TECHNICAL COMMUNICATIONS CORP
Form 10-Q
May 13, 2014

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 March 29, 2014

¨ **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. 1,838,921 shares of Common Stock, $0.10 par value, outstanding as of May 9, 2014.

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TECHNICAL COMMUNICATIONS CORPORATION AND SUBSIDIARIES

Condensed Consolidated Balance Sheets

(Unaudited)

	March 29, 2014	September 28, 2013
Assets		
Current Assets:		
Cash and cash equivalents	$ 2,743,803	$ 2,810,923
Marketable securities		
Available for sale securities	2,577,833	1,247,384
Held to maturity securities	616,196	522,856
Accounts receivable - trade, less allowance of $25,000 at March 29, 2014 and September 28, 2013	250,843	1,375,764
Inventories	2,129,000	2,618,604
Income taxes receivable	728,900	723,988
Deferred income taxes		894,459
Other current assets	234,585	225,583
Total current assets	9,281,160	10,419,561
Marketable securities		
Held to maturity securities	1,335,040	1,462,622
Equipment and leasehold improvements	4,400,665	4,300,304
Less: accumulated depreciation and amortization	(3,927,124)	(3,831,402)
Equipment and leasehold improvements, net	473,541	468,902
Total Assets	$ 11,089,741	$ 12,351,085
Liabilities and Stockholders Equity		
Current Liabilities:		
Accounts payable	$ 159,308	$ 261,588
Customer deposits	357,294	259,602
Accrued liabilities:		
Accrued compensation and related expenses	190,147	241,003
Accrued expenses	110,304	166,848
Total current liabilities	817,053	929,041
Commitments and contingencies		

Stockholders Equity:		
Common stock, par value $0.10 per share; 7,000,000 shares authorized; 1,838,921 and 1,838,716 shares issued and outstanding at March 29, 2014 and September 28, 2013	183,892	183,872
Additional paid-in capital	3,912,631	3,774,759
Accumulated other comprehensive loss	(6,889)	(2,020)
Retained earnings	6,183,054	7,465,433
Total stockholders equity	10,272,688	11,422,044
Total Liabilities and Stockholders Equity	$ 11,089,741	$ 12.351,085

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

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TECHNICAL COMMUNICATIONS CORPORATION AND SUBSIDIARIES

Condensed Consolidated Statements of Operations

(Unaudited)

	Three Months Ended	
	March 29, 2014	**March 30, 2013**
Net sales	$ 1,293,478	$ 545,759
Cost of sales	337,592	56,408
Gross profit	955,886	489,351
Operating expenses:		
Selling, general and administrative	841,988	692,645
Product development	765,852	789,398
Total operating expenses	1,607,840	1,482,043
Operating loss	(651,954)	(992,692)
Other income:		
Interest income	6,491	9,052
Loss before provision (benefit) for income taxes	(645,463)	(983,640)
Provision (benefit) for income taxes	821,066	(655,673)
Net loss	$ (1,466,529)	$ (327,967)
Net loss per common share:		
Basic	$ (0.80)	$ (0.18)
Diluted	$ (0.80)	$ (0.18)
Weighted average shares:		
Basic	1,838,907	1,838,716
Diluted	1,838,907	1,838,716

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

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TECHNICAL COMMUNICATIONS CORPORATION AND SUBSIDIARIES

Condensed Consolidated Statements of Operations

(Unaudited)

	Six Months Ended	
	March 29, 2014	**March 30, 2013**
Net sales	$ 3,802,198	$ 2,142,455
Cost of sales	1,126,452	551,372
Gross profit	2,675,746	1,591,083
Operating expenses:		
Selling, general and administrative	1,549,106	1,470,542
Product development	1,527,737	1,644,809
Total operating expenses	3,076,843	3,115,351
Operating loss	(401,097)	(1,524,268)
Other income:		
Interest income	13,176	16,326
Loss before provision (benefit) for income taxes	(387,921)	(1,507,942)
Provision (benefit) for income taxes	894,458	(869,785)
Net loss	$ (1,282,379)	$ (638,157)
Net loss per common share:		
Basic	$ (0.70)	$ (0.35)
Diluted	$ (0.70)	$ (0.35)
Weighted average shares:		
Basic	1,838,812	1,838,716
Diluted	1,838,812	1,838,716
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 SUBSIDIARIES

Condensed Consolidated Statements of Comprehensive Loss

(Unaudited)

	Three Months Ended	
	March 29, 2014	March 30, 2013
Net loss	$ (1,466,529)	$ (327,967)
Unrealized (loss) gain on available for sale securities, net of tax	(455)	5,154
Comprehensive loss	$ (1,466,984)	$ (322,813)

	Six Months Ended	
	March 29, 2014	March 30, 2013
Net loss	$ (1,282,379)	$ (638,157)
Unrealized (loss) gain on available for sale securities, net of tax	(4,869)	4,152
Comprehensive loss	$ (1,287,248)	$ (634,005)

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

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TECHNICAL COMMUNICATIONS CORPORATION AND SUBSIDIARIES

Condensed Consolidated Statements of Cash Flows

(Unaudited)

	Six Months Ended	
	March 29, 2014	**March 30, 2013**
Operating Activities:		
Net loss	$ (1,282,379)	$ (638,157)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation and amortization	101,897	100,852
Share-based compensation	138,878	126,538
Deferred income taxes	894,459	(112,730)
Amortization of premium on held to maturity securities	32,924	33,170
Changes in certain operating assets and liabilities:		
Accounts receivable	1,124,921	540,063
Inventories	489,604	60,497
Income taxes receivable	(4,912)	(401,499)
Other current assets	(9,002)	(116,228)
Customer deposits	97,692	27,320
Accounts payable and other accrued liabilities	(210,666)	(138,162)
Net cash provided by (used in) operating activities	1,373,416	(518,336)
Investing Activities:		
Additions to equipment and leasehold improvements	(106,536)	(48,878)
Proceeds from maturities of marketable securities	1,245,000	1,361,732
Purchases of marketable securities	(2,579,000)	(59,776)
Net cash (used in) provided by investing activities	(1,440,536)	1,253,078
Financing Activities:		
Dividends paid		(183,872)
Net cash used in financing activities		(183,872)
Net (decrease) increase in cash and cash equivalents	(67,120)	550,870
Cash and cash equivalents at beginning of the period	2,810,923	2,056,311

Cash and cash equivalents at end of the period	$ 2,743,803	$ 2,607,181
Supplemental Disclosures:		
Interest paid	$	$
Income taxes paid	4,942	506

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

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TECHNICAL COMMUNICATIONS CORPORATION AND SUBSIDIARIES

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 27, 2014.

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 Annual Report on Form 10-K for the fiscal year ended September 28, 2013 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 judgments 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, marketable 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. By their nature estimates are subject to an inherent degree of uncertainty. Actual results may differ from these estimates under different assumptions or conditions.

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.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Cont d)

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 cost 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 date 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 March 29, 2014 and September 28, 2013 was $25,000.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Cont d)

Marketable Securities

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 holds certain marketable securities classified as available for sale or held to maturity. The available for sale investments are valued 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 Company s held to maturity securities, comprised of investments in municipal bonds, are valued at amortized cost. 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 condensed 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, reserves on accounts receivable and inventory, as well as depreciation differences 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 approximately $2.1 million as of March 29, 2014 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, which 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, and it is not anticipated that we will be subject to foreign taxes in the near future.

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 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.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Cont d)

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 holds certain marketable securities classified as available for sale. These available for sale securities are comprised of 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 & Poor s, Bloomberg, etc.), or in the case of mutual funds, at their closing net asset value.

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 three and six month periods ended March 29, 2014, 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 March 29, 2014 and September 28, 2013, in accordance with the fair value hierarchy as defined above. As of March 29, 2014 and September 28, 2013, the Company did not hold any assets classified as Level 3.

	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)
March 29, 2014 (Unaudited)			
Certificates of deposits:			
Certificates of deposit	$ 2,577,833	$	$ 2,577,833
Total debt instruments	2,577,833		2,577,833
Mutual funds:			
Money market funds	589,781	589,781	
Total mutual funds	589,781	589,781	
Total investments	$ 3,167,614	$ 589,781	$ 2,577,833
September 28, 2013			
Certificates of deposits:			

Certificates of deposit	$ 1,247,384	$	$ 1,247,384
Total debt instruments	1,247,384		1,247,384
Mutual funds:			
Money market funds	880,230	880,230	
Total mutual funds	880,230	880,230	
Total investments	$ 2,127,614	$ 880,230	$ 1,247,384

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Cont d)

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 March 29, 2014 and September 28, 2013, 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.

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 participant 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. There were no excess tax benefits recorded during the three and six month periods ended March 29, 2014 and March 30, 2013.

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 Six Months Ended	
	March 29, 2014	**March 30, 2013**
Option term	6.5 years	6.5 years
Risk-free interest rate	1.33% to 1.53%	0.71% to 0.79%
Stock price volatility	60% to 65%	66%
Dividend yield		

There were 14,200 options granted during the six months ended March 29, 2014, and 16,500 options granted during the six months ended March 30, 2013. The weighted average grant date fair value for the options granted during the six month periods ended March 29, 2014 and March 30, 2013 was $4.53 and $2.89, respectively.

The following table summarizes share-based compensation costs included in the Company s condensed consolidated income statements for the three and six month periods ended March 29, 2014 and March 30, 2013 (unaudited):

	March 29, 2014		March 30, 2013	
	3 months	**6 months**		**6 months**

			3 months	
Cost of sales	$ 4,079	$ 8,158	$ 4,074	$ 8,148
Selling, general and administrative expenses	75,360	87,290	51,810	63,777
Product development expenses	21,165	43,430	25,739	54,613
Total share-based compensation expense before taxes	$ 100,604	$ 138,878	$ 81,623	$ 126,538

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Cont d)

As of March 29, 2014 and September 28, 2013, there was $210,558 and $289,838, respectively, of unrecognized compensation cost related to options granted. The unrecognized compensation cost will be recognized over the remaining requisite service period. As of March 29, 2014, the weighted average period over which the compensation cost is expected to be recognized is 1.7 years.

The Company had the following stock option plans outstanding as of March 29, 2014: 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 750,000 shares authorized for issuance under these plans, of which options to purchase 268,185 shares were outstanding at March 29, 2014. Vesting periods for options 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 March 29, 2014, there were no shares available for new option grants under the 2001 Stock Option Plan, there were 19,723 shares available for grant under the 2005 Non-Statutory Stock Option Plan and there were 56,903 shares available for grant under the 2010 Equity Incentive Plan.

The following table summarizes stock option activity during the first six months of fiscal 2014 (unaudited):

	Options Outstanding				
	Number of Shares			Weighted Average	Weighted Average
	Unvested	**Vested**	**Total**	**Exercise Price**	**Contractual Life**
Outstanding, September 28, 2013	60,488	197,094	257,582	$ 8.83	6.21 years
Grants	200		200	7.65	
Vested	(1,600)	1,600		8.02	
Cancellations/forfeitures					
Outstanding, December 28, 2013	59,088	198,694	257,782	$ 8.83	5.96 years
Grants		14,000	14,000	7.65	
Vested	(900)	900		6.55	
Exercises		(900)	(900)	5.00	
Cancellations/forfeitures	(1,079)	(1,618)	(2,697)	11.51	
Outstanding, March 29, 2014	57,109	211,076	268,185	$ 8.75	5.93 years

Information related to the stock options vested and expected to vest as of March 29, 2014 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	1.44	$ 3.00	15,288	$ 3.00
$ 3.01 - $ 4.00	16,600	2.33	$ 3.66	16,600	$ 3.66
$ 4.01 - $ 5.00	28,000	7.05	$ 4.78	26,700	$ 4.78
$ 5.01 - $10.00	68,600	6.20	$ 7.48	65,080	$ 7.45
$ 10.01 - $15.00	139,697	6.50	$ 11.41	87,408	$ 11.36
	268,185	5.93	$ 8.75	211,076	$ 8.11

The aggregate intrinsic value of the Company s in-the-money outstanding and exercisable options as of March 29, 2014 and September 28, 2013 was $138,632 and $159,521, respectively. Unvested common stock options are subject to the risk of forfeiture until the fulfillment of specified conditions.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Cont d)

NOTE 2. Inventories

Inventories consisted of the following:

	March 29, 2014 (unaudited)	September 28, 2013
Finished goods	$ 10,295	$ 10,295
Work in process	685,886	1,110,169
Raw materials	1,432,819	1,498,140
	$ 2,129,000	$ 2,618,604

NOTE 3. Income Taxes

During the three months ended March 29, 2014, the Company established a valuation allowance against deferred tax assets and as a result recorded an income tax provision for the six month period ended March 29, 2014 of $894,458. The valuation allowance is related to uncertainty with respect to the Company s ability to realize its deferred tax assets. Deferred tax assets consist of net operating loss carryforwards, tax credits, inventory differences and other temporary differences.

During the six months ended March 30, 2013, the Company recorded an income tax benefit of $869,785 based on its expected effective tax rate for its fiscal year. The effective tax rate for the first six months of fiscal year 2013 was increased to 57.7% from 41% in the first quarter of fiscal 2013 due to a revision of the full year pre-tax forecast in the second 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 six months ended March 30, 2013, was 50%.

NOTE 4. Earnings Per Share

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

	March 29, 2014		March 30, 2013	
	3 months	6 months	3 months	6 months
Net loss	$ (1,466,529)	$ (1,282,379)	$ (327,967)	$ (638,157)
Weighted average shares outstanding - basic	1,838,907	1,838,812	1,838,716	1,838,716

Dilutive effect of stock options								
Weighted average shares outstanding-diluted		1,838,907		1,838,812		1,838,716		1,838,716
Basic net loss per share	$	(0.80)	$	(0.70)	$	(0.18)	$	(0.35)
Diluted net loss per share	$	(0.80)	$	(0.70)	$	(0.18)	$	(0.35)

Outstanding potentially dilutive stock options, which were not included in the earnings per share calculations because their inclusion would have been anti-dilutive due to the Company s loss position, were 268,185 at March 29, 2014 and 258,182 at March 30, 2013.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Cont d)

NOTE 5. Major Customers and Export Sales

During the three months ended March 29, 2014, the Company had one customer that represented 70% of net sales as compared to the three months ended March 30, 2013, during which two customers represented 97% (73% and 24%, respectively) of net sales. During the six months ended March 29, 2014, the Company had three customers that represented 81% (46%, 24% and 11%, respectively) of net sales as compared to the six month period ended March 30, 2013, during which two customers represented 86% (45% and 41%, respectively) of net sales.

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

	March 29, 2014		March 30, 2013	
	3 months	6 months	3 months	6 months
Domestic	$ 1,262,434	$ 3,525,188	$ 542,699	$ 2,059,652
Foreign	31,044	277,010	3,060	82,803
Total sales	$ 1,293,478	$ 3,802,198	$ 545,759	$ 2,142,455

The Company sold products into one country during each of the three month periods ended March 29, 2014 and March 30, 2013. The Company sold products into two countries during the six month period ended March 29, 2014 and three countries during the six month period ended March 30, 2013. 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).

	March 29, 2014		March 30, 2013	
	3 months	6 months	3 months	6 months
Colombia		89%		
Saudi Arabia	100%	11%		88%
Mexico			100%	4%
Jordan				8%

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

	March 29, 2014		March 30, 2013	
	3 months	6 months	3 months	6 months
North America (excluding the U.S.)			100%	4%
Central and South America		89%		
Europe				
Mid-East and Africa	100%	11%		96%
Far East				

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 either available for sale or held to maturity. Available for sale securities are carried at fair value, with unrealized holding gains and losses reported in stockholders equity as a separate component of accumulated other comprehensive income (loss). Held to maturity securities are carried at amortized cost. 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. During fiscal year 2013, the Company determined it would hold its investment in municipal bonds until maturity and subsequently reclassified these securities from available for sale to held to maturity. These securities are now carried at amortized cost.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Cont d)

As of March 29, 2014, available for sale securities consisted of the following (unaudited):

	Cost	Accrued Interest	Gross Gains	Unrealized Losses	Estimated Fair Value
Money market funds	$ 589,781	$	$	$	$ 589,781
Certificates of deposit	2,582,020	2,702		6,889	2,577,833
	$ 3,171,801	$ 2,702	$	$ 6,889	$ 3,167,614

As of March 29, 2014, held to maturity securities consisted of the following (unaudited):

	Cost	Accrued Interest	Amortization Bond Premium	Amortized Cost	Unrealized Gains	Estimated Fair Value
Municipal bonds	$ 2,056,276	$ 24,428	$ 129,468	$ 1,951,236	$ 13,467	$ 1,964,703

As of September 28, 2013, available for sale securities consisted of the following:

	Cost	Accrued Interest	Gross Gains	Unrealized Losses	Estimated Fair Value
Money market funds	$ 880,230	$	$	$	$ 880,230
Certificates of deposit	1,248,043	1,186		1,845	1,247,384
	$ 2,128,273	$ 1,186	$	$ 1,845	$ 2,127,614

As of September 28, 2013, held to maturity securities consisted of the following:

	Cost	Accrued Interest	Amortization Bond Premium	Amortized Cost	Unrealized Gains	Estimated Fair Value
Municipal bonds	$ 2,056,276	$ 24,087	$ 94,885	$ 1,985,478	$ 10,425	$ 1,995,903

The contractual maturities of available for sale investments as of March 29, 2014 were all due within eighteen months. The contractual maturities of held to maturity investments as of March 29, 2014 were as follows (unaudited):

Cost	Amortized Cost

Within 1 year	$ 661,011	$ 616,196
After 1 year through 5 years	1,395,265	1,335,040
	$ 2,056,276	$ 1,951,236

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

	March 29, 2014 (unaudited)	**September 28, 2013**
Cash and cash equivalents	$ 589,781	$ 880,230
Marketable securities	2,577,833	1,247,384
	$ 3,167,614	$ 2,127,614

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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 the effect of foreign political unrest; domestic and foreign government policies and economic conditions; future changes in export laws or regulations; changes in technology; 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 Annual Report on Form 10-K for the fiscal year ended September 28, 2013.

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 28, 2013, 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 28, 2013 as filed with the SEC.

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Results of Operations

Three Months ended March 29, 2014 as compared to Three Months ended March 30, 2013

Net Sales

Net sales for the quarter ended March 29, 2014 were $1,293,000, compared to $546,000 for the quarter ended March 30, 2013, an increase of 137%. Sales for the second quarter of fiscal 2014 consisted of $1,262,000, or 98%, from domestic sources and $31,000, or 2%, from international customers as compared to the same period in fiscal 2013, during which sales consisted of $543,000, or 99%, from domestic sources and $3,000, or 1%, from international customers.

Foreign sales consisted of shipments to one country during each of the quarters ended March 29, 2014 and March 30, 2013. 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 second quarters of fiscal 2014 and 2013:

	2014	2013
Saudi Arabia	$ 31,000	
Mexico		$ 3,000
	$ 31,000	$ 3,000

For the three months ended March 29, 2014, product sales revenue was derived primarily from shipments of our narrowband radio encryptors to a U.S. radio manufacturer for deployment into Afghanistan amounting to $908,000. The Company also made shipments of our narrowband radio encryptors, and supplied customized cryptographic services and tools and training, for a domestic prime contractor supporting a government customer in North Africa amounting to $144,000 during the quarter. We also had royalty sales to a domestic radio manufacturer for $105,000.

Revenue for the second quarter of fiscal 2013 was primarily derived from the sale of engineering services amounting to $400,000; we also had sales of our link encryptor to a domestic contractor for deployment into the Middle East amounting to $130,000.

Gross Profit

Gross profit for the second quarter of fiscal 2014 was $956,000, compared to gross profit of $489,000 for the same period of fiscal 2013. Gross profit expressed as a percentage of sales was 74% for the second quarter of fiscal 2014 and 90% for the second quarter of fiscal 2013. The 96% dollar value increase in gross profit was the result of the higher sales volume during the quarter ended March 29, 2014.

Operating Costs and Expenses

Selling, General and Administrative Expenses

Selling, general and administrative expenses for the second quarter of fiscal 2014 were $842,000, compared to $693,000 for the same quarter in fiscal 2013. This increase of $149,000, or 22%, was attributable to an increase in selling and marketing expenses of $55,000 and an increase in general and administrative expenses of $94,000 during the second quarter of the 2014 fiscal year.

The increase in selling and marketing expenses for the three months ended March 29, 2014 was primarily attributable to increases in trade show, travel and product demonstration costs of $42,000, outside consulting costs of $27,000, and engineering sales support expenses of $53,000 during the quarter. These increases were partially offset by a decrease in product evaluation costs of $38,000 and a decrease in bid and proposal efforts of $20,000.

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The increase in general and administrative costs during the second quarter of 2014 was attributable to increases in personnel-related costs of $38,000, charitable contributions of $30,000 and professional and other public company fees of $31,000 for the period.

Product Development Costs

Product development costs for the quarter ended March 29, 2014 were $766,000, compared to $789,000 for the quarter ended March 30, 2013, a decrease of $23,000 or 3%. The decrease was attributable to decreases in outside contractor costs of $20,000, project material costs of $19,000 and personnel-related costs of $29,000. The decrease was partially offset by a decrease in engineering support of sales and business development activities, which resulted in increased product development costs of approximately $45,000.

Engineering department costs are charged to product development, billable engineering services, bid and proposal efforts or support of business development activities, as appropriate. Engineering department costs charged to billable projects are recorded as cost of sales; engineering department costs charged to bid and proposal efforts are recorded as selling expenses; and engineering department 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 no billable engineering services revenue generated during the second quarter of fiscal 2014 compared with $400,000 of billable engineering services revenue generated during the second quarter of fiscal 2013.

Net Income

The Company generated a net loss of $1,467,000 for the second quarter of fiscal 2014, compared to a net loss of $328,000 for the same period of fiscal 2013. This 347% increase in net loss is primarily attributable to a 225% increase in the income tax provision and an 8% increase in operating expenses, partially offset by a 137% increase in sales volume during the second quarter of fiscal 2014. During the three months ended March 29, 2014, the Company established a valuation allowance against deferred tax assets and as a result recorded an income tax provision for the six month period ended March 29, 2014 of $821,000. This compares to an income tax benefit of $656,000 during the second quarter of fiscal 2013 based on an expected effective tax rate of 57.7% for the six month period ended March 30, 2013.

The effects of inflation and changing costs have not had a significant impact on sales or earnings in recent years. As of March 29, 2014, 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.

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Six Months ended March 29, 2014 as compared to Six Months ended March 30, 2013

Net Sales

Net sales for the six months ended March 29, 2014 were $3,802,000, compared to $2,142,000 for the six months ended March 30, 2013, an increase of $1,660,000 or 77%. Sales for the first six months of fiscal 2014 consisted of $3,525,000, or 93%, from domestic sources and $277,000, or 7%, from international customers as compared to the same period in fiscal 2013, during which sales consisted of $2,060,000, or 96%, from domestic sources and $82,000, or 4%, from international customers.

Foreign sales consisted of shipments to two countries during the six months ended March 29, 2014 and three countries during the six months ended March 30, 2013. 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 first six months of fiscal 2014 and 2013:

	2014	2013
Colombia	$ 245,000	$
Saudi Arabia	32,000	74,000
Other		8,000
	$ 277,000	$ 82,000

For the six months ended March 29, 2014, product sales revenue was derived from the Company making additional shipments, amounting to $1,764,000, to the U.S. Army Communications and Electronics Command to upgrade the DSD 72A-SP military bulk encryption system currently in use by the Government of Egypt. The Company also made shipments of our narrowband radio encryptors to a U.S. radio manufacturer for deployment into Afghanistan amounting to $908,000 during the period. The Company made shipments of our narrowband radio encryptors, and supplied customized cryptographic services and tools and training, for a domestic prime contractor supporting a government customer in North Africa amounting to $408,000 during the period. In addition, we sold our secure telephone, fax, and data encryptors to a foreign customer amounting to $246,000. The Company also made shipments of our narrowband radio encryptors to supply the secure radio and telephone encryption solutions for a domestic customer supporting a government customer in North Africa amounting to $220,000 during the period. We also had royalty sales of $120,00 during the six months ended March 29, 2014 to a domestic radio manufacturer.

Revenue for the first six months of fiscal 2013 was derived 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 $840,000 and we had sales of our link encryptor into the Middle East amounting to $204,000. Royalty income for the six months ended March 30, 2013 amounted to $43,000.

Gross Profit

Gross profit for the first six months of fiscal 2014 was $2,676,000, compared to gross profit of $1,591,000 for the same period of fiscal 2013. Gross profit expressed as a percentage of sales was 70% for the first six months of fiscal 2014 and 74% for the first six months of fiscal 2013. The 68% dollar value increase in gross profit was the result of the higher sales volume during the six months ended March 29, 2014.

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Operating Costs and Expenses

Selling, General and Administrative Expenses

Selling, general and administrative expenses for the first six months of fiscal 2014 were $1,549,000, compared to $1,471,000 for the same period in fiscal 2013. This increase of $78,000, or 5%, was attributable to an increase in general and administrative expenses of $115,000, partially offset by a decrease in selling and marketing expenses of $37,000 during the first six months of the 2014 fiscal year.

The decrease in selling and marketing expenses for the six months ended March 29, 2014 was primarily attributable to decreases in product evaluation costs of $111,000, bid and proposal efforts of $21,000 and outside sales and marketing agreements of $18,000. These decreases were offset by increases in trade show, travel and product demonstration costs of $47,000, an increase in engineering sales support expenses of $32,000 and an increase in outside consulting services of $29,000 during the period.

The increase in general and administrative costs during the first six months of 2014 was primarily attributable to increases in personnel-related costs of $82,000 and professional and other public company fees of $49,000 for the period. These increases were partially offset by a decrease in recruiting costs of $21,000 during the period.

Product Development Costs

Product development costs for the six months ended March 29, 2014 were $1,528,000, compared to $1,645,000 for the six months ended March 30, 2013, a decrease of $117,000 or 7%. The decrease was attributable to project development cost decreases in outside contractor costs of $162,000, project material costs of $54,000 and personnel-related costs of $48,000. The decrease was partially offset by a decrease in engineering support of sales and business development activities, which resulted in increased product development costs of approximately $156,000.

Engineering department costs are charged to product development, billable engineering services, bid and proposal efforts or support of business development activities, as appropriate. Engineering department costs charged to billable projects are recorded as cost of sales; engineering department costs charged to bid and proposal efforts are recorded as selling expenses; and engineering department 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 no billable engineering services revenue generated during the first six months of fiscal 2014 compared with $840,000 of billable engineering services revenue generated during the first six months of fiscal 2013.

Net Income

The Company generated a net loss of $1,282,000 for the first six months of fiscal 2014, compared to a net loss of $638,000 for the same period of fiscal 2013. This 101% increase in net loss is primarily attributable to a 203% increase in the income tax provision, partially offset by a 77% increase in sales volume during the first six months of fiscal 2014. During the six months ended March 29, 2014, the Company established a valuation allowance against deferred tax assets and as a result recorded an income tax provision for the six month period ended March 29, 2014 of $894,000. This compares to an income tax benefit of $870,000 for the first six months of fiscal 2013 based on an expected effective tax rate of 57.7% for the period.

The effects of inflation and changing costs have not had a significant impact on sales or earnings in recent years. As of March 29, 2014, 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.

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Liquidity and Capital Resources

We believe that our overall financial condition remains strong. Our cash, cash equivalents and marketable securities at March 29, 2014 totaled $7,273,000 compared with $6,044,000 at September 28, 2013. We continue to have no long-term debt and do not expect to incur any significant indebtedness in the near future. 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.

Cash Requirements

We believe that the combination of existing cash, cash equivalents, and highly liquid short-term investments, together with future cash to be generated by operations, will be sufficient to meet our ongoing operating and capital expenditure requirements for the foreseeable future. We also believe that, in the long term, an anticipated improvement of business prospects, billable activities and cash from operations will be sufficient to fund the Company s planned investment in product development, although we can give no assurances. Although expected to decrease in fiscal 2014, any increase in development 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.

Sources and Uses of Cash

The following table presents our abbreviated cash flows for the six month periods ended:

	March 29, 2014 (Unaudited)	March 30, 2013 Unaudited)
Net loss	$ (1,282,000)	$ (638,000)
Changes not affecting cash	1,168,000	148,000
Changes in assets and liabilities	1,487,000	(28,000)
Cash provided by (used in) operating activities	1,373,000	(518,000)
Cash (used in) provided by investing activities	(1,440,000)	1,253,000
Cash used in financing activities		(184,000)
Net change in cash and cash equivalents	(67,000)	551,000
Cash and cash equivalents beginning of period	2,811,000	2,056,000
Cash and cash equivalents end of period	$ 2,744,000	$ 2,607,000

Operating Activities

The Company generated approximately $1,891,000 more cash from operating activities in the first six months of fiscal 2014 compared to the same period in fiscal 2013. This increase was primarily attributable to higher collections of accounts and income taxes receivable as well as a reduction of inventories, offset by decreases in accounts payable and accrued expenses during the six month period.

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Investing Activities

Cash used in investing activities during the first six months of fiscal 2014 increased by approximately $2,693,000 compared to the same period in fiscal 2013. This change is primarily attributable to the purchase in the first six months of 2014 of $2,579,000 in short-term investments in marketable securities.

Financing Activities

Cash used for financing activities during the first six months of fiscal 2013 was $184,000 compared to no activity during the first six months of fiscal 2014. The reduction in activity is due to the suspension of dividend payments following the first six months of fiscal 2013.

Debt Instruments and Related Covenants

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 2.75% 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, with which the Company was in compliance at March 29, 2014. The line is available to support new letters of credit issued by the Company, however any standby letters of credit will be required to be secured with cash. There were no cash borrowings against the line during the six months ended March 29, 2014 or the fiscal year ended September 28, 2013.

Company Facilities

On April 1, 2014, the Company entered into a new 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 is for five years through March 31, 2019 at an annual rate of $171,000. In addition the lease contains options to extend the lease for two and one half years through September 30, 2021 and another two and one half years through March 31, 2024, at an annual rate of $171,000. Rent expense for each of the six month periods ended March 29, 2014 and March 30, 2013 was $85,000.

Backlog

Backlog at March 29, 2014 and September 28, 2013 amounted to $1,009,000 and $2,285,000, respectively. The orders in backlog at March 29, 2014 are expected to ship over the next six months depending on customer requirements and product availability.

Performance guaranties

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 March 29, 2014, the Company had one outstanding letter of credit amounting to $14,903, which is secured by a cash certificate of deposit in the amount of $14,903.

Research and development

Research and development efforts are undertaken by the Company primarily on its own initiative. In order to compete successfully, the Company must attract and retain qualified personnel, improve existing products and develop new products. No assurances can be given that the Company will be able to hire and train such technical management and sales personnel or successfully improve and develop its products.

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During the six months ended March 29, 2014 and March 30, 2013, the Company spent $1,528,000 and $1,645,000, respectively, on internal product development. During the first six months of 2014, the Company s internal product development expenses were lower than the same period of fiscal 2013 but in line with the Company s planned commitment to research and development, and reflected the costs of product testing and production readiness efforts

During the remainder of fiscal 2014, the Company expects to focus technical efforts on three principal areas: development of solutions that meet the needs of original equipment manufacturers (OEMs); product enhancements that include expanded features, planned capability and applications growth; and custom solutions that tailor our products to meet the unique needs of our customers.

The Company began pursuing OEM technical partnerships in 2012, and these relationships continue to develop albeit at a slower pace than originally projected. TCC believes that the resulting products will be embedded 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.

Other than those stated above, there are no plans for significant internal product development during the remainder of fiscal 2014 and the Company does not anticipate any significant capital expenditures during the last six months of the year.

New Accounting Pronouncements

ASU 2013-11, Income Taxes (Topic 740): Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists (a consensus of the FASB Emerging Issues Task Force)

In July 2013, the FASB issued guidance on the financial statement presentation of an unrecognized tax benefit when a net operating loss carryforward, a similar tax loss, or a tax credit carryforward exists. This guidance requires an unrecognized tax benefit, or a portion of an unrecognized tax benefit, 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 a net operating loss carryforward, a similar tax loss, or a tax credit carryforward is not available at the reporting date, the unrecognized tax benefit should be presented in the financial statements as a liability and not combined with deferred tax assets. This guidance is effective prospectively for fiscal years, and interim periods within those years, beginning after December 15, 2014, with early adoption permitted. The Company is currently evaluating the impact of this amendment on its consolidated financial statements. The adoption of this guidance is not expected to have a material effect on the Company s consolidated financial statements. This guidance will become effective for TCC as of the beginning of our 2015 fiscal year and is consistent with our present practice.

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.

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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 March 29, 2014 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

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 Officer and Chief Financial Officer 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)
May 13, 2014 Date	By: /s/ Carl H. Guild, Jr. Carl H. Guild, Jr., President and Chief Executive Officer
May 13, 2014 Date	By: /s/ Michael P. Malone Michael P. Malone, Chief Financial Officer