there any assurance that such worldwide economic volatility experienced recently will not continue.

***Major disruptions to our logistics capability could have a material adverse impact on our operations.***

Our global logistics services are operated through specialized and centralized distribution centers. We depend on third party transportation service providers for the delivery of products to our customers. A major interruption or disruption in service at any of our distribution centers for any reason (such as natural disasters, pandemics, or significant disruptions of services from our third party providers) could cause cancellations or delays in a significant number of shipments to customers and, as a result, could have a severe impact on our business, operations and financial performance.

***We may be subject to intellectual property rights claims, which are costly to defend, could require payment of damages or licensing fees, and/or could limit our ability to use certain technologies in the future.***

Substantial litigation and threats of litigation regarding intellectual property rights exist in the display systems and electronics industries. From time to time, third parties, including certain companies in the business of acquiring patents with the intention of aggressively seeking licensing revenue from purported infringers, may assert patent and/or other intellectual property rights to technologies that are important to our business. In any dispute involving products that we have sold, our customers could also become the target of litigation. We are obligated in many instances to indemnify and defend our customers if the products we sell are alleged to infringe any third party's intellectual property rights. In some cases, depending on the nature of the claim, we may be able to seek indemnification from our suppliers for our self and our customers against such claims, but there is no assurance that we will be successful in obtaining such indemnification or that we are fully protected against such claims. Any infringement claim brought against us, regardless of the duration, outcome or size of damage award, could result in substantial cost, divert our management's attention, be time consuming to defend, result in significant damage awards, cause product shipment delays, or require us to enter into royalty or other licensing agreements.

Additionally, if an infringement claim is successful we may be required to pay damages or seek royalty or license arrangements which may not be available on commercially reasonable terms. The payment of any such damages or royalties may significantly increase our operating expenses and harm our operating results and financial condition. Also, royalty or license arrangements may not be available at all. We may have to stop selling certain products or certain technologies, which could affect our ability to compete effectively.

Potential lawsuits, with or without merit, may divert management's attention, and we may incur significant expenses in our defense. In addition, we may be required to pay damage awards or settlements, become subject to injunctions or other equitable remedies, or determine to abandon certain lines of business, that may cause a material adverse effect on our results of operations, financial position, and cash flows.

***If we fail to maintain an effective system of internal controls or discover material weaknesses in our internal controls over financial reporting, we may not be able to detect fraud or report our financial results accurately or timely.***

An effective internal control environment is necessary for us to produce reliable financial reports and is an important part of our effort to prevent financial fraud. We are required to periodically evaluate the effectiveness of the design and operation of our internal controls over financial reporting. Based on these evaluations, we may conclude that enhancements, modifications, or changes to internal controls are necessary or desirable. While management evaluates the effectiveness of our internal controls on a regular basis, these controls may not always be effective. There are inherent limitations on the effectiveness of internal controls, including fraud, collusion, management override, and failure in human judgment. In addition, control procedures are designed to reduce rather than eliminate business risks.

If we fail to maintain an effective system of internal controls, or if management or our independent registered public accounting firm discovers material weaknesses in our internal controls, we may be unable to produce reliable financial reports or prevent fraud. In addition, we may be subject to sanctions or investigation by regulatory authorities, such as the Securities and Exchange Commission or NASDAQ. Any such actions could result in an adverse reaction in the financial markets due to a loss of confidence in the reliability of our financial statements.

***If we are deemed to be an investment company, we will be required to meet burdensome compliance requirements and restrictions on our activities.***

We currently have significant cash and investments. If we are deemed to be an "investment company" as defined under the Investment Company Act of 1940 (the "Investment Company Act"), the nature of our investments may be subject to various restrictions. We do not believe that our principal activities subject us to the Investment Company Act. If we

are deemed to be subject to the Investment Company Act, compliance with required additional regulatory burdens would increase our operating expenses.

*The company's goodwill and identifiable intangible assets could become impaired, which could reduce the value of our assets and reduce our net income in the year in which the write-off occurs.*

Our goodwill and intangible assets could become impaired, which could reduce the value of our assets and reduce our net income in the year in which the write-off occurs. We ascribe value to certain intangible assets, which consist of customer lists and trade names resulting from acquisitions. We may incur an impairment charge on goodwill or on intangible assets if we determine that the fair value of the intangible assets are less than their current carrying values. We evaluate whether events have occurred that indicate all, or a portion, of the carrying amount of goodwill or intangible assets may no longer be recoverable. If this is the case, an impairment charge to earnings would be necessary.

#### **ITEM 1B. Unresolved Staff Comments**

None.

**ITEM 2. Properties**

The Company owns two facilities and leases 30 facilities. We own our corporate facility and largest distribution center, which is located on approximately 100 acres in LaFox, Illinois and consists of approximately 242,000 square feet of manufacturing, warehouse, and office space. We maintain geographically diverse facilities because we believe this provides value to our customers and suppliers, and limits market risk and exchange rate exposure. We consider our properties to be well maintained, in sound condition, and adequate for our present needs. The extent of utilization varies from property to property and from time to time during the year.

Our facility locations, their primary use, and segments served are as follows:

<b>Location</b>	<b>Leased/Owned</b>	<b>Use</b>	<b>Segment</b>
Woodland Hills, California	Leased	Sales	PMT
Farmington, Connecticut	Leased	Sales	PMT
Brooksville, Florida	Leased	Sales	PMT
Fort Lauderdale, Florida	Leased	Sales	PMT
LaFox, Illinois *	Owned	Corporate/Sales/Distribution/Manufacturing	PMT/Canvys/Healthcare
Rockland, Massachusetts	Leased	Sales	PMT
Marlborough, Massachusetts	Leased	Sales/Distribution/Manufacturing	Canvys