

DATA I/O CORP  
Form 10-Q  
August 12, 2013

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

**FORM 10-Q**

(Mark One)

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

For the quarterly period ended **June 30, 2013**

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: **0-10394**

**DATA I/O CORPORATION**

(Exact name of registrant as specified in its charter)

Washington  
(State or other jurisdiction of incorporation or organization)

91-0864123  
(I.R.S. Employer Identification No.)

**6464 185<sup>th</sup> Ave NE, Suite 101, Redmond, Washington, 98052**

(Address of principal executive offices, including zip code)

**(425) 881-6444**

(Registrant's telephone number, including area code)

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 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  Accelerated filer  Non-accelerated filer  Smaller reporting company

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

Shares of Common Stock, no par value, outstanding as of August 1, 2013:

7,769,954

**DATA I/O CORPORATION**  
**FORM 10-Q**  
**For the Quarter Ended June 30, 2013**

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**PART I - FINANCIAL INFORMATION****Item 1.                    Financial Statements**

**DATA I/O CORPORATION**  
**CONSOLIDATED BALANCE SHEETS**  
**(in thousands, except share data)**  
**(UNAUDITED)**

|   | <b>June 30,<br/>2013</b> | <b>December 31,<br/>2012</b> |
|---|--------------------------|------------------------------|
| <b>ASSETS</b>   |                          |                              |
| CURRENT ASSETS:   |                          |                              |
| Cash and cash equivalents   | \$10,588                 | \$10,528                     |
| Trade accounts receivable, net of allowance for<br>doubtful accounts of \$92 and \$89, respectively | 3,204                    | 2,648                        |
| Inventories   | 3,393                    | 4,033                        |
| Other current assets  | 304                      | 486                          |
| <b>TOTAL CURRENT ASSETS</b>   | <b>17,489</b>            | <b>17,695</b>                |
| Property, plant and equipment – net   | 906                      | 1,006                        |
| Intangible software technology – net  | 33                       | 35                           |
| Other assets  | 85                       | 86                           |
| <b>TOTAL ASSETS</b>   | <b>\$18,513</b>          | <b>\$18,822</b>              |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>   |                          |                              |
| CURRENT LIABILITIES:  |                          |                              |
| Accounts payable  | \$1,117                  | \$850                        |
| Accrued compensation  | 1,009                    | 1,183                        |
| Deferred revenue  | 1,234                    | 1,238                        |
| Other accrued liabilities   | 565                      | 539                          |
| Accrued costs of business restructuring   | 332                      | 25                           |
| Income taxes payable  | 6                        | 23                           |
| <b>TOTAL CURRENT LIABILITIES</b>  | <b>4,263</b>             | <b>3,858</b>                 |
| Long-term other payables  | 393                      | 219                          |
| <b>COMMITMENTS</b>  | <b>-</b>                 | <b>-</b>                     |
| <b>STOCKHOLDERS' EQUITY</b>   |                          |                              |
| Preferred stock -   |                          |                              |
| Authorized, 5,000,000 shares, including   |                          |                              |

|  |          |          |
|--|----------|----------|
| 200,000 shares of Series A Junior Participating<br>Issued and outstanding, none<br>Common stock, at stated value -<br>Authorized, 30,000,000 shares<br>Issued and outstanding, 7,769,954 shares as of<br>June 30, 2013 | -        | -        |
| and 7,741,686 shares as of December 31, 2012   | 18,131   | 17,928   |
| Accumulated earnings (deficit)   | (5,549)  | (4,466)  |
| Accumulated other comprehensive income   | 1,275    | 1,283    |
| TOTAL STOCKHOLDERS' EQUITY   | 13,857   | 14,745   |
| TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY   | \$18,513 | \$18,822 |

*See notes to consolidated financial statements*

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**DATA I/O CORPORATION**  
**CONSOLIDATED STATEMENTS OF OPERATION**  
(in thousands, except per share amounts)  
**(UNAUDITED)**

|  | <b>Three Months Ended</b> |             | <b>Six Months Ended</b> |             |
|--|---------------------------|-------------|-------------------------|-------------|
|  | <b>June 30,</b>           |             | <b>June 30,</b>         |             |
|  | <b>2013</b>               | <b>2012</b> | <b>2013</b>             | <b>2012</b> |
| Net Sales                                | \$5,271                   | \$5,360     | \$10,029                | \$9,039     |
| Cost of goods sold                       | 2,332                     | 2,419       | 4,549                   | 4,157       |
| Gross margin                             | 2,939                     | 2,941       | 5,480                   | 4,882       |
| Operating expenses:                      |                           |             |                         |             |
| Research and development                 | 1,117                     | 1,427       | 2,321                   | 2,819       |
| Selling, general and administrative      | 1,785                     | 1,996       | 3,592                   | 4,245       |
| Provision for business restructuring     | 642                       | -           | 642                     | -           |
| Total operating expenses                 | 3,544                     | 3,423       | 6,555                   | 7,064       |
| Operating income (loss)                  | (605)                     | (482)       | (1,075)                 | (2,182)     |
| Non-operating income (expense):          |                           |             |                         |             |
| Interest income                          | 56                        | 174         | 74                      | 207         |
| Foreign currency transaction gain (loss) | (55)                      | (45)        | (57)                    | (36)        |
| Total non-operating income (expense)     | 1                         | 129         | 17                      | 171         |
| Income (loss) before income taxes        | (604)                     | (353)       | (1,058)                 | (2,011)     |
| Income tax (expense) benefit             | (20)                      | 296         | (25)                    | 276         |
| Net income (loss)                        | (\$624)                   | (\$57)      | (\$1,083)               | (\$1,735)   |
| <br>                                     |                           |             |                         |             |
| Basic earnings (loss) per share          | (\$0.08)                  | (\$0.01)    | (\$0.14)                | (\$0.21)    |
| Weighted-average basic shares            | 7,762                     | 7,734       | 7,756                   | 8,250       |

*See notes to consolidated financial statements*

**DATA I/O CORPORATION**  
**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)**  
(in thousands)  
**(UNAUDITED)**

|  | <b>Three Months Ended</b> |             | <b>Six Months Ended</b> |             |
|--|---------------------------|-------------|-------------------------|-------------|
|  | <b>June 30,</b>           |             | <b>June 30,</b>         |             |
|  | <b>2013</b>               | <b>2012</b> | <b>2013</b>             | <b>2012</b> |
| Net Income (loss)                        | (\$624)                   | (\$57)      | (\$1,083)               | (\$1,735)   |
| Other comprehensive income:              |                           |             |                         |             |
| Foreign currency translation gain (loss) | 71                        | (163)       | (8)                     | (60)        |
| Comprehensive income (loss)              | (\$553)                   | (\$220)     | (\$1,091)               | (\$1,795)   |

*See notes to consolidated financial statements*

**DATA I/O CORPORATION**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(in thousands, except share amounts)  
**(UNAUDITED)**

|   | <b>For the Six Months<br/>Ended<br/>June 30,</b> |             |
|---|--|-------------|
|   | <b>2013</b>                                      | <b>2012</b> |
| <b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>  |  |             |
| Net income (loss)   | (\$1,083)  | (\$1,735)   |
| Adjustments to reconcile net income (loss)<br>to net cash provided by (used in) operating activities: |  |             |
| Depreciation and amortization   | 343  | 649         |
| Equipment transferred to cost of goods sold   | (5)  | 185         |
| Share-based compensation  | 206  | 281         |
| Net change in:  |  |             |
| Trade accounts receivable   | (559)  | 683         |
| Inventories   | 640  | (681)       |
| Other current assets  | 182  | 143         |
| Accrued cost of business restructuring  | 503  | -           |
| Accounts payable and accrued liabilities  | 99   | (126)       |
| Deferred revenue  | 2  | (71)        |
| Other long-term liabilities   | (27)   | 20          |
| Deposits and other long-term assets   | 1  | (1)         |
| Net cash provided by (used in) operating activities   | 302  | (653)       |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>  |  |             |
| Purchases of property, plant and equipment  | (236)  | (378)       |
| Cash provided by (used in) investing activities   | (236)  | (378)       |
| <b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>  |  |             |
| Proceeds from issuance of common stock  | 5  | 6           |
| Repurchase of common stock  | (5)  | (6,026)     |
| Cash provided by (used in) financing activities   | -  | (6,020)     |
| Increase/(decrease) in cash and cash equivalents  | 66   | (7,051)     |
| Effects of exchange rate changes on cash  | (6)  | (38)        |
| Cash and cash equivalents at beginning of period  | 10,528   | 18,120      |
| Cash and cash equivalents at end of period  | \$10,588   | \$11,031    |
| <b>Supplemental disclosure of non-cash financing activities:</b>                                      |  |             |
| Cash paid during the year for:  |  |             |
| Income Taxes  | (\$39)   | (\$213)     |

*See notes to consolidated financial statements*

**DATA I/O CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**(UNAUDITED)**

**NOTE 1 - FINANCIAL STATEMENT PREPARATION**

Data I/O Corporation (“Data I/O”, “We”, “Our”, “Us”) prepared the financial statements as of June 30, 2013 and June 30, 2012 according to the rules and regulations of the Securities and Exchange Commission (“SEC”). These statements are unaudited but, in the opinion of management, include all adjustments (consisting of normal recurring adjustments and accruals) necessary to present fairly the results for the periods presented. The balance sheet at December 31, 2012 has been derived from the audited financial statements at that date. We have condensed or omitted certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America according to such SEC rules and regulations. Operating results for the three months and six months ended June 30, 2013 are not necessarily indicative of the results that may be expected for the year ending December 31, 2013. These financial statements should be read in conjunction with the annual audited financial statements and the accompanying notes included in our Form 10-K for the year ended December 31, 2012.

Revenue Recognition

We recognize revenue at the time the product is shipped. We have determined that our programming equipment has reached a point of maturity and stability such that product acceptance can be assured by testing at the factory prior to shipment and that the installation meets the criteria to be considered a separate element. These systems are standard products with published product specifications and are configurable with standard options. The evidence that these systems could be deemed as accepted was based upon having standardized factory production of the units, results from batteries of tests of product performance to our published specifications, quality inspections and installation standardization, as well as past product operation validation with the customer and the history provided by our installed base of products upon which the current versions were based. When arrangements include multiple elements, we recognize revenue when the criteria for revenue recognition have been met for each element individually, with multiple elements done on a pro-rata basis.

Installation that is considered perfunctory includes any installation that can be performed by other parties, such as distributors, other vendors, or in most cases the customers themselves. This takes into account the complexity, skill and training needed as well as customer expectations regarding installation. The revenue related to products requiring installation that is perfunctory is recognized at the time of shipment provided that persuasive evidence of an arrangement exists, shipment has occurred, the price is fixed or determinable, and collectability is reasonably assured.

We record revenue from the sale of service and update contracts as deferred revenue and we recognize it on a straight-line basis over the contractual period, which is typically one year. We establish a reserve for sales returns based on historical trends in product returns and estimates for new items. We recognize revenue when, the price is fixed or determinable, the buyer has paid or is obligated to pay and the obligation is not contingent on resale of the product, the buyer's obligation would not be changed in the event of theft, physical destruction or damage to the product, the buyer acquiring the product for resale has economic substance apart from us and we do not have significant obligations for future performance to directly bring about the resale of the product by the buyer.

Sales were recorded net of actual sales returns and changes to the associated sales return reserve. Sales return reserves were \$60,000 and \$60,000 at June 30, 2013 and December 31, 2012, respectively.

When we sell software separately, we recognize software revenue upon shipment provided that only inconsequential obligations remain on our part, substantive acceptance conditions, if any, have been met and when the fee is fixed and determinable and when collection is deemed probable.

Certain fixed-price engineering services contracts that require significant production or customization of software, are accounted for using the percentage-of-completion method. We use the percentage-of-completion method of accounting because it is the most accurate method to recognize revenue based on the nature and scope of certain of our fixed-price engineering services contracts. It is a better measure of periodic income results than other methods and it better matches revenue recognized with the cost incurred.

Percentage-of-completion is measured based primarily on input measures such as hours incurred to date compared to estimated total hours at completion, with consideration given to output measures, such as contract milestones, when applicable. Significant judgment is required when estimating total hours and progress to completion on these arrangements which determines the amount of revenue we recognize as well as whether a loss is recognized if expected to be incurred upon project completion. Revisions to hour and cost estimates are incorporated in the period the amounts are recognized if the results of the period have not been reported; otherwise, the revision of estimates are recognized in the period in which the facts that give rise to the revision become known. No revenues were recorded using the percentage-of-completion method during the three months and six months ended June 30, 2013 and 2012, respectively.

We transfer certain products out of service from their internal use and make them available for sale. The products transferred are our standard products in one of the following areas: service loaners, rental or test units; engineering test units; or sales demonstration equipment. Once transferred, the equipment is sold by our regular sales channels as used equipment inventory. These product units often involve refurbishing and an equipment warranty, and are conducted as sales in our normal and ordinary course of business. The transfer amount is the product unit's net book value and the sale transaction is accounted for as revenue and cost of goods sold.

### Stock-Based Compensation Expense

We measure and recognize compensation expense as required for all share-based payment awards, including employee stock options and restricted stock awards, based on estimated fair values on the grant dates.

### Income Tax

Historically when accounting for uncertainty in income taxes, we have not incurred any interest or penalties associated with tax matters and no interest or penalties were recognized

during the three months and six months ended June 30, 2013. However, we have adopted a policy whereby amounts related to penalties associated with tax matters are classified as general and administrative expense when incurred and amounts related to interest associated with tax matters are classified as interest income or interest expense.

We have incurred net operating losses in the current and certain past years. We continue to maintain a valuation allowance for the full amount of the net deferred tax asset balance associated with our net operating losses and credit carryforwards, as sufficient uncertainty exists regarding our ability to realize such tax assets in the future. There was \$132,000 and \$117,000 unrecognized tax benefits related to uncertain tax positions and related valuation allowance as of June 30, 2013 and 2012, respectively.

Tax years that remain open for examination include 2009, 2010, 2011 and 2012 in the United States of America. In addition, tax years from 2000 to 2008 may be subject to examination in the event that we utilize the net operating losses and credit carryforwards from those years in our current or future year tax returns.

#### Recent Accounting Pronouncements

In July 2013, the FASB issued ASU 2013-11, *"Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists,"* ("ASU 2013-11"), an amendment to ASC 740, "Income Taxes." ASU 2013-11 clarifies that an unrecognized tax benefit, or a portion of an unrecognized tax benefit, should be presented in the financial statements as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward if such settlement is required or expected in the event the uncertain tax benefit is disallowed. In situations where a net operating loss carryforward, a similar tax loss, or a tax credit carryforward is not available at the reporting date under the tax law of the applicable jurisdiction or the tax law of the jurisdiction does not require, and the entity does not intend to use, the deferred tax asset for such purpose, the unrecognized tax benefit should be presented in the financial statements as a liability and should not be netted with the deferred tax asset. The amendments in ASU 2013-11 are effective for fiscal years, and interim periods within those years, beginning after December 15, 2013. Early adoption is permitted. The amendments should be applied prospectively to all unrecognized tax benefits that exist at the effective date. Retrospective application is permitted. We are currently evaluating the impact that the adoption will have on the determination or reporting of our financial results.

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In March 2013, the FASB issued ASU 2013-05, “*Parent’s Accounting for the Cumulative Translation Adjustment upon Derecognition of Certain Subsidiaries or Groups of Assets within a Foreign Entity or of an Investment in a Foreign Entity,*” (“ASU 2013-05”). The objective of ASU 2013-05 is to clarify the applicable guidance for the release into net income of the cumulative translation adjustment upon derecognition of a subsidiary or group of assets within a foreign entity. ASU 2013-05 is effective for annual and interim reporting periods beginning after December 15, 2013 with early adoption permitted. We are currently evaluating the impact that the adoption will have on the determination or reporting of our financial results.

In February 2013, the FASB issued ASU No. 2013-02, “*Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income.*” Under ASU 2013-02, an entity is required to provide information about the amounts reclassified out of Accumulated Other Comprehensive Income (“AOCI”) by component. In addition, an entity is required to present, either on the face of the financial statements or in the notes, significant amounts reclassified out of AOCI by the respective line items of net income, but only if the amount reclassified is required to be reclassified in its entirety in the same reporting period. For amounts that are not required to be reclassified in their entirety to net income, an entity is required to cross-reference to other disclosures that provide additional details about those amounts. ASU 2013-02 does not change the current requirements for reporting net income or other comprehensive income in the financial statements. ASU 2013-02 is effective for us on January 1, 2013. The adoption of this update did not have a material impact on our financial statements.

## NOTE 2 – INVENTORIES

Inventories consisted of the following components:

|                 | June 30,<br>2013 | December 31,<br>2012 |
|-----------------|------------------|----------------------|
| (in thousands)  |                  |                      |
| Raw material    | \$1,902          | \$2,166              |
| Work-in-process | 1,000            | 1,262                |
| Finished goods  | 491              | 605                  |
| Inventories     | \$3,393          | \$4,033              |

## NOTE 3 – PROPERTY, PLANT AND EQUIPMENT, NET

Property and equipment consisted of the following components:

|                        | June 30,<br>2013 | December 31,<br>2012 |
|------------------------|------------------|----------------------|
| (in thousands)         |                  |                      |
| Leasehold improvements | \$481            | \$481                |

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|                               |       |         |
|-------------------------------|-------|---------|
| Equipment                     | 7,075 | 7,618   |
|                               | 7,556 | 8,099   |
| Less accumulated depreciation | 6,650 | 7,093   |
| Property and equipment, net   | \$906 | \$1,006 |

**NOTE 4 – BUSINESS RESTRUCTURING**

As a result of the business downturn we experienced in the second half of 2011 and in 2012, as well as the uncertain business outlook at the time, we took restructuring actions in September 2012 to reduce quarterly operating expenses and production costs. These actions included reductions in personnel and the use of contractors, professionals, and consultants, as well as focusing our development efforts on a smaller number of projects. The net restructuring charge associated with these 2012 actions was \$207,000 and was primarily related to severance. The remaining 2012 restructuring actions were completely paid out during the first quarter of 2013.

We took additional restructuring actions in the second quarter of 2013 to reduce our excess office space and eliminate certain job positions. In addition to these previously announced actions in April which resulted in restructuring costs of \$525,000, additional personnel related actions were taken in June that increased the restructuring charge by \$117,000 to a total \$642,000 for the quarter. The positions eliminated will allow us to have the flexibility to add other critical positions or change fixed to variable costs through outsourcing.

The restructuring charges associated with the second quarter of 2013 actions are approximately \$313,000 for personnel severance related costs and approximately \$329,000 for lease abandonment space. These restructuring charges were recorded in the second quarter of 2013; however the \$329,000 related to lease abandonments will continue to be paid over the term of the leases unless the applicable leases are renegotiated with the landlords or costs are partially offset by unanticipated subleases.

An analysis of the business restructuring is as follows:

|                                   | Reserve<br>Balance<br>Dec 31,<br>2011 | 2012<br>Expense | 2012<br>Payments/<br>Write-Offs | Reserve<br>Balance<br>Dec 31,<br>2012 | 2013<br>Expense | 2013<br>Payments/<br>Write-Offs | Reserve<br>Balance<br>Jun 30,<br>2013 |
|-----------------------------------|---------------------------------------|-----------------|---------------------------------|---------------------------------------|-----------------|---------------------------------|---------------------------------------|
| (in thousands)                    |                                       |                 |                                 |                                       |                 |                                 |                                       |
| Downsizing US<br>operations:      |                                       |                 |                                 |                                       |                 |                                 |                                       |
| Employee severance                | \$0                                   | \$103           | \$103                           | \$0                                   | \$302           | \$75                            | \$227                                 |
| Other costs                       | -                                     | 4               | 4                               | -                                     | 273             | 8                               | 265                                   |
| Downsizing foreign<br>operations: |                                       |                 |                                 |                                       |                 |                                 |                                       |
| Employee severance                | -                                     | 57              | 32                              | 25                                    | 20              | 45                              | -                                     |
| Other costs                       | -                                     | 43              | 43                              | -                                     | 47              | 11                              | 36                                    |
| Total                             | \$0                                   | \$207           | \$182                           | \$25                                  | \$642           | \$139                           | \$528                                 |

The portion of the reserve expected to be paid over the next twelve months is \$332,000 while the long term liability is \$196,000. The long term portion relates to the lease abandonment payments that are due in over one year.

**NOTE 5 – OTHER ACCRUED LIABILITIES**

Other accrued liabilities consisted of the following components:

| (in thousands)            | June 30,<br>2013 | December 31,<br>2012 |
|---------------------------|------------------|----------------------|
| Product warranty          | \$287            | \$260                |
| Sales return reserve      | 60               | 60                   |
| Other taxes               | 90               | 86                   |
| Other                     | 128              | 133                  |
| Other accrued liabilities | \$565            | \$539                |

The changes in Data I/O's product warranty liability for the six months ending June 30, 2013 are as follows:

| (in thousands)               | June 30,<br>2013 |
|------------------------------|------------------|
| Liability, beginning balance | \$260            |
| Net expenses                 | 216              |
| Warranty claims              | (216)            |
| Accrual revisions            | 27               |
| Liability, ending balance    | \$287            |

**NOTE 6 – OPERATING LEASE COMMITMENTS**

We have commitments under non-cancelable operating leases and other agreements, primarily for factory and office space, with initial or remaining terms of one year or more as follows:

For the years ending December 31:

| (in thousands)   | Operating<br>Leases |
|------------------|---------------------|
| 2013 (remaining) | \$588               |
| 2014             | 1,015               |
| 2015             | 840                 |
| 2016             | 513                 |
| Total            | \$2,956             |

**NOTE 7 – OTHER COMMITMENTS**

We have purchase obligations for inventory and production costs as well as other obligations such as capital expenditures, service contracts, marketing, and development agreements. Arrangements are considered purchase obligations if a contract specifies all significant terms,

including fixed or minimum quantities to be purchased, a pricing structure and approximate timing of the transaction. Most arrangements are cancelable without a significant penalty, and with short notice, typically less than 90 days. At June 30, 2013, the purchase commitments and other obligations totaled \$1,212,000 and are expected to be paid over the next twelve months.

**NOTE 8 – CONTINGENCIES**

As of June 30, 2013, we were not a party to any legal proceedings, the adverse outcome of which in management's opinion, individually or in the aggregate, would have a material adverse effect on our results of operations or financial position.

Indemnification Arrangements: We may, from time to time in the ordinary course of our business enter into contractual arrangements with third parties that include indemnification obligations. Under these contractual arrangements, we have agreed to defend, indemnify and/or hold the third party harmless from and against certain liabilities. These arrangements include indemnities in favor of customers in the event that our programming system products infringe a third party's intellectual property and indemnities in favor of our lessors in connection with facility leasehold liabilities that we may cause. In addition, we have entered into indemnification agreements with our directors and certain of our officers, and our bylaws contain indemnification obligations in favor of our directors, officers and agents. These indemnity arrangements may limit the type of the claim, the total amount that we can be required to be paid in connection with the indemnification obligation and the time within which an indemnification claim can be made. The duration of the indemnification obligation may vary, and for most arrangements, survives the agreement term and is indefinite. We believe that substantially all of our indemnity arrangements provide either for limitations on the maximum potential future payments we could be obligated to make, or for limitations on the types of claims and damages we could be obligated to indemnify, or both. However, it is not possible to determine or reasonably estimate the maximum potential amount of future payments under these indemnification obligations due to the varying terms of such obligations, a lack of history of prior indemnification claims, the unique facts and circumstances involved in each particular contractual arrangement and in each potential future claim for indemnification, and the contingency of any potential liabilities upon the occurrence of events that are not reasonably determinable. We have not had any requests for indemnification under these arrangements. Our management believes that any liability for these indemnity arrangements would not be material to our accompanying consolidated financial statements. We have not recorded any liabilities for these indemnification arrangements on our consolidated balance sheet as of June 30, 2013.

## **NOTE 9 – EARNINGS PER SHARE**

Basic earnings per share is calculated based on the weighted average number of common shares outstanding during each period. Diluted earnings per share is calculated based on these same weighted average shares outstanding plus the effect of potential shares issuable upon assumed exercise of stock options based on the treasury stock method. Potential shares issuable upon the exercise of stock options are excluded from the calculation of diluted earnings per share to the extent their effect would be anti-dilutive.

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

Three Months Ended

Six Months Ended

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|   | June 30,<br>2013 | June 30,<br>2012 | June 30,<br>2013 | June 30,<br>2012 |
|---|------------------|------------------|------------------|------------------|
| (in thousands except per share data)                                    |                  |                  |                  |                  |
| Numerator for basic and diluted earnings (loss) per share:              |                  |                  |                  |                  |
| Net income (loss)   | (\$624)          | (\$57)           | (\$1,083)        | (\$1,735)        |
| Denominator for basic earnings (loss) per share:                        |                  |                  |                  |                  |
| weighted-average shares   | 7,762            | 7,734            | 7,756            | 8,250            |
| Employee stock options and awards                                       | -                | -                | -                | -                |
| Denominator for diluted earnings (loss) per share:                      |                  |                  |                  |                  |
| adjusted weighted-average shares & assumed conversions of stock options | 7,762            | 7,734            | 7,756            | 8,250            |
| Basic and diluted earnings (loss) per share:                            |                  |                  |                  |                  |
| Total basic earnings (loss) per share                                   | (\$0.08)         | (\$0.01)         | (\$0.14)         | (\$0.21)         |
| Total diluted earnings (loss) per share                                 | (\$0.08)         | (\$0.01)         | (\$0.14)         | (\$0.21)         |

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The earnings per share computation for the three months and six months ended June 30, 2013 and 2012 excludes the following options to purchase common stock, as their effect is anti-dilutive:

|  | Three Months Ended |                  | Six Months Ended |                  |
|--|--------------------|------------------|------------------|------------------|
|  | June 30,<br>2013   | June 30,<br>2012 | June 30,<br>2013 | June 30,<br>2012 |
| Anti-dilutive options to purchase shares | 910,392            | 1,086,892        | 990,998          | 905,571          |

#### **NOTE 10 – SHARE-BASED COMPENSATION**

For share-based awards granted, we have recognized compensation expense based on the estimated grant date fair value method. For these awards we have recognized compensation expense using a straight-line amortization method and reduced for estimated forfeitures.

The impact on our results of operations of recording share-based compensation, net of forfeitures, for the three months and six months ended June 30, 2013 and 2012, respectively, was as follows:

|                                     | Three Months Ended |                  | Six Months Ended |                  |
|-------------------------------------|--------------------|------------------|------------------|------------------|
|                                     | June 30,<br>2013   | June 30,<br>2012 | June 30,<br>2013 | June 30,<br>2012 |
| (in thousands)                      |                    |                  |                  |                  |
| Cost of goods sold                  | \$13               | \$15             | \$24             | \$26             |
| Research and development            | 28                 | 34               | 48               | 60               |
| Selling, general and administrative | 95                 | 101              | 134              | 195              |
| Total share-based compensation      | \$136              | \$150            | \$206            | \$281            |
| Impact on net earnings per share:   |                    |                  |                  |                  |
| Basic and diluted                   | (\$0.02)           | (\$0.02)         | (\$0.03)         | (\$0.03)         |



The fair value of share-based awards for employee stock options was estimated using the Black-Scholes valuation model. The following weighted average assumptions were used to calculate the fair value of stock options granted during the three months and six months ended June 30, 2013 and 2012:

|                                      | Three Months Ended |                  | Six Months Ended |                  |
|--------------------------------------|--------------------|------------------|------------------|------------------|
|                                      | June 30,<br>2013   | June 30,<br>2012 | June 30,<br>2013 | June 30,<br>2012 |
| Risk-free interest rates             | 0.50%              | 0.61%            | 0.66%            | 0.62%            |
| Volatility factors                   | 0.54               | 0.53             | 0.54             | 0.53             |
| Expected life of the option in years | 4.00               | 4.00             | 4.00             | 4.00             |
| Expected dividend yield              | None               | None             | None             | None             |

Stock option grants during the three months and six months ended June 30, 2013 and 2012 were as follows:

|                       | Three Months Ended |                  | Six Months Ended |                  |
|-----------------------|--------------------|------------------|------------------|------------------|
|                       | June 30,<br>2013   | June 30,<br>2012 | June 30,<br>2013 | June 30,<br>2012 |
| Stock Options Granted | 3,000              | 175,000          | 33,000           | 190,000          |

The remaining unamortized expected future compensation expense and remaining amortization period associated with unvested option grants and restricted stock awards at June 30, 2013 are:

|   |                                 |
|---|---------------------------------|
| Unamortized future compensation expense                 | June 30,<br>2013<br>\$1,102,965 |
| Remaining weighted average amortization period in years | 2.74                            |



**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

General

**Forward-Looking Statements**

This Quarterly Report on Form 10-Q includes forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. This Act provides a “safe harbor” for forward-looking statements to encourage companies to provide prospective information about themselves as long as they identify these statements as forward-looking and provide meaningful cautionary statements identifying important factors that could cause actual results to differ from the projected results. All statements other than statements of historical fact made in this Quarterly Report on Form 10-Q are forward-looking. In particular, statements herein regarding industry prospects or trends; expected revenues; expected level of expense; future results of operations; reversals of tax valuation allowances; restructuring implications; breakeven point, or financial position; changes in gross margin; economic conditions and capital spending outlook; market acceptance of our newly introduced or upgraded products; development, introduction and shipment of new products; sales channels and any other guidance on future periods are forward-looking statements. Forward-looking statements reflect management’s current expectations and are inherently uncertain. Although we believe that the expectations reflected in these forward-looking statements are reasonable, we cannot guarantee future results, levels of activity, performance, achievements, or other future events. Moreover, neither we nor anyone else assumes responsibility for the accuracy and completeness of these forward-looking statements. We are under no duty to update any of these forward-looking statements after the date of this report. The reader should not place undue reliance on these forward-looking statements. The discussions above and in the section in Item 1A., Risk Factors “Cautionary Factors That May Affect Future Results” in our Annual report on Form 10-K for the year ended December 31, 2012 describe some, but not all, of the factors that could cause these differences.

**OVERVIEW**

We have renewed our focus on managing the core programming business to return to profitability, while developing and enhancing products to drive future revenue and earnings growth. Our challenge continues to be operating in a cyclical and rapidly evolving industry environment. We are continuing our efforts to balance business geography shifts, increasing

costs and strategic investments in our business with the level of demand and mix of business we expect. During the second quarter of 2013, we took the additional restructuring actions discussed below under “Business Restructuring Progress”.

We are focusing our research and development efforts in our strategic growth markets, namely new programming technology, automated programming systems for the manufacturing environment and software. We continue to focus on extending the capabilities and support for our product lines.

At the end of 2012, an impairment evaluation of our Azido software technology acquired in April of 2011 resulted in a \$2.3 million write down of the investment. We are continuing the process of evaluating strategic alternatives for the Azido technology.

Our customer focus has been on strategic high volume manufacturers in key market segments like wireless and consumer electronics, automotive electronics, industrial controls and programming centers. Our product focus has been on automated programming systems, enhancing our programming technology and supporting the latest semiconductor devices, including NAND Flash, like e-MMC, and microcontrollers on our newer products.

## **BUSINESS RESTRUCTURING PROGRESS**

As a result of the business downturn we experienced in the second half of 2011 and in 2012, as well as the uncertain business outlook at the time, we took restructuring actions in September 2012 to reduce quarterly operating expenses and production costs. These actions included reductions in personnel and the use of contractors, professionals, and consultants, as well as focusing our development efforts on a smaller number of projects. The net restructuring charge associated with these 2012 actions was \$207,000 and was primarily related to severance. The remaining 2012 restructuring actions were completely paid out during the first quarter of 2013.

During the second quarter of 2013, we took additional restructuring actions to reduce our excess office space and eliminate certain job positions. In addition to these previously announced actions in April, which resulted in restructuring costs of \$525,000, additional personnel related actions were taken in June that increased the restructuring charge by \$117,000 to a total \$642,000 for the quarter. The positions eliminated will allow us to have the flexibility to add other critical positions or change fixed to variable costs through outsourcing. The net effect of the space and personnel reductions, offset in part by the other planned additions, will be to reduce annual operating expenses by approximately \$300,000 when fully implemented by the third quarter of 2013.

The restructuring charges associated with the second quarter of 2013 actions are approximately \$313,000 for personnel severance related costs and approximately \$329,000 for lease abandonment space. These restructuring charges were recorded in the second quarter of 2013; however the \$329,000 related to lease abandonments will continue to be paid over the term of the leases unless the applicable leases are renegotiated with the landlords or costs are partially offset by unanticipated subleases.

## **CRITICAL ACCOUNTING POLICY JUDGMENTS AND ESTIMATES**

The preparation of financial statements in accordance with accounting principles generally accepted in the United States of America requires that we make estimates and judgments, which affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosures of contingent assets and liabilities. On an on-going basis, we evaluate our estimates, including those related to revenue recognition, estimating the percentage-of-completion on fixed-price professional engineering service contracts, sales returns, bad debts, inventories, investments, intangible assets, income taxes, warranty obligations, restructuring charges, contingencies such as litigation, and contract terms that have multiple elements and other complexities typical in the capital equipment industry. We base our estimates on historical experience and other assumptions that we believe are reasonable under the circumstances. Actual results may differ from these estimates under different assumptions or conditions.

We believe the following critical accounting policies affect the more significant judgments and estimates used in the preparation of our financial statements:

Revenue Recognition: We recognize revenue at the time the product is shipped. We have determined that our programming equipment has reached a point of maturity and stability such that product acceptance can be assured by testing at the factory prior to shipment and that the installation meets the criteria to be considered a separate element. These systems are standard products with published product specifications and are configurable with standard options. The evidence that these systems could be deemed as accepted was based upon having standardized factory production of the units, results from batteries of tests of product performance to our published specifications, quality inspections and installation standardization, as well as past product operation validation with the customer and the history provided by our installed base of products upon which the current versions were based. When arrangements include multiple elements, we recognize revenue when the criteria for revenue recognition have been met for each element individually, with multiple elements done on a pro-rata basis.

Installation that is considered perfunctory includes any installation that can be performed by other parties, such as distributors, other vendors, or in most cases the customers themselves. This takes into account the complexity, skill and training needed as well as customer expectations regarding installation. The revenue related to products requiring installation that is perfunctory is recognized at the time of shipment provided that persuasive evidence of an arrangement exists, shipment has occurred, the price is fixed or determinable, and collectability is reasonably assured.

We record revenue from the sale of service and update contracts as deferred revenue and we recognize it on a straight-line basis over the contractual period, which is typically one year. We establish a reserve for sales returns based on historical trends in product returns and estimates for new items. We recognize revenue when, the price is fixed or determinable, the buyer has paid or is obligated to pay and the obligation is not contingent on resale of the product, the buyer's obligation would not be changed in the event of theft, physical destruction or damage to the product, the buyer acquiring the product for resale has economic substance apart from us and we do not have significant obligations for future performance to directly bring about the resale of the product by the buyer.

Sales were recorded net of actual sales returns and changes to the associated sales return reserve. Sales return reserves were \$60,000 and \$60,000 at June 30, 2013 and December 31, 2012, respectively.

When we sell software separately, we recognize software revenue upon shipment provided that only inconsequential obligations remain on our part, substantive acceptance conditions, if any, have been met and when the fee is fixed and determinable and when collection is deemed probable.

Certain fixed-price engineering services contracts that require significant production or customization of software are accounted for using the percentage-of-completion method. We use the percentage-of-completion method of accounting because it is the most accurate method to recognize revenue based on the nature and scope of certain of our fixed-price engineering services contracts. It is a better measure of periodic income results than other methods and it better matches revenue recognized with the cost incurred.

Percentage-of-completion is measured based primarily on input measures such as hours incurred to date compared to estimated total hours at completion, with consideration given to output measures, such as contract milestones, when applicable. Significant judgment is required when estimating total hours and progress to completion on these arrangements which determines the amount of revenue we recognize as well as whether a loss is recognized if expected to be incurred upon project completion. Revisions to hour and cost estimates are incorporated in the period the amounts are recognized if the results of the period have not been reported; otherwise, the revision of estimates are recognized in the period in which the facts that give rise to the revision become known. No revenues were recorded using the percentage-of-completion method during the three months and six months ended June 30, 2013 and 2012, respectively.

We transfer certain products out of service from their internal use and make them available for sale. The products transferred are our standard products in one of the following areas: service loaners, rental or test units; engineering test units; or sales demonstration equipment. Once transferred, the equipment is sold by our regular sales channels as used equipment inventory. These product units often involve refurbishing and an equipment warranty, and are conducted as sales in our normal and ordinary course of business. The transfer amount is the product unit's net book value and the sale transaction is accounted for as revenue and cost of goods sold.

**Allowance for Doubtful Accounts:** We base the allowance for doubtful accounts receivable on our assessment of the collectability of specific customer accounts and the aging of accounts receivable. If there is deterioration of a major customer's credit worthiness or actual defaults are higher than historical experience, our estimates of the recoverability of amounts due to us could be adversely affected.

**Inventory:** Inventories are stated at the lower of cost or market. Adjustments are made to standard cost, which approximates actual cost on a first-in, first-out basis. We estimate reductions to inventory for obsolete, slow-moving, excess and non-salable inventory by reviewing current transactions and forecasted product demand. We evaluate our inventories on an item by item basis and record inventory adjustments accordingly. If there is a significant decrease in demand for our products or there is a higher risk of inventory obsolescence because of rapidly changing technology and customer requirements, we may be required to increase our inventory adjustments and our gross margin could be adversely affected.

**Warranty Accruals:** We accrue for warranty costs based on the expected material and labor costs to fulfill our warranty obligations. If we experience an increase in warranty claims, which are higher than our historical experience, our gross margin could be adversely affected.

**Tax Valuation Allowances:** Given the uncertainty created by our loss history, as well as the current uncertain economic outlook for our industry and capital spending, we expect to continue to limit the recognition of net deferred tax assets and accounting for uncertain tax positions and maintain the tax valuation allowances. At the current time, we expect, therefore, that reversals of the tax valuation allowance will take place only as we are able to take advantage of the underlying tax loss or other attributes in carry forward. The transfer pricing and expense or cost sharing arrangements are complex areas where judgments, such as the determination of arms-length arrangements, can be subject to challenges by different tax jurisdictions.

**Share-based Compensation:** We account for share-based awards made to our employees and directors, including employee stock option awards and restricted stock awards, using the estimated grant date fair value method of accounting. We estimate the fair value using the Black-Scholes valuation model, which requires the input of highly subjective assumptions, including the option's expected life and the price volatility of the underlying stock. The expected stock price volatility assumption was determined using the historical volatility of our common stock. Changes in the subjective assumptions required in the valuation model may significantly affect the estimated value of the awards, the related stock-based compensation expense and, consequently, our results of operations.

## Results of Operations

### **Net Sales**

| Net sales by product line (in thousands) | Three Months Ended |        |               | Six Months Ended |        |               |
|--|--------------------|--------|---------------|------------------|--------|---------------|
|  | June 30, 2013      | Change | June 30, 2012 | June 30, 2013    | Change | June 30, 2012 |
| Automated programming systems            | \$3,543            | (1.3%) | \$3,590       | \$6,484          | 15.4%  | \$5,620       |
| Non-automated programming systems        | 1,728              | (2.4%) | 1,770         | 3,545            | 3.7%   | 3,419         |
| Total programming systems                | \$5,271            | (1.7%) | \$5,360       | \$10,029         | 11.0%  | \$9,039       |

| Net sales by location | Three Months Ended |        |               | Six Months Ended |        |               |
|-----------------------|--------------------|--------|---------------|------------------|--------|---------------|
|                       | June 30, 2013      | Change | June 30, 2012 | June 30, 2013    | Change | June 30, 2012 |

|                |         |         |         |         |         |         |
|----------------|---------|---------|---------|---------|---------|---------|
| (in thousands) |         |         |         |         |         |         |
| United States  | \$501   | (33.7%) | \$756   | \$862   | (29.7%) | \$1,226 |
| % of total     | 9.5%    |         | 14.1%   | 8.6%    |         | 13.6%   |
| International  | \$4,770 | 3.6%    | \$4,604 | \$9,167 | 17.3%   | \$7,813 |
| % of total     | 90.5%   |         | 85.9%   | 91.4%   |         | 86.4%   |

Net sales decreased slightly when compared to the second quarter of 2012. On a regional basis, net sales increased 27% in the Americas and 80% in Asia, while declining 60% in Europe compared to the second quarter of 2012. International sales were 90% of total sales for the second quarter of 2013 compared to 86% for the second quarter of 2012.

Orders for the second quarter of 2013 were \$6.7 million, up 30%, compared with \$5.2 million in the second quarter of 2012 and sequentially up 41% compared to the first quarter of 2013. The increase in orders was primarily due to a significant PS and FLX order we received from a manufacturer of consumer electronics and most of this order remained in backlog at the end of the quarter. On a regional basis, order bookings increased 41% in the Americas and 192% in Asia, while declining 54% in Europe compared to the second quarter of 2012. We ended the quarter with a backlog of \$2.4 million, compared to \$1.1 million at the end of the second quarter of 2012 and \$0.9 million at December 31, 2012. The systems in backlog are scheduled to ship in the third and fourth quarter.

For the six months ending June 30, 2013, the sales increase compared to the same period of 2012, was primarily due to purchasing by wireless original equipment manufacturer (“OEM”) and related electronics manufacturing service (“EMS”) customers and a new consumer home electronics customer. For the six months ending June 30, 2013 compared to the same period of 2012, orders increased 22% primarily due to same reasons sales increased, as well as the significant PS and FLX order we received from a manufacturer of consumer electronics in the second quarter of 2013.

### Gross Margin

|                         | Three Months Ended |        |               | Six Months Ended |        |               |
|-------------------------|--------------------|--------|---------------|------------------|--------|---------------|
|                         | June 30, 2013      | Change | June 30, 2012 | June 30, 2013    | Change | June 30, 2012 |
| (in thousands)          |                    |        |               |                  |        |               |
| Gross margin            | \$2,939            | (0.1%) | \$2,941       | \$5,480          | 12.2%  | \$4,882       |
| Percentage of net sales | 55.8%              |        | 54.9%         | 54.6%            |        | 54.0%         |

Gross margin as a percentage of sales in the second quarter of 2013 was 55.8%, compared with 54.9% in the second quarter of 2012. The gross margin increase as a percentage of sales for the second quarter was primarily due to a favorable product mix and favorable variances. The favorable product mix was largely due to an increase in sales of RoadRunner systems, which have a higher gross margin. The significant backlog of PS and FLX systems at the end of the quarter, indicate that next quarter a lower gross margin may be expected due to a less favorable product mix with higher direct material costs.

For the first six months of 2013, the gross margin increase as a percentage of sales was primarily due to the increased sales volume in relation to fixed costs, as well as the same factors affecting the second quarter of 2013.

### Research and Development

|                          | Three Months Ended |         |               | Six Months Ended |         |               |
|--------------------------|--------------------|---------|---------------|------------------|---------|---------------|
|                          | June 30, 2013      | Change  | June 30, 2012 | June 30, 2013    | Change  | June 30, 2012 |
| (in thousands)           |                    |         |               |                  |         |               |
| Research and development | \$1,117            | (21.7%) | \$1,427       | \$2,321          | (17.7%) | \$2,819       |
| Percentage of net sales  | 21.2%              |         | 26.6%         | 23.1%            |         | 31.2%         |

Research and development (“R&D”) decreased by \$310,000 in the second quarter of 2013 compared to the same period in 2012 primarily due to the elimination of most of the amortization and expenses related to the Azido initiative, as well as savings from personnel reductions from the April 2013 and September 2012 restructuring actions and reduced use of contractors that support R&D efforts.

For the first six months of 2013 compared to the same period in 2012, the decrease in R&D expense was due to the same factors as for the second quarter.

### **Selling, General and Administrative**

|                                   | Three Months Ended |         |                  | Six Months Ended |         |                  |
|-----------------------------------|--------------------|---------|------------------|------------------|---------|------------------|
|                                   | June 30,<br>2013   | Change  | June 30,<br>2012 | June 30,<br>2013 | Change  | June 30,<br>2012 |
| (in thousands)                    |                    |         |                  |                  |         |                  |
| Selling, general & administrative | \$1,785            | (10.6%) | \$1,996          | \$3,592          | (15.4%) | \$4,245          |
| Percentage of net sales           | 33.9%              |         | 37.2%            | 35.8%            |         | 47.0%            |

Selling, General and Administrative expenses decreased \$211,000 in the second quarter of 2013 compared to the second quarter of 2012. The decrease was primarily related to savings from personnel and contractor reductions from the September 2012 restructuring actions, offset in part by \$50,000 of relocation costs, \$40,000 higher incentive compensation and higher commissions related to sales volume and channel mix.

For the first six months of 2013 compared to the same period in 2012, the decrease in SG&A expense was primarily due to the CEO search firm and separation pay expense of \$460,000 in 2012 as well as the same general factors discussed above for the second quarter.

## Interest

|                 | Three Months Ended |         |                     | Six Months Ended |         |                  |
|-----------------|--------------------|---------|---------------------|------------------|---------|------------------|
|                 | June 30,<br>2013   | Change  | June<br>30,<br>2012 | June 30,<br>2013 | Change  | June 30,<br>2012 |
| (in thousands)  |                    |         |                     |                  |         |                  |
| Interest income | \$56               | (67.8%) | \$174               | \$74             | (64.3%) | \$207            |

Interest income for the second quarter and first six months of 2013 decreased compared to the same periods in 2012 primarily due to interest received related to foreign income tax refunds that occurred in 2012.

## Income Taxes

|                              | Three Months Ended  |          |                     | Six Months Ended    |          |                     |
|------------------------------|---------------------|----------|---------------------|---------------------|----------|---------------------|
|                              | June<br>30,<br>2013 | Change   | June<br>30,<br>2012 | June<br>30,<br>2013 | Change   | June<br>30,<br>2012 |
| (in thousands)               |                     |          |                     |                     |          |                     |
| Income tax (expense) benefit | (\$20)              | (106.8%) | \$296               | (\$25)              | (109.1%) | \$276               |

Income tax (expense) benefit recorded for the second quarter and first six months of 2013 resulted primarily from current year foreign taxes on subsidiary income. Income tax (expense) benefit recorded for the second quarter and first six months of 2012 resulted primarily from refund settlements received of foreign income taxes during 2012, offset in part by foreign taxes on current year subsidiary income.

The effective tax rate differed from the statutory tax rate primarily due to the effect of valuation allowances, as well as foreign taxes. We have a valuation allowance of \$11.1 million as of June 30, 2013. Our deferred tax assets and valuation allowance have been reduced by approximately \$132,000 and \$117,000 associated with the requirements of accounting for uncertain tax positions as of June 30, 2013 and 2012, respectively. Given the uncertainty created by our past loss history and the cyclical nature of the industry in which we operate, we expect to continue to limit the recognition of net deferred tax assets and maintain the tax valuation allowances.

## Financial Condition

### **Liquidity and Capital Resources**

| (in thousands)  | June 30,<br>2013 | Change  | December 31,<br>2012 |
|-----------------|------------------|---------|----------------------|
| Working capital | \$13,226         | (\$611) | \$13,837             |

Our cash position at June 30, 2013 increased \$196,000 during the quarter to \$10.6 million. This increase in cash was primarily attributable to the reduction of inventory during the quarter, offset in part by other changes in working capital. Accounts receivable increased to \$3.2 million at June 30, 2013 compared to \$2.6 million at December 31, 2012. Inventories were at \$3.4 million at June 30, 2013, down from \$4.0 million at December 31, 2012. We expect that inventories will increase during the third quarter as we expect to replenish or increase certain product inventories.

Although we have no significant capital expenditure plans currently, we expect that we will continue to make capital expenditures to support our business. Capital expenditures are expected to be funded by existing and internally generated funds or lease financing.

As a result of our significant product development, customer support, selling and marketing efforts, we have required substantial working capital to fund our operations. Over the last few years and again during the second quarter of 2013, we restructured our operations to lower our costs and operating expenditures in some geographic regions, while investing in other regions; creating headroom to hire critical product development resources; and to lower the level of revenue required for our net income breakeven point; as well as offsetting in part, costs rising over time; to preserve our cash position and to focus on profitable operations. See “Business Restructuring Progress” discussion above for future expected restructuring related payments.

We believe that we have sufficient working capital available under our operating plan to fund our operations and capital requirements through at least the next one-year period. Approximately \$8.8 million of our cash is located in foreign subsidiary accounts at June 30, 2013. Although we have no current repatriation plans, there may be tax and other impediments to repatriating the cash to the United States. Our working capital may be used to fund share repurchases and growth initiatives including acquisitions, which could reduce our liquidity. Any substantial inability to achieve our current business plan could have a material adverse impact on our financial position, liquidity, or results of operations and may require us to reduce expenditures and/or seek additional financing.

### **OFF-Balance sheet arrangements**

Except as noted in the accompanying consolidated financial statements in Note 6, “Operating Lease Commitments” and Note 7, “Other Commitments”, we have no off-balance sheet arrangements.

**Non-Generally accepted accounting principles (GAAP) FINANCIAL Measures**

Earnings before interest, taxes, depreciation and amortization (“EBITDA”) was a loss of \$498,000 and \$192,000 for the three months ended June 30, 2013 and 2012, respectively. Excluding the restructuring charge, EBITDA was a profit of \$144,000 for the second quarter of 2013. Non-GAAP financial measures should not be considered a substitute for, or superior to, measures of financial performance prepared in accordance with GAAP. We believe that this non-GAAP financial measure provides meaningful supplemental information regarding our results and facilitates the comparison of results. A reconciliation of net income (loss) to EBITDA follows:

|  | Three Months Ended |                  | Six Months Ended |                  |
|--|--------------------|------------------|------------------|------------------|
|  | June 30,<br>2013   | June 30,<br>2012 | June 30,<br>2013 | June 30,<br>2012 |
| (in thousands)   |                    |                  |                  |                  |
| Net Income (loss)  | (\$624)            | (\$57)           | (\$1,083)        | (\$1,735)        |
| Interest income  | (56)               | (174)            | (74)             | (207)            |
| Taxes  | 20                 | (296)            | 25               | (276)            |
| Depreciation and<br>amortization                                       | 162                | 335              | 343              | 649              |
| EBITDA earnings (loss)   | (\$498)            | (\$192)          | (\$789)          | (\$1,569)        |
| Restructuring Charges  | 642                | -                | 642              | -                |
| Adjusted EBITDA<br>earnings (loss)<br>excluding restructure<br>charges | \$144              | (\$192)          | (\$147)          | (\$1,569)        |

**RECENT ACCOUNTING ANNOUNCEMENTS**

In July 2013, the FASB issued ASU 2013-11, “*Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists*,” (“ASU 2013-11”), an amendment to ASC 740, “Income Taxes.” ASU 2013-11 clarifies that an unrecognized tax benefit, or a portion or an unrecognized tax benefit, should be presented in the financial statements as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward if such settlement is required or expected in the event the uncertain tax benefit is disallowed. In situations where a net

operating loss carryforward, a similar tax loss, or a tax credit carryforward is not available at the reporting date under the tax law of the applicable jurisdiction or the tax law of the jurisdiction does not require, and the entity does not intend to use, the deferred tax asset for such purpose, the unrecognized tax benefit should be presented in the financial statements as a liability and should not be netted with the deferred tax asset. The amendments in ASU 2013-11 are effective for fiscal years, and interim periods within those years, beginning after December 15, 2013. Early adoption is permitted. The amendments should be applied prospectively to all unrecognized tax benefits that exist at the effective date. Retrospective application is permitted. We are currently evaluating the impact that the adoption will have on the determination or reporting of our financial results.

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In March 2013, the FASB issued ASU 2013-05, *“Parent’s Accounting for the Cumulative Translation Adjustment upon Derecognition of Certain Subsidiaries or Groups of Assets within a Foreign Entity or of an Investment in a Foreign Entity,”* (“ASU 2013-05”). The objective of ASU 2013-05 is to clarify the applicable guidance for the release into net income of the cumulative translation adjustment upon derecognition of a subsidiary or group of assets within a foreign entity. ASU 2013-05 is effective for annual and interim reporting periods beginning after December 15, 2013 with early adoption permitted. We are currently evaluating the impact that the adoption will have on the determination or reporting of our financial results.

In February 2013, the FASB issued ASU No. 2013-02, *“Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income.”* Under ASU 2013-02, an entity is required to provide information about the amounts reclassified out of Accumulated Other Comprehensive Income (“AOCI”) by component. In addition, an entity is required to present, either on the face of the financial statements or in the notes, significant amounts reclassified out of AOCI by the respective line items of net income, but only if the amount reclassified is required to be reclassified in its entirety in the same reporting period. For amounts that are not required to be reclassified in their entirety to net income, an entity is required to cross-reference to other disclosures that provide additional details about those amounts. ASU 2013-02 does not change the current requirements for reporting net income or other comprehensive income in the financial statements. ASU 2013-02 is effective for us on January 1, 2013. The adoption of this update did not have a material impact on our financial statements.

**Item 3.**                    **Quantitative and Qualitative Disclosures About Market Risk**

Not applicable.

**Item 4.**                    **Controls and Procedures**

**Evaluation of disclosure controls and procedures**

Under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, we evaluated the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rule 13a-15(e) and Rule 15d-15(e) under the Exchange Act) as of the end of the period covered by this report (the “Evaluation Date”). Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that, as of the Evaluation Date, our disclosure controls and procedures were effective at the reasonable level of assurance. Disclosure Controls are controls and procedures designed to reasonably assure that information required to be disclosed in our reports filed under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in the SEC’s rules and forms. Disclosure Controls are also designed to reasonably assure that such information is accumulated and communicated to our management, including the CEO and CFO, as appropriate to allow timely decisions regarding required disclosure.

## **Changes in internal controls**

There were no changes made in our internal controls during the period covered by this report that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

## **PART II - OTHER INFORMATION**

### **Item 1.                    Legal Proceedings**

From time to time, we may be involved in litigation relating to claims arising out of our operations in the normal course of business. As of June 30, 2013, we were not a party to any material pending legal proceedings.

### **Item 1A.                Risk Factors**

In addition to the other information set forth in this report, you should carefully consider the factors discussed in Part I, "Item 1A. Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2012, which could materially affect our business, financial condition or future results. The risks described in our Annual Report on Form 10-K are not the only risks facing our Company. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition and/or operating results. There are no material changes to the Risk Factors described in our Annual Report.

**Item 2.**                    **Unregistered Sales of Equity Securities and Use of Proceeds**

None

**Item 3.**                    **Defaults Upon Senior Securities**

None

**Item 4.**                    **Mine Safety Disclosures**

Not Applicable

**Item 5.**                    **Other Information**

None

**Item 6.**                    **Exhibits**

(a) **Exhibits**

10    **Material Contracts:**

2002:                    31    **Certification pursuant to Section 302 of the Sarbanes Oxley Act of**

31.1 Chief Executive Officer  
Certification

31.2 Chief Financial Officer  
Certification

**32 Certification pursuant to Section 906 of the Sarbanes Oxley Act of 2002:**

32.1 Chief Executive Officer  
Certification

32.2 Chief Financial Officer Certification

**101 Interactive Data Files Pursuant to Rule 405 of Regulation S-T**

## SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

DATED: August 12, 2013

### **DATA I/O CORPORATION**

(REGISTRANT)

By: //S//Anthony  
Ambrose

Anthony Ambrose

President and Chief Executive Officer

(Principal Executive Officer and Duly Authorized Officer)

By: //S//Joel S. Hatlen

Joel S. Hatlen

Vice President and Chief Financial Officer

Secretary and Treasurer

(Principal Financial Officer and Duly Authorized Officer)



Exhibit 31.1

CERTIFICATION

I, Anthony Ambrose, certify that:

- 1) I have reviewed this quarterly report on Form 10-Q of Data I/O Corporation;
- 2) Based on my knowledge, this report does not contain any untrue statement of material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
- 3) Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
- 4) The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)), for the registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
  - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this quarterly report based on such evaluation; and
  - d) Disclosed in this quarterly report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5) The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

DATED: August 12, 2013

/s/ Anthony Ambrose

Anthony Ambrose

Chief Executive Officer

(Principal Executive Officer)

Exhibit 31.2

CERTIFICATION

I, Joel S. Hatlen, certify that:

- 1) I have reviewed this quarterly report on Form 10-Q of Data I/O Corporation;
- 2) Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
- 3) Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this quarterly report;
- 4) The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)), for the registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
  - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this quarterly report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this quarterly report based on such evaluation; and
  - d) Disclosed in this quarterly report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5) The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

DATED: August 12, 2013

/s/ Joel S. Hatlen

Joel S. Hatlen

Chief Financial Officer

(Principal Financial Officer)

Exhibit 32.1

Certification by Chief Executive Officer

Pursuant to 18 U.S.C. Section 1350

As Adopted Pursuant to

Section 906 of the Sarbanes-Oxley Act of 2002

In connection with the quarterly report of Data I/O Corporation (the "Company") on Form 10-Q for the period ended June 30, 2013 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Anthony Ambrose, Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 as amended; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Anthony Ambrose

Anthony Ambrose

Chief Executive Officer

(Principal Executive Officer)

August 12, 2013



Exhibit 32.2

Certification by Chief Financial Officer

Pursuant to 18 U.S.C. Section 1350

As Adopted Pursuant to

Section 906 of the Sarbanes-Oxley Act of 2002

In connection with the quarterly report of Data I/O Corporation (the "Company") on Form 10-Q for the period ended June 30, 2013 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Joel S. Hatlen, Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 as amended; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Joel S. Hatlen

Joel S. Hatlen

Chief Financial Officer

(Principal Financial Officer)

August 12, 2013