TECHNICAL COMMUNICATIONS CORP
Form 10-Q
August 13, 2013
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 10-Q

(Mark One)

x **Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the quarterly period ended June 29, 2013

¨ **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: 001-34816

TECHNICAL COMMUNICATIONS CORPORATION

(Exact name of registrant as specified in its charter)

Massachusetts	**04-2295040**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**
100 Domino Drive, Concord, MA	**01742-2892**
(Address of principal executive offices)	**(Zip Code)**

Registrant s telephone number, including area code: (978) 287-5100

N/A

(Former name, former address and former fiscal year, if changed since last report)

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

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 during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x 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. (Check one):

Large accelerated filer	¨	Accelerated filer	¨
Non-accelerated filer	¨	Smaller reporting company	x

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

Indicate the number of shares outstanding of each of the issuer s classes of common stock as of the latest practicable date. 1,838,716 shares of Common Stock, $0.10 par value, outstanding as of August 9, 2013.

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TECHNICAL COMMUNICATIONS CORPORATION AND SUBSIDIARY

Condensed Consolidated Balance Sheets

(Unaudited)

	June 29, 2013	September 29, 2012
Assets		
Current Assets:		
Cash and cash equivalents	$ 991,259	$ 2,056,311
Marketable securities	4,440,748	4,668,864
Accounts receivable - trade, less allowance of $25,000 at June 29, 2013 and September 29, 2012	467,949	1,380,472
Inventories	2,931,124	2,633,408
Income taxes receivable	1,207,997	859,336
Deferred income taxes	893,768	618,078
Other current assets	248,689	170,729
Total current assets	11,181,534	12,387,198
Equipment and leasehold improvements	4,172,856	4,084,886
Less: accumulated depreciation and amortization	(3,777,360)	(3,632,288)
Equipment and leasehold improvements, net	395,496	452,598
Total Assets	$ 11,577,030	$ 12,839,796
Liabilities and Stockholders Equity		
Current Liabilities:		
Accounts payable	$ 231,047	$ 167,313
Customer deposits	16,025	52,372
Accrued liabilities:		
Accrued compensation and related expenses	282,300	316,751
Accrued expenses	120,146	176,281
Total current liabilities	649,518	712,717
Commitments and contingencies		
Stockholders Equity:		
Common stock, par value $0.10 per share; 7,000,000 shares authorized; 1,838,716 shares issued and outstanding at June 29, 2013 and September 29, 2012	183,872	183,872
Additional paid-in capital	3,735,915	3,569,731
Accumulated other comprehensive (loss) income	(11,901)	10,042
Retained earnings	7,019,626	8,363,434
Total stockholders equity	10,927,512	12,127,079
Total Liabilities and Stockholders Equity	$ 11,577,030	$ 12.839.796

The accompanying notes are an integral part of these condensed consolidated financial statements.

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TECHNICAL COMMUNICATIONS CORPORATION AND SUBSIDIARY

Condensed Consolidated Statements of Operations

(Unaudited)

	Three Months Ended	
	June 29, 2013	**June 23, 2012**
Net sales	$ 969,694	$ 733,693
Cost of sales	376,512	161,482
Gross profit	593,182	572,211
Operating expenses:		
Selling, general and administrative	739,397	788,335
Product development	586,164	1,350,170
Total operating expenses	1,325,561	2,138,505
Operating loss	(732,379)	(1,566,294)
Other income:		
Interest income	11,953	5,494
Loss before benefit for income taxes	(720,426)	(1,560,800)
Benefit for income taxes	(198,647)	(645,941)
Net loss	$ (521,779)	$ (914,859)
Net loss per common share:		
Basic	$ (0.28)	$ (0.50)
Diluted	$ (0.28)	$ (0.50)
Weighted average shares:		
Basic	1,838,716	1,832,287
Diluted	1,838,716	1,832,287
Dividends paid per common share:		$ 0.10

The accompanying notes are an integral part of these condensed consolidated financial statements.

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TECHNICAL COMMUNICATIONS CORPORATION AND SUBSIDIARY

Condensed Consolidated Statements of Operations

(Unaudited)

	Nine Months Ended	
	June 29, 2013	**June 23, 2012**
Net sales	$ 3,112,149	$ 6,791,104
Cost of sales	927,884	1,580,321
Gross profit	2,184,265	5,210,783
Operating expenses:		
Selling, general and administrative	2,209,939	2,525,293
Product development	2,230,973	3,299,024
Total operating expenses	4,440,912	5,824,317
Operating loss	(2,256,647)	(613,534)
Other income:		
Interest income	28,279	8,591
Loss before benefit for income taxes	(2,228,368)	(604,943)
Benefit for income taxes	(1,068,432)	(252,857)
Net loss	$ (1,159,936)	$ (352,086)
Net loss per common share:		
Basic	$ (0.63)	$ (0.19)
Diluted	$ (0.63)	$ (0.19)
Weighted average shares:		
Basic	1,838,716	1,829,363
Diluted	1,838,716	1,829,363
Dividends paid per common share:	$ 0.10	$ 0.30

The accompanying notes are an integral part of these condensed consolidated financial statements.

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TECHNICAL COMMUNICATIONS CORPORATION AND SUBSIDIARY

Condensed Consolidated Statements of Comprehensive Income (Loss)

(Unaudited)

	Three Months Ended		Nine Months Ended	
	June 29, 2013	**June 23, 2012**	**June 29, 2013**	**June 23, 2012**
Net loss	$ (521,779)	$ (914,859)	$ (1,159,936)	$ (352,086)
Other comprehensive (loss) income, net of tax	(26,095)	9,469	(21,943)	(3,275)
Comprehensive loss	$ (547,874)	$ (905,390)	$ (1,181,879)	$ (355,361)

The accompanying notes are an integral part of these consolidated financial statements.

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TECHNICAL COMMUNICATIONS CORPORATION AND SUBSIDIARY

Condensed Consolidated Statements of Cash Flows

(Unaudited)

	Nine Months Ended June 29, 2013	Nine Months Ended June 23, 2012
Operating Activities:		
Net loss	$ (1,159,936)	$ (352,086)
Adjustments to reconcile net loss to net cash (used in) provided by operating activities:		
Depreciation and amortization	145,072	179,960
Amortization of premium on available for sale securities	38,937	
Share-based compensation	166,184	190,002
Deferred income taxes	(275,690)	
Changes in certain operating assets and liabilities:		
Accounts receivable	912,523	708,684
Inventories	(297,716)	517,500
Income taxes receivable	(348,661)	(283,865)
Other current assets	(77,960)	(121,507)
Customer deposits	(36,347)	(88,936)
Accounts payable and other accrued liabilities	(26,852)	(418,742)
Net cash (used in) provided by operating activities	(960,446)	331,010
Investing Activities:		
Additions to equipment and leasehold improvements	(87,970)	(148,859)
Proceeds from maturities of marketable securities	1,711,799	292,000
Purchases of marketable securities	(1,544,563)	(4,822,757)
Net cash provided by (used in) investing activities	79,266	(4,679,616)
Financing Activities:		
Proceeds from exercise of stock options		19,500
Dividends paid	(183,872)	(549,469)
Net cash used in financing activities	(183,872)	(529,969)
Net decrease in cash and cash equivalents	(1,065,052)	(4,878,575)
Cash and cash equivalents at beginning of the period	2,056,311	9,231,717
Cash and cash equivalents at end of the period	$ 991,259	$ 4,353,142
Supplemental Disclosures:		
Interest paid	$	$

Income taxes paid	506	30,000

The accompanying notes are an integral part of these condensed consolidated financial statements.

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TECHNICAL COMMUNICATIONS CORPORATION AND SUBSIDIARY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

STATEMENT OF FAIR PRESENTATION

Interim Financial Statements. The accompanying interim unaudited condensed consolidated financial statements of Technical Communications Corporation (the Company or TCC) and its wholly-owned subsidiary include all adjustments which are, in the opinion of management, necessary for a fair presentation of the financial position and results of operations for the periods presented and in order to make the financial statements not misleading. All such adjustments are of a normal recurring nature. Interim results are not necessarily indicative of the results to be expected for the fiscal year ending September 28, 2013.

Certain footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted as allowed by Securities and Exchange Commission (SEC) rules and regulations. The accompanying unaudited condensed consolidated financial statements should be read in conjunction with the Company s consolidated financial statements and the notes thereto in the Company s Quarterly Reports on Form 10-Q for the quarters ended March 30, 2013 and December 29, 2012 and its Annual Report on Form 10-K for the fiscal year ended September 29, 2012 as filed with the SEC.

We follow accounting standards set by the Financial Accounting Standards Board, commonly referred to as the FASB. The FASB sets generally accepted accounting principles (GAAP) that we follow to ensure we consistently report our financial condition, results of operations, and cash flows. References to GAAP issued by the FASB in these footnotes are to the *FASB Accounting Standards Codification*™ - sometimes referred to as the Codification or ASC.

NOTE 1. Summary of Significant Accounting Policies and Significant Judgments and Estimates

Basis of Presentation. The accompanying condensed consolidated financial statements include the accounts of the Company and its wholly-owned subsidiary. All significant intercompany accounts and transactions have been eliminated in consolidation.

The discussion and analysis of our financial condition and results of operations are based on our condensed consolidated financial statements, which have been prepared in accordance with GAAP. The preparation of these condensed consolidated financial statements requires management to make estimates and judgements that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported revenues and expenses during the reporting periods.

On an ongoing basis, management evaluates its estimates and judgments, including but not limited to those related to revenue recognition, inventory reserves, receivable reserves, investment securities, income taxes, fair value of financial instruments and share-based compensation. Management bases its estimates on historical experience and on various other factors that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Cont d)

The accounting policies that management believes are most critical to aid in fully understanding and evaluating our reported financial results include the following:

Revenue Recognition

Product revenue is recognized when there is persuasive evidence of an arrangement, the fee is fixed or determinable, delivery of the product to the customer has occurred and we have determined that collection of the fee is probable. Title to the product generally passes upon shipment of the product, as the products are shipped FOB shipping point, except for certain foreign shipments for which title passes upon entry of the product into the first port in the buyer s country. If the product requires installation to be performed by TCC, all revenue related to the product is deferred and recognized upon completion of the installation. We provide for a warranty reserve at the time the product revenue is recognized.

We perform funded research and development and technology development for commercial companies and government agencies under both cost reimbursement and fixed-price contracts. Cost reimbursement contracts provide for the reimbursement of allowable costs and, in some situations, the payment of a fee. These contracts may contain incentive clauses providing for increases or decreases in the fee depending on how actual costs compare with a budget. Revenue from reimbursement contracts is recognized as services are performed. On fixed-price contracts that are expected to exceed one year in duration, revenue is recognized pursuant to the proportional performance method based upon the proportion of actual costs incurred to the total estimated costs for the contract. In each type of contract, we receive periodic progress payments or payments upon reaching interim milestones, and we retain the rights to the intellectual property developed in government contracts. All payments to TCC for work performed on contracts with agencies of the U.S. government are subject to audit and adjustment by the Defense Contract Audit Agency. Adjustments are recognized in the period made. When current estimates of total contract revenue and contract costs for a product development contract indicate a loss, a provision for the entire loss on the contract is recorded. Any losses incurred in performing funded research and development projects are recognized as funded research and development expenses.

Cost of product revenue includes material, labor and overhead. Costs incurred in connection with funded research and development are included in cost of sales. Product development costs are charged to billable engineering services, bid and proposal efforts or support of business development activities, as appropriate. Product development costs charged to billable projects are recorded as cost of sales, engineering costs charged to bid and proposal efforts are recorded as selling expenses, and product development costs charged to business development activities are recorded as marketing expenses. Product development costs consist primarily of personnel costs, outside contractor and engineering services, supplies and materials.

Inventory

We value our inventory at the lower of actual cost (based on first-in, first-out (FIFO)) to purchase and/or manufacture or the current estimated market value (based on the estimated selling prices, less the cost to sell) of the inventory. We periodically review inventory quantities on hand and record a provision for excess and/or obsolete inventory based primarily on our estimated forecast of product demand, as well as historical usage. Due to the custom and specific nature of certain of our products, demand and usage for products and materials can fluctuate significantly. A significant decrease in demand for our products could result in a short-term increase in the cost of inventory purchases and an increase in excess inventory quantities on hand. In addition, our industry is characterized by rapid technological change, frequent new product development and rapid product obsolescence, any of which could result in an increase in the amount of obsolete inventory quantities on hand. Therefore, although we make every effort to ensure the accuracy of our forecasts of future product demand, any significant unanticipated changes in demand or technological developments could have a significant negative impact on the value of our inventory and would reduce our reported operating results.

Accounts Receivable

Accounts receivable are reduced by an allowance for amounts that may become uncollectible in the future. The estimated allowance for uncollectible amounts is based primarily on a specific analysis of accounts in the receivable portfolio and historical write-off experience. While management believes the allowance to be adequate, if the financial condition of our customers were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances may be required, which would reduce net income. The allowance recorded for accounts receivable at June 29, 2013 and September 29, 2012 was $25,000.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Cont d)

Investment Securities

The Company accounts for investment securities in accordance with FASB ASC 320, *Investments - Debt and Equity Securities.* All investment securities must be classified as one of the following: held-to-maturity, available-for-sale, or trading. The Company holds certain marketable securities classified as available-for-sale and, as such, carries the investments at fair value, with unrealized holding gains and losses reported in stockholders equity as a separate component of accumulated other comprehensive income (loss). The cost of securities sold is determined based on the specific identification method. Realized gains and losses, and declines in value judged to be other than temporary, are included in investment income. The purchase discount or premium is amortized to income or expense, respectively, over the life of the securities.

Accounting for Income Taxes

The preparation of our consolidated financial statements requires us to estimate our income taxes in each of the jurisdictions in which we operate, including those outside the United States, which may subject the Company to certain risks that ordinarily would not be expected in the United States. The income tax accounting process involves estimating our actual current exposure together with assessing temporary differences resulting from differing treatments of items, such as deferred revenue, for tax and accounting purposes. These differences result in the recognition of deferred tax assets and liabilities. We must then record a valuation allowance to reduce our deferred tax assets to the amount that is more likely than not to be realized.

Significant management judgment is required in determining our provision for income taxes, our deferred tax assets and liabilities, and any valuation allowance recorded against deferred tax assets. We have recorded a valuation allowance against our deferred tax assets of $1.1 million as of June 29, 2013 due to uncertainties related to our ability to utilize these assets. The valuation allowance is based on our estimates of taxable income by jurisdiction and the period over which our deferred tax assets will be recoverable. In the event that actual results differ from these estimates or we adjust these estimates in future periods, we may need to adjust our valuation allowance. Any such adjustment could materially impact our financial position and results of operation.

Due to the nature of our current operations in foreign countries (selling products into these countries with the assistance of local representatives), the Company has not been subject to any foreign taxes in recent years. Also, it is not anticipated that we will be subject to foreign taxes in the near future.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Cont d)

Fair Value of Financial Instruments

In determining the fair value of financial instruments, the Company follows the provisions of FASB ASC 820, *Fair Value Measurements and Disclosures*. FASB ASC 820 defines fair value, establishes a framework for measuring fair value under GAAP and enhances disclosures about fair value measurements. The topic provides a consistent definition of fair value which focuses on an exit price, which is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The topic also prioritizes, within the measurement of fair value, the use of market-based information over entity specific information and establishes a three-level hierarchy for fair value measurements based on the nature of inputs used in the valuation of an asset or liability as of the measurement date. The three level hierarchy is as follows:

Level 1 - Pricing inputs are quoted prices available in active markets for identical investments as of the reporting date.

Level 2 - Pricing inputs are either quoted prices for similar investments, or inputs that are observable, either directly or indirectly, for substantially the full term through corroboration with observable market data.

Level 3 - Pricing inputs are unobservable for the investment, that is, inputs that reflect the reporting entity s own assumptions about the assumptions market participants would use in pricing the asset or liability.

In certain cases, the inputs used to measure fair value may fall into different levels of the fair value hierarchy. In such cases, an investment s level within the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement. The Company s assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment, and considers factors specific to the investment.

The Company s available-for-sale securities are comprised of investments in municipal bonds, brokered certificates of deposit and mutual funds. These securities represent ownership in individual bonds in municipalities within the United States, certificates of deposit in U.S. banks and money market funds held in a brokerage account. The fair value of these investments is based on quoted prices from recognized pricing services (e.g. Standard & Poors, Bloomberg, etc.) or, in the case of mutual funds, at their closing net asset values.

The Company assesses the levels of the investments at each measurement date, and transfers between levels are recognized on the actual date of the event or change in circumstances that caused the transfer in accordance with the Company s accounting policy regarding the recognition of transfers between levels of the fair value hierarchy. During the nine months ended June 29, 2013 there were no transfers between levels.

The following table sets forth by level, within the fair value hierarchy, the financial instruments carried at fair value as of June 29, 2013 and September 29, 2012, in accordance with the fair value hierarchy as defined above.

June 29, 2013 (Unaudited)	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)
Debt and certificates of deposits:			
Municipal bonds	$ 1,950,877	$	$ 1,950,877
Certificates of deposit	2,489,871		2,489,871
Total debt instruments	4,440,748		4,440,748
Mutual funds:			
Money market funds	337,673	337,673	

Total mutual funds	337,673		337,673		
Total investments	$ 4,778,421	$	337,673	$	4,440,748

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Cont d)

September 29, 2012

Debt and certificates of deposits:			
Municipal bonds	$ 1,925,371	$	$ 1,925,371
Certificates of deposit	2,743,493		2,743,493
Total debt instruments	4,668,864		4,668,864
Mutual funds:			
Money market funds	1,340,440	1,340,440	
Total mutual funds	1,340,440	1,340,440	
Total investments	$ 6,009,304	$ 1,340,440	$ 4,668,864

Assets and liabilities measured at fair value on a nonrecurring basis are recognized at fair value subsequent to initial recognition when they are deemed to be impaired. As of June 29, 2013 and September 29, 2012, the Company s assets and liabilities subject to measurement at fair value on a nonrecurring basis are equipment and leasehold improvements. Neither was deemed to be impaired or measured at fair value on a nonrecurring basis.

Short-Term Debt

The Company maintains a line of credit agreement with Bank of America (the Bank) for a line of credit not to exceed the principal amount of $600,000. The line is supported by a financing promissory note. The loan is a demand loan with interest payable at the Bank s prime rate plus 1% on all outstanding balances. During the fiscal year ended September 29, 2012, the Company failed to comply with its tangible net worth covenant with respect to the line of credit. The Bank waived the violation and the parties amended the agreement on February 8, 2013 to lower the tangible net worth requirement. In addition, the line is now only available to support new letters of credit issued by the Company. Future standby letters of credit will be required to be secured with cash. The Company has no borrowings against this line of credit; however, there is an outstanding standby letter of credit which is secured by the line amounting to $14,903 at June 29, 2013.

Share-Based Compensation

Share-based compensation cost is measured at the grant date based on the calculated fair value of the award. The expense is recognized over the employee s requisite service period, generally the vesting period of the award. The related excess tax benefit received upon the exercise of stock options, if any, is reflected in the Company s statement of cash flows as a financing activity rather than an operating activity. There were no excess tax benefits for the three and nine month periods ended June 29, 2013 and June 23, 2012.

The Company selected the Black-Scholes option pricing model as the method for determining the estimated fair value of its stock awards. The Black-Scholes method of valuation requires several assumptions: (1) the expected term of the stock award, (2) the expected future stock price volatility over the expected term, (3) a risk-free interest rate and (4) the expected dividend rate. The expected term represents the expected period of time the Company believes the options will be outstanding based on historical information. Estimates of expected future stock price volatility are based on the historic volatility of the Company s common stock and the risk free interest rate is based on the U.S. Treasury Note rate. The Company utilizes a forfeiture rate based on an analysis of its actual experience. The forfeiture rate is not material to the calculation of share-based compensation.

The fair value of options at date of grant was estimated with the following assumptions (unaudited):

	Three and Nine Months Ended	
	June 29, 2013	**June 23, 2012**
Option term	6.5 years	6.5 years
Risk-free interest rate	0.71% to 0.79%	0.83 to 0.94%
Stock price volatility	66%	68%
Dividend yield		4%

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Cont d)

There were 16,500 options granted during the nine months ended June 29, 2013, and 17,000 options granted during the nine months ended June 23, 2012. The weighted average grant date fair value for the options granted during such nine month periods was $2.89 and $4.47, respectively.

The following table summarizes share-based compensation costs included in the Company s condensed consolidated income statements for the three and nine month periods ended June 29, 2013 and June 23, 2012 (unaudited):

	June 29, 2013		June 23, 2012	
	3 months	9 months	3 months	9 months
Cost of sales	$ 4,079	$ 12,227	$ 4,065	$ 12,192
Selling, general and administrative expenses	11,910	75,688	61,111	88,980
Product development expenses	23,656	78,269	29,358	88,830
Total share-based compensation expense before taxes	$ 39,645	$ 166,184	$ 94,534	$ 190,002

As of June 29, 2013 and June 23, 2012, there was $328,683 and $521,669, respectively, of unrecognized compensation cost related to options granted. The unrecognized compensation cost will be recognized as the options vest. The weighted average period over which the compensation cost is expected to be recognized is 2.36 years and 3.2 years, respectively.

The Company had the following stock option plans outstanding as of June 29, 2013: the Technical Communications Corporation 2001 Stock Option Plan, the 2005 Non-Statutory Stock Option Plan and the 2010 Equity Incentive Plan. There were an aggregate of 750,000 shares authorized for issuance under these plans, of which options to purchase 257,582 shares were outstanding at June 29, 2013. Vesting periods are at the discretion of the Board of Directors and typically range between zero and five years. Options under these plans are granted with an exercise price equal to fair market value at time of grant and have a term of ten years from the date of grant.

As of June 29, 2013, there were no shares available for new option grants under the 2001 Stock Option Plan; there were 33,028 shares available for grant under the 2005 Non-Statutory Stock Option Plan; and there were 54,406 shares available for grant under the 2010 Equity Incentive Plan.

The following table summarizes stock option activity during the first nine months of fiscal 2013 (unaudited):

	Options Outstanding				
	Number of Shares			Weighted Average	Weighted Average
	Unvested	Vested	Total	Exercise Price	Contractual Life
Outstanding, September 29, 2012	93,418	151,784	245,202	$ 9.12	6.99 years
Grants	1,000		1,000	5.40	
Vested	(1,400)	1,400		8.40	
Cancellations/forfeitures	(1,257)	(838)	(2,095)	11.51	
Outstanding, December 29, 2012	91,761	152,346	244,107	$ 9.09	6.75 years
Grants	1,500	14,000	15,500	4.73	
Vested	(4,600)	4,600		6.61	
Cancellations/forfeitures	(855)	(570)	(1,425)	11.51	
Outstanding, March 30, 2013	87,806	170,376	258,182	$ 8.81	6.69 years

Grants						
Vested	(800)	800			8.59	
Cancellations/forfeitures		(600)	(600)		0.99	
Outstanding, June 29, 2013	87,006	170,576	257,582	$	8.83	6.46 years

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Cont d)

Information related to the stock options vested and expected to vest as of June 29, 2013 is as follows (unaudited):

Range of Exercise Prices	Number of Shares	Weighted-Average Remaining Contractual Life (years)	Weighted Average Exercise Price	Exercisable Number of Shares	Exercisable Weighted-Average Exercise Price
$2.01 - $3.00	15,288	2.19	$ 3.00	15,288	$ 3.00
$3.01 - $4.00	16,600	3.08	$ 3.66	16,600	$ 3.66
$4.01 - $5.00	28,900	7.68	$ 4.79	26,300	$ 4.78
$5.01 - $10.00	54,400	5.99	$ 7.43	49,440	$ 7.41
$10.01 - $15.00	142,394	7.24	$ 11.41	62,948	$ 11.29
	257,582	6.46	$ 8.83	170,576	$ 7.68

The aggregate intrinsic value of the Company s in-the-money outstanding and exercisable options as of June 29, 2013 and June 23, 2012 was $222,176 and $277,555, respectively. Unvested common stock options are subject to the risk of forfeiture until the fulfillment of specified conditions.

NOTE 2. Inventories

Inventories consisted of the following:

	June 29, 2013 (unaudited)	September 29, 2012
Finished goods	$ 8,015	$ 38,406
Work in process	899,126	642,159
Raw materials	2,023,983	1,952,843
	$ 2,931,124	$ 2,633,408

NOTE 3. Income Taxes

During the nine months ended June 29, 2013 and June 23, 2012, the Company recorded an income tax benefit based on its expected effective tax rate for its fiscal year. The effective tax rate for the first nine months of fiscal year 2013 was decreased to 48% from 57.7% in the second quarter of fiscal 2013 due to a revision of the full year pre-tax forecast in the third fiscal quarter of 2013 and the tax benefit recorded related to the research credit, which was extended on January 2, 2013 by the America Taxpayer Relief Act of 2012. The effective tax rate excluding discrete events for the nine months ended June 29, 2013 was 42.9%. This compares to 41.8% for the same period of fiscal 2012.

Deferred tax assets consist of tax credits, inventory differences and other temporary differences. The Company s valuation allowance is related to the temporary differences associated with its inventory. The Company has determined that the tax benefit related to its obsolete inventory will not likely be realized, and therefore has provided a full valuation allowance against the related deferred tax asset. It is the Company s intention to maintain the related inventory items for the foreseeable future to support equipment in the field, and therefore cannot determine when the tax benefit, if any, will be realized.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Cont d)

NOTE 4. Earnings Per Share

Basic and diluted earnings per share were calculated as follows (unaudited):

	June 29, 2013		June 23, 2012	
	3 months	9 months	3 months	9 months
Net loss	$ (521,779)	$ (1,159,936)	$ (914,859)	$ (352,086)
Weighted average shares outstanding - basic	1,838,716	1,838,716	1,832,287	1,829,363
Dilutive effect of stock options				
Weighted average shares outstanding - diluted	1,838,716	1,838,716	1,832,287	1,829,363
Basic net loss per share	$ (0.28)	$ (0.63)	$ (0.50)	$ (0.19)
Diluted net loss per share	$ (0.28)	$ (0.63)	$ (0.50)	$ (0.19)

Outstanding potentially dilutive stock options, which were not included in the earnings per share calculations because their inclusion would have been anti-dilutive, were 257,582 at June 29, 2013 and 268,852 at June 23, 2012.

NOTE 5. Major Customers and Export Sales

During the quarter ended June 29, 2013, the Company had three customers that represented 86% (41%, 30% and 15%, respectively) of net sales as compared to the quarter ended June 23, 2012, during which three customers represented 83% (42%, 24%, and 17%, respectively) of net sales. During the nine month period ended June 29, 2013, the Company had two customers that represented 72% (41%, and 31%, respectively) of net sales as compared to the nine month period ended June 23, 2012, during which one customer represented 84% of net sales.

A breakdown of foreign and domestic net sales is as follows (unaudited):

	June 29, 2013		June 23, 2012	
	3 months	9 months	3 months	9 months
Domestic	$ 532,214	$ 2,591,866	$ 377,292	$ 5,907,328
Foreign	437,480	520,283	356,401	883,776
Total sales	$ 969,694	$ 3,112,149	$ 733,693	$ 6,791,104

The Company sold products into four countries during the three month period ended June 29, 2013 and five countries during the three month period ended June 23, 2012. The Company sold products into five countries during the nine month period ended June 29, 2013 and six countries during the nine month period ended June 23, 2012. A sale is attributed to a foreign country based on the location of the contracting party. Domestic revenue may include the sale of products shipped through domestic resellers or manufacturers to international destinations. The table below summarizes our foreign revenues by country as a percentage of total foreign revenue (unaudited).

June 29, 2013		June 23, 2012	
3 months	9 months	3 months	9 months

Saudi Arabia	65.6%	69.3%	34.6%	37.7%
Jordan		1.3%	0.3%	35.7%
Egypt	34.1%	28.6%	50.2%	20.2%
Thailand			14.2%	5.7%
Other	0.3%	0.8%	0.7%	0.7%

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Cont d)

A summary of foreign revenue, as a percentage of total foreign revenue by geographic area, is as follows (unaudited):

	June 29, 2013		June 23, 2012	
	3 months	9 months	3 months	9 months
North America (excluding the U.S.)		0.6%		
Central and South America				0.3%
Europe				
Mid-East and Africa	100%	99.4%	85.8%	93.9%
Far East			14.2%	5.8%

NOTE 6. Cash Equivalents and Marketable Securities

The Company considers all highly liquid instruments with an original maturity of three months or less to be cash equivalents. Substantially all cash equivalents are invested in money market mutual funds. Money market mutual funds held in a brokerage account are considered available-for-sale. The Company accounts for marketable securities in accordance with FASB ASC 320, *Investments - Debt and Equity Securities.* All marketable securities must be classified as one of the following: held-to-maturity, available-for-sale, or trading. The Company classifies its marketable securities as available-for-sale and, as such, carries the investments at fair value, with unrealized holding gains and losses reported in stockholders equity as a separate component of accumulated other comprehensive income (loss). The cost of securities sold is determined based on the specific identification method. Realized gains and losses, and declines in value judged to be other than temporary, are included in investment income. The purchase discount or premium is amortized to income or expense, respectively, over the life of the securities.

As of June 29, 2013, available-for-sale securities consisted of the following (unaudited):

	Cost	Accrued Interest	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
Money market funds	$ 337,673	$	$	$	$ 337,673
Certificates of deposit	2,493,054	1,989		5,172	2,489,871
Municipal bonds	1,921,692	27,817	1,368		1,950,877
	$ 4,752,419	$ 29,806	$ 1,368	$ 5,172	$ 4,778,421

The contractual maturities of these investments as of June 29, 2013 were as follows (unaudited):

	Cost	Fair Value
Within 1 year	$ 3,035,743	$ 3,034,021
After 1 year through 5 years	1,716,676	1,744,400
	$ 4,752,419	$ 4,778,421

The Company s available-for-sale securities were included in the following captions in the condensed consolidated balance sheets:

	June 29, 2013 (unaudited)	September 29, 2012
Cash and cash equivalents	$ 337,673	$ 361,584
Marketable securities	4,440,748	4,668,864
	$ 4,778,421	$ 5,030,448

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

Forward-Looking Statements

Certain statements contained herein or as may otherwise be incorporated by reference herein that are not purely historical constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Forward-looking statements include but are not limited to statements regarding anticipated operating results, future earnings, and the Company s ability to achieve growth and profitability. Such forward-looking statements involve known and unknown risks, uncertainties and other factors, including but not limited to future changes in export laws or regulations; changes in technology; the effect of foreign political unrest; the ability to hire, retain and motivate technical, management and sales personnel; the risks associated with the technical feasibility and market acceptance of new products; changes in telecommunications protocols; the effects of changing costs, exchange rates and interest rates; and the Company s ability to secure adequate capital resources. Such risks, uncertainties and other factors could cause the actual results, performance or achievements of the Company, or industry results, to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements. For a more detailed discussion of the risks facing the Company, see the Company s filings with the SEC, including its Quarterly Report on Form 10-Q for the quarters ended March 30, 2013 and December 29, 2012 and its Annual Report on Form 10-K for the fiscal year ended September 29, 2012.

Overview

The Company designs, manufactures, markets and sells communications security equipment that utilizes various methods of encryption to protect the information being transmitted. Encryption is a technique for rendering information unintelligible, which information can then be reconstituted if the recipient possesses the right decryption key . The Company manufactures several standard secure communications products and also provides custom-designed, special-purpose secure communications products for both domestic and international customers. The Company s products consist primarily of voice, data and facsimile encryptors. Revenue is generated principally from the sale of these products, which have traditionally been to foreign governments either through direct sale, pursuant to a U.S. government contract or made as a sub-contractor to domestic corporations under contract with the U.S. government. We have also sold these products to commercial entities and U.S. government agencies. We generate additional revenues from contract engineering services performed for certain government agencies, both domestic and foreign, and commercial entities.

Critical Accounting Policies and Significant Judgments and Estimates

There have been no material changes in the Company s critical accounting policies or critical accounting estimates since September 29, 2012, nor have we adopted any accounting policy that has or will have a material impact on our consolidated financial statements. For further discussion of our accounting policies see Note 1, *Summary of Significant Accounting Policies and Significant Judgments and Estimates* in the Notes to Condensed Consolidated Financial Statements in this Quarterly Report on Form 10-Q and the Notes to Consolidated Financial Statements in our Annual Report on Form 10-K for the fiscal year ended September 29, 2012 as filed with the SEC.

Results of Operations

Three Months ended June 29, 2013 as compared to Three Months ended June 23, 2012

Net Sales

Net sales for the quarter ended June 29, 2013 were $970,000, compared to $734,000 for the quarter ended June 23, 2012, an increase of 32%. Sales for the third quarter of fiscal 2013 consisted of $532,000, or 55%, from domestic sources and $438,000, or 45%, from international customers as compared to the same period in fiscal 2012, during which sales consisted of $377,000, or 51%, from domestic sources and $357,000, or 49%, from international customers.

Foreign sales consisted of shipments to four countries during the quarter ended June 29, 2013 and five countries during the quarter ended June 23, 2012. A sale is attributed to a foreign country based on the location of the contracting party. Domestic revenue may include the sale of products shipped through domestic resellers or manufacturers to international destinations. The table below summarizes our principal foreign sales by country during the third quarters of fiscal 2013 and 2012:

	2013	2012
Egypt	$ 149,000	$ 179,000
Saudi Arabia	287,000	123,000
Thailand		51,000
Other	2,000	4,000
	$ 438,000	$ 357.000

Revenue for the third quarter of fiscal 2013 was primarily derived from the sale of engineering services amounting to $400,000; we also had sales of our Ethernet IP encryptor for deployment into the Middle East amounting to $263,000, a spare parts order shipped to Egypt amounting to $149,000 and a domestic order for our narrowband radio encryptors amounting to $65,000.

Revenue for the third quarter of fiscal 2012 was primarily derived from the sale of the Company s narrowband radio encryptors to a U.S. radio manufacturer for deployment into Afghanistan amounting to $311,000 and to an additional domestic customer amounting to $55,000. In addition, we sold spare parts to two foreign customers amounting to $229,000 and we had sales of our frame relay and internet protocol encryptor products to two customers amounting to $122,000 during the period.

Gross Profit

Gross profit for the third quarter of fiscal 2013 was $593,000, compared to gross profit of $572,000 for the same period of fiscal 2012, a 4% increase. Gross profit expressed as a percentage of sales was 61% for the third quarter of fiscal 2013 and 78% for the third quarter of fiscal 2012. The decrease in the gross profit percentage was primarily the result of the sale of lower margin engineering services work during the quarter ended June 29, 2013.

Operating Costs and Expenses

Selling, General and Administrative Expenses

Selling, general and administrative expenses for the third quarter of fiscal 2013 were $739,000, compared to $788,000 for the same quarter of fiscal 2012. This decrease of $49,000 or 6% was attributable to a decrease in selling and marketing expenses of $55,000, offset by an increase in general and administrative expenses of $6,000 during the third quarter of the 2013 fiscal year.

The decrease in selling and marketing costs for the three months ended June 29, 2013 was primarily attributable to decreases in product evaluation costs of $26,000, personnel-related costs of $28,000, travel related costs of $21,000, product demonstration costs of $13,000 and outside consulting expenses of $13,000 for the period. These decreases were partially offset by increases in outside commissions and third party sales agreements amounting to $47,000.

The increase in general and administrative costs during the third quarter of 2013 was primarily attributable to an increase in outside consulting costs of $4,000 for the period.

Product Development Costs

Product development costs for the quarter ended June 29, 2013 were $586,000, compared to $1,350,000 for the quarter ended June 23, 2012, a decrease of $764,000 or 57%. The decrease was attributable to project development cost decreases in outside contractor costs of $359,000 and project material cost decreases of $39,000. During the quarter there was an increase of billable engineering services work, which decreased product development costs by $380,000. There were also decreases in recruiting costs of $30,000 and personnel-related costs of $30,000 during the third quarter of fiscal 2013. These decreases were partially offset by a decrease in engineering support of business development activities and a decrease in manufacturing support of engineering services, which increased product development costs by approximately $31,000 and $58,000, respectively for the period.

Product development costs are charged to billable engineering services, bid and proposal efforts or support of business development activities, as appropriate. Product development costs charged to billable projects are recorded as cost of sales, engineering costs charged to bid and proposal efforts are recorded as selling expenses, and product development costs charged to business development activities are recorded as marketing expenses.

The Company actively sells its engineering services in support of funded research and development. The receipt of these orders is sporadic, although such programs can span over several months. In addition to these programs, the Company also invests in research and development to enhance its existing products or to develop new products, as it deems appropriate. There was $400,000 of billable engineering services revenue generated during the third quarter of fiscal 2013 and no such revenue generated during the same period of fiscal 2012.

Net Income

The Company generated a net loss of $522,000 for the third quarter of fiscal 2013, compared to a net loss of $915,000 for the same period of fiscal 2012. This 43% decrease in net loss is primarily attributable to a 38% decrease in operating expenses, which was partially offset by a 69% decrease in income tax benefit recognized during the third quarter of fiscal 2013. The Company recorded an income tax benefit of $199,000 for the period based on its expected effective tax rate of 48% for the 2013 fiscal year. This compares to a tax benefit of $646,000 recorded in same period of fiscal 2012.

The Company recorded a net operating loss of $732,000 before accounting for such tax benefit for the third quarter of fiscal 2013, compared to a net operating loss of $1,566,000 for the same period of fiscal 2012. This 53% decrease in net operating loss is primarily attributable to a 38% decrease in operating expenses during the third quarter of fiscal 2013.

The effects of inflation and changing costs have not had a significant impact on sales or earnings in recent years. As of June 29, 2013, none of the Company s monetary assets or liabilities was subject to foreign exchange risks. The Company usually includes an inflation factor in its pricing when negotiating multi-year contracts with customers.

Nine Months ended June 29, 2013 as compared to Nine Months ended June 23, 2012

Net Sales

Net sales for the nine months ended June 29, 2013 were $3,112,000, compared to $6,791,000 for the nine months ended June 23, 2012, a decrease of 54%. Sales for the first nine months of fiscal 2013 consisted of $2,592,000, or 83%, from domestic sources and $520,000, or 17%, from international customers as compared to the same period in fiscal 2012, during which sales consisted of $5,907,000, or 87%, from domestic sources and $884,000, or 13%, from international customers.

Foreign sales consisted of shipments to five countries during the nine months ended June 29, 2013 and six countries for the nine months ended June 23, 2012. A sale is attributed to a foreign country based on the location of the contracting party. Domestic revenue may include the sale of products shipped through domestic resellers or manufacturers to international destinations.

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The table below summarizes our principal foreign sales by country during the first nine months of fiscal 2013 and 2012:

	2013	2012
Saudi Arabia	$ 360,000	$ 333,000
Jordan	7,000	316,000
Egypt	149,000	179,000
Other	4,000	56,000
	$ 520,000	$ 884,000

Revenue for the nine months ended June 29, 2013 was derived in part from the sale of the Company s narrowband radio encryptors to a U.S. radio manufacturer for deployment into Afghanistan amounting to $955,000. In addition, we sold engineering services amounting to $1,240,000 and we had sales of our link encryptor into the Middle East amounting to $204,000 during the period. We also had sales of our Ethernet IP encryptor for deployment into the Middle East amounting to $263,000, a spare parts order shipped to Egypt amounting to $149,000 and a domestic order for our narrowband radio encryptors amounting to $65,000. Royalty income for the first nine months of fiscal 2013 amounted to $45,000.

Revenue for the nine months ended June 23, 2012 was primarily derived from the sale of the Company s narrowband radio encryptors to a U.S. radio manufacturer for deployment into Afghanistan amounting to $5,682,000 and to an additional domestic customer amounting to $113,000. In addition we sold our secure telephone, fax, and data encryptors to a foreign customer amounting to $314,000 and we had sales of our frame relay and internet protocol encryptor products to three customers amounting to $225,000. We also had sales of our link encryptors into the Middle East for $93,000 and we sold spare parts to three foreign customers amounting to $287,000 during the first nine months of fiscal 2012.

Gross Profit

Gross profit for the first nine months of fiscal 2013 was $2,184,000, compared to gross profit of $5,211,000 for the same period of fiscal 2012. Gross profit expressed as a percentage of sales was 70% for the first nine months of fiscal 2013 and 77% for the first nine months of fiscal 2012. The decrease in the gross profit percentage was primarily the result of the sale of lower margin engineering services work during the nine months ended June 29, 2013.

Operating Costs and Expenses

Selling, General and Administrative Expenses

Selling, general and administrative expenses for the first nine months of fiscal 2013 were $2,210,000, compared to $2,525,000 for the same period of fiscal 2012. This decrease of $315,000 or12% was attributable to a decrease in selling and marketing expenses of $335,000, offset by an increase in general and administrative expenses of $20,000 during the first nine months of the 2013 fiscal year.

The decrease in selling and marketing costs for the nine months ended June 29, 2013 was primarily attributable to a decrease in product evaluation costs of $266,000, as well as decreases in personnel-related costs of $63,000, travel related costs of $63,000 and outside consulting costs of $42,000. These decreases were partially offset by an increase in outside commissions and sales and marketing agreements of $104,000 for the period.

The increase in general and administrative costs during the first nine months of 2013 was primarily attributable to increases in personnel-related costs of $63,000, recruiting fees of $22,000 and outside consulting costs of $4,000 for the period. These increases were partially offset by decreases in charitable contributions of $19,000 and professional and other public company fees of $65,000 for the nine months ended June 29, 2013.

Product Development Costs

Product development costs for the nine months ended June 29, 2013 were $2,231,000, compared to $3,299,000 for the nine months ended June 23, 2012, a decrease of $1,068,000 or 32%. The decrease was attributable to decreases in outside contractor costs of $625,000 and personnel-related costs of $35,000. There was also a decrease in recruiting costs of $80,000 and in project material costs of $26,000 during the first nine months of fiscal 2013. During the period there was an increase of billable engineering services work, which decreased product development costs by $698,000. These decreases were offset by a decrease in engineering support of business development activities and a decrease in manufacturing support of engineering services, which increased product development costs by approximately $159,000 and $249,000, respectively for the period.

Product development costs are charged to billable engineering services, bid and proposal efforts or support of business development activities, as appropriate. Product development costs charged to billable projects are recorded as cost of sales, engineering costs charged to bid and proposal efforts are recorded as selling expenses, and product development costs charged to business development activities are recorded as marketing expenses.

The Company actively sells its engineering services in support of funded research and development. The receipt of these orders is sporadic, although such programs can span over several months. In addition to these programs, the Company also invests in research and development to enhance its existing products or to develop new products, as it deems appropriate. There was $1,240,000 of billable engineering services revenue generated during the first nine months of fiscal 2013 and no such revenue generated during the same period of fiscal 2012.

Net Income

The Company generated a net loss of $1,160,000 for the first nine months of fiscal 2013, compared to a net loss of $352,000 for the same period of fiscal 2012. This 229% increase in net loss is primarily attributable to a 54% decrease in sales volume, which was partially offset by a 24% decrease in operating expenses during the first nine months of fiscal 2013. The Company recorded an income tax benefit of $1,068,000 during the first nine months of fiscal 2013 based on its expected effective tax rate of 48% for the 2013 fiscal year. This compares to a tax benefit of $253,000 recorded in the nine month period ended June 23, 2012.

The effects of inflation and changing costs have not had a significant impact on sales or earnings in recent years. As of June 29, 2013, none of the Company s monetary assets or liabilities was subject to foreign exchange risks. The Company usually includes an inflation factor in its pricing when negotiating multi-year contracts with customers.

Liquidity and Capital Resources

Cash and cash equivalents decreased by $1,065,000 to $991,000 as of June 29, 2013, from a balance of $2,056,000 at September 29, 2012. This decrease was primarily attributable to a net loss of $1,160,000, increases in income taxes receivable of $349,000 and inventories of $298,000, capital acquisitions of $88,000 and the payment of cash dividends of $184,000 during the first nine months of the year. This decrease was partially offset by a decrease in accounts receivable of $913,000.

As noted above the Company paid cash dividends of $184,000 during the first nine months of fiscal 2013. The payment of these dividends was based on the profits generated by the Company during prior periods. It is not the Company s intention to pay dividends on a regular basis unless future profits warrant such actions. The Board of Directors decided on December 6, 2012 that it would suspend consideration of future dividends until such time as the Company s revenue and profit performance justified it.

It is anticipated that our cash balances and cash generated from operations will be sufficient to fund our near-term research and development and marketing activities. We also believe that, in the long term, an anticipated improvement in business prospects, current billable activities and cash from operations will be sufficient to meet the development goals of the Company, although we can give no assurances. Although expected to continue to be depressed during the remainder of fiscal 2013, any material increase in activities - either billable or new product related - will require additional resources, which we may not be able to fund through cash from operations. In circumstances where resources will be insufficient, the Company will look to other sources of financing, including debt and/or equity investments.

Backlog at June 29, 2013 and June 23, 2012 amounted to $4,852,000 and $1,316,000, respectively. The orders in backlog at June 29, 2013 are expected to ship over the next six months depending on customer requirements and product availability.

The Company has a line of credit agreement with Bank of America (the Bank) for a line of credit not to exceed the principal amount of $600,000. The line is supported by a financing promissory note. The loan is a demand loan with interest payable at the Bank s prime rate plus 1% on all outstanding balances. The loan is secured by all assets of the Company (excluding consumer goods) and requires the Company to maintain its deposit accounts with the Bank, as well as comply with certain other covenants. As a result of the Company s failure to comply with its tangible net worth covenant with respect to the line of credit, the parties amended the agreement on February 8, 2013 to lower the tangible net worth requirement. In addition, the line is now only available to support new letters of credit issued by the Company. Future standby letters of credit will be required to be secured with cash. There were no cash borrowings against the line during the nine months ended June 29, 2013, or the fiscal year ended September 29, 2012. However, a standby letter of credit in the amount of $14,903 was issued in December 2012 and is secured by the line of credit with the Bank as noted.

Certain foreign customers require the Company to guarantee bid bonds and performance of products sold. These guaranties typically take the form of standby letters of credit. Guaranties are generally required in amounts of 5% to 10% of the purchase price and last in duration from three months to one year. At June 29, 2013, the Company had two outstanding letters of credit amounting to $32,786, one of which is secured by a cash certificate of deposit amounting to $17,883. The second in the amount of $14,903 is secured by the Company s line of credit as noted above.

In April 2007, the Company entered into a lease for its current facilities. This lease is for 22,800 square feet located at 100 Domino Drive, Concord, MA. The Company has been a tenant in this space since 1983. This is the Company s only facility and houses all manufacturing, research and development, and corporate operations. The initial term of the lease was for five years through March 31, 2012 at an annual rate of $159,000. In addition the lease contains options to extend the lease for two and one half years through September 30, 2014 and another two and one half years through March 31, 2017, at an annual rate of $171,000. Rent expense for the nine month periods ended June 29, 3013 and June 23, 2012 was $128,000 and $122,000, respectively. On September 30, 2011 the Company exercised its option to extend the lease for the period April 1, 2012 through September 30, 2014.

In fiscal 2012, the Company s internal product development expenses were higher than prior years but in line with its planned commitment to research and development, and reflected the costs of product testing and production readiness efforts. During the first nine months of fiscal 2013, development expenses decreased by 32% as compared to fiscal 2012. This trend is expected to continue during the remainder of fiscal 2013, with development expenses for the year expected to be approximately 34% lower than fiscal year 2012. It is expected that research and development expenses in fiscal 2014 will be lower than in fiscal 2013 given that planned major product developments will be complete. Nevertheless, there will continue to be significant technical effort focused on product enhancements and applications engineering in support of specific business development and sales initiatives.

By the end of fiscal 2013, the Company anticipates completing the development of three new products - the HSE 6000 radio encryptor, the Cipher X 7211 100Mbs - 1Gbs IP Encryptor (CX7211) and the DSD 72B Optical Encryptor - and continue the process of reorienting some of its development investment toward collaborative product developments with major original equipment manufacturers (OEMs). The Company began establishing these technical partnerships in 2012, which continue to develop albeit at a slower pace than originally projected. TCC believes that the resulting products will be imbedded proprietary encryption solutions that will significantly enhance the value of the OEMs products and allow TCC encryption to be carried to the market by major equipment providers.

HSE 6000: In 2013, the Company will have completed development and pilot production of the HSE 6000, a low-cost, battery-powered man-borne encryptor that provides highly secure communications between personnel and base command units. The HSE 6000 is designed for the rugged environments of military and police operations and can function with most VHF and HF radios systems. The HSE 6000 can interoperate with the TCC DSP 9000 Radio Encryption System which is deployed extensively throughout the world. Customer demonstrations have been conducted in several countries. The HSE6000 has several derivative forms that are being considered for research and development investment in 2014.

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CX7211: The Company also anticipates completing in fiscal 2013 the major development of an advanced, 100Mbs through 1Gbs IP encryptor and the KEYNET Management system to service private network markets for government, military and satellite users. The initial release of this new network product, named the CX7211, has been sold and installed in selected customer networks with excellent results. The CX7211 allows its throughput capacity to be easily increased as network loads increase. TCC believes this feature makes the CX7211 very cost-effective for new installations and very easy to expand when the market demands it. TCC is continuing with the development of new software features for the CX7211 that will expand the system s capabilities and applications.

With the completion of these new products, the Company expects to focus its technical efforts going forward on three principal areas: development of solutions that meet the needs of OEMs; product enhancements that include expanded features, planned capability and applications growth; and product customizations that tailor our products to meet the unique needs of our customers. TCC believes that we either have or can obtain the personnel and capital resources needed to accomplish these objectives.

Other than those stated above, there are no plans for significant internal product development or significant capital expenditures during the remainder of fiscal 2013.

Off-Balance Sheet Arrangements

The Company does not have any off-balance sheet arrangements.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Not applicable.

Item 4. Controls and Procedures

Evaluation of disclosure controls and procedures. The Company s chief executive officer and chief financial officer have reviewed and evaluated the effectiveness of the Company s disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) promulgated under the Securities Exchange Act of 1934, as amended (the Exchange Act)) as of the end of the period covered by this quarterly report. Based on that review and evaluation, the chief executive officer and chief financial officer have concluded that the Company s current disclosure controls and procedures, as designed and implemented, are effective to ensure that such officers are provided with information relating to the Company required to be disclosed in the reports the Company files or submits under the Exchange Act and that such information is recorded, processed, summarized and reported within the specified time periods.

Changes in internal control over financial reporting. There were no changes in the Company s internal control over financial reporting that occurred during the quarter ended June 29, 2013 that have materially affected, or are reasonably likely to materially affect, the Company s internal control over financial reporting.

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PART II. Other Information

Item 1. Legal Proceedings

There were no legal proceedings pending against or involving the Company or its subsidiary during the period covered by this quarterly report.

Item 1A. Risk Factors

Not applicable.

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

Not applicable.

Item 3. Defaults Upon Senior Securities

Not applicable.

Item 4. Mine Safety Disclosures

Not applicable.

Item 5. Other Information

Not applicable.

Item 6. Exhibits

10.1	Contract with U.S. Army Contracting Command, dated May 2, 2013, contract No. W15P7T-13-C-D519 (*Confidential portions of this exhibit have been omitted and filed separately with the Securities and Exchange Commission pursuant to a request for confidential treatment.)*
31.1	Certification of principal executive officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of principal financial officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1	Certifications of Chief Executive and Chief Financial Officers pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
101.INS	XBRL Report Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Calculation Linkbase Document
101.LAB	XBRL Taxonomy Label Linkbase Document
101.PRE	XBRL Presentation Linkbase Document

101.DEF	XBRL Taxonomy Extension Definition Linkbase Document

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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.

	TECHNICAL COMMUNICATIONS CORPORATION (Registrant)
August 13, 2013 Date	By: /s/ Carl H. Guild, Jr. Carl H. Guild, Jr., President and Chief Executive Officer
August 13, 2013 Date	By: /s/ Michael P. Malone Michael P. Malone, Chief Financial Officer