SUNTRON CORP
Form 10-Q
May 14, 2003

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

FORM 10-Q

þ Quarterly report pursuant to section 13 or 15 (d) of the Securities Exchange Act of 1934
For the fiscal quarter ended **March 30, 2003,** or

o Transition report pursuant section 13 or 15 (d) of the Securities Exchange Act of 1934
For the transition period from __________ to __________

Commission file number **0-49651**

SUNTRON CORPORATION

(Exact Name of Registrant as Specified in Its Charter)

Delaware	**86-1038668**
(State of Incorporation)	(I.R.S. Employer Identification No.)

2501 West Grandview Road, Phoenix, Arizona 85023

(Address of Principal Executive Offices) (Zip Code)

(602) 789-6600

(Registrant s telephone number, including area code)

Not Applicable

(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 þ No o

Indicate by check mark if the Registrant is an accelerated filer (as defined in Exchange Act Rule 12b-2). Yes o No þ

As of **May 2, 2003,** there were outstanding **27,409,338** shares of the registrant s Common Stock, $0.01 par value.

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SUNTRON CORPORATION AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
December 31, 2002 and March 30, 2003
(Dollars in Thousands, Except Per Share Amounts)

	2002	2003
ASSETS		
Current Assets:		
Cash and equivalents	$ 1,621	$ 78
Trade receivables, net of allowance for doubtful accounts of $1,740 and $1,621, respectively	29,161	36,452
Inventories	67,381	62,314
Prepaid expenses and other	1,860	1,383
Total Current Assets	100,023	100,227
Property, Plant and Equipment, at cost:		
Land	4,798	4,798
Buildings and improvements	25,721	25,805
Manufacturing machinery and equipment	53,699	54,042
Furniture, computer equipment and software	32,056	31,982
Total	116,274	116,627
Less accumulated depreciation and amortization	(54,368)	(58,919)
Net Property, Plant and Equipment	61,906	57,708
Intangible and Other Assets:		
Goodwill	6,964	6,964
Identifiable intangible assets, net of accumulated amortization of $4,004 and $4,143, respectively	1,708	1,570
Debt issuance costs, net	1,156	1,144
Deposits and other	459	433
Total Intangible and Other Assets	10,287	10,111
	$ 172,216	$ 168,046

The Accompanying Notes Are an Integral Part of These Consolidated Financial Statements.

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SUNTRON CORPORATION AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS, Continued
December 31, 2002 and March 30, 2003
(Dollars in Thousands, Except Per Share Amounts)

	2002	2003
LIABILITIES AND STOCKHOLDERS EQUITY		
Current Liabilities:		
Accounts payable	$ 32,550	$ 34,903
Outstanding checks in excess of cash balances		598
Accrued compensation and benefits	7,268	5,643
Current portion of accrued exit costs related to facility closures	3,341	2,971
Accrued interest expense	87	102
Payable to affiliates	295	248
Accrued property taxes	1,626	649
Other accrued liabilities	4,484	3,459
Total Current Liabilities	49,651	48,573
Long-term Liabilities:		
Revolving line of credit	10,856	18,960
Accrued exit costs related to facility closures	6,980	6,701
Other	718	275
Total Liabilities	68,205	74,509
Stockholders Equity:		
Preferred stock, $.01 par value. Authorized 10,000,000 shares, none issued		
Common stock, $.01 par value. Authorized 75,000,000 shares; issued and outstanding 27,409,338 shares	274	274
Additional paid-in capital	380,175	380,182
Deferred stock compensation cost	(351)	(302)
Accumulated deficit	(276,087)	(286,617)
Total Stockholders Equity	104,011	93,537
	$ 172,216	$ 168,046

The Accompanying Notes Are an Integral Part of These Consolidated Financial Statements.

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SUNTRON CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
For The Quarters Ended March 31, 2002 And March 30, 2003
(Dollars In Thousands, Except Per Share Amounts)

	2002	2003
Net Sales	$ 92,608	$ 80,164
Cost of Goods Sold	95,182	84,451
Gross profit (loss)	(2,574)	(4,287)
Operating Costs and Expenses:		
Selling, general and administrative expenses	7,230	5,627
Related party expenses- management fees	271	188
Merger transaction costs	265	
Total operating costs and expenses	7,766	5,815
Operating loss	(10,340)	(10,102)
Other Income (Expense):		
Interest expense	(1,234)	(480)
Reduction in interest expense due to settlement of dispute	1,029	
Gain (loss) on sale of assets	(149)	29
Interest and other income	38	23
Loss before income taxes and cumulative effect of change in accounting principle	(10,656)	(10,530)
Income Tax Benefit (Expense)	236	
Loss before cumulative effect of change in accounting principle	(10,420)	(10,530)
Cumulative Effect of Change in Accounting Principle	(69,015)	
Net loss	$ (79,435)	$ (10,530)
Loss Per Share Applicable to Common Stockholders (Basic and Diluted):		
Loss before cumulative effect of change in accounting principle	$ (0.38)	$ (0.38)
Cumulative effect of change in accounting principle	(2.52)	
Net loss	$ (2.90)	$ (0.38)
Number of Shares Used for Computation:		
Basic and diluted	27,414,000	27,409,000

The Accompanying Notes Are an Integral Part of These Consolidated Financial Statements.

SUNTRON CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
For The Quarters Ended March 31, 2002 And March 30, 2003
(Dollars in Thousands)

	2002	2003
Cash Flows from Operating Activities:		
Net loss	$(79,435)	$(10,530)
Adjustments to reconcile net loss to net cash provided (used) by operating activities:		
Cumulative effect of change in accounting principle	69,015	
Depreciation and amortization	5,549	5,232
Amortization of debt issuance costs	498	197
Change in accrued severance, retention and lease exit costs	(396)	(1,127)
Reduction of interest expense due to settlement	(1,029)	
Loss (gain) on sale of assets	149	(29)
Stock-based compensation and services expense	7	56
Changes in operating assets and liabilities, net of effects of purchases and sales of businesses:		
Decrease (increase) in:		
Trade receivables, net	(5,719)	(7,291)
Inventories	14,372	5,067
Prepaid expenses and other	(919)	503
Increase (decrease) in:		
Accounts payable	3,405	2,332
Accrued compensation and benefits	(2,404)	(1,603)
Other accrued liabilities	(451)	(1,800)
Net cash provided (used) by operating activities	2,642	(8,993)
Cash Flows from Investing Activities:		
Proceeds from sale of assets, net of cash transferred	96	7
Payments for acquisition of businesses	(5,523)	
Capital expenditures	(478)	(896)
Net cash used by investing activities	(5,905)	(889)
Cash Flows from Financing Activities:		
Proceeds from long-term debt	67,102	81,899
Principal payments on long-term debt	(83,178)	(73,973)
Payments for debt issuance costs	(133)	(185)
Increase in outstanding checks in excess of cash balances	5,448	598
Net cash provided (used) by financing activities	(10,761)	8,339
Net decrease in cash and equivalents	(14,024)	(1,543)
Cash and Equivalents:		
Beginning of period	14,172	1,621
End of period	$ 148	$ 78

The Accompanying Notes Are an Integral Part of These Consolidated Financial Statements.

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SUNTRON CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS, Continued
For The Quarters Ended March 31, 2002 And March 30, 2003
(Dollars in Thousands)

	2002	2003
Supplemental Disclosure of Cash Flow Information:		
Cash paid for interest	$ 602	$ 269
Cash paid for income taxes	$	$
Supplemental Schedule of Non-cash Investing and Financing Activities:		
Reduction of goodwill and note payable to Former Parent due to settlement of dispute	$ 6,860	$

The Accompanying Notes Are an Integral Part of These Consolidated Financial Statements.

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SUNTRON CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Dollars in Thousands, Except Per Share Amounts)

1. Basis of Presentation

The accompanying unaudited consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and in conformity with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the quarter ended March 30, 2003 are not necessarily indicative of the results that may be expected for the year ending December 31, 2003. The unaudited consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in Suntron s Annual Report on Form 10-K for the year ended December 31, 2002.

During the fourth quarter of 2002, the Company completed an accounting system conversion to integrate the accounts of K*TEC into the system used by the Company. During this process, management reclassified certain prior year amounts to conform to the 2003 presentation.

2. New Accounting Standards

In July 2001, the Financial Accounting Standards Board (FASB) issued Statement No. 141, Business Combinations and Statement No. 142, Goodwill and Other Intangible Assets. Statement No. 141 requires that the purchase method of accounting be used for business combinations initiated after June 30, 2001, except for business combinations between entities under common control. The provisions of Statement 142 were required to be adopted by the Company beginning in the first quarter of 2002. Statement 142 addresses how intangible assets that are acquired individually or with a group of other assets (but not those acquired in a business combination) should be accounted for in financial statements upon their acquisition. Statement 142 also addresses how goodwill and other intangible assets should be accounted for after they have been initially recognized in the financial statements.

During the first quarter of 2002, the Company adopted the provisions of Statement 142, which resulted in the elimination of the requirement under previous accounting rules to amortize goodwill. Instead of amortizing goodwill, Statement 142 requires a periodic impairment test, using a two-step process. The first step is to identify if potential impairment of goodwill exists. If impairment of goodwill is determined to exist, the second step of the goodwill impairment test measures the amount of the impairment loss, using a fair value-based approach.

In connection with the adoption of Statement 142, the Company engaged an independent firm specializing in valuation services to assist in the determination if impairment of goodwill should be recognized under Statement 142. The Company concluded that goodwill related to the K*TEC reporting unit (which arose in connection with the October 2000 acquisition from Kent Electronics) was determined to be impaired for the entire carrying value which resulted in an

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impairment loss of $69,015, which was accounted for as the cumulative effect of a change in accounting principle.

In August 2001, the Financial Accounting Standards Board (FASB) issued Statement No. 143, *Accounting for Asset Retirement Obligations*. This standard requires entities to record the fair value of a liability for an asset retirement obligation in the period in which it is incurred. When the liability is initially recorded, the entity capitalizes a cost by increasing the carrying amount of the related long-lived asset. Over time, the liability is accreted to its present value each period, and the capitalized cost is depreciated over the useful life of the related asset. Upon settlement of the liability, an entity either settles the obligation for its recorded amount or incurs a gain or loss upon settlement. This standard was adopted by the Company in the first quarter of 2003, and the initial application of Statement 143 did not have any impact on the Company s consolidated financial statements.

In July 2002, the FASB issued Statement No. 146, *Accounting for Costs Associated with Exit or Disposal Activities*. This standard requires companies to recognize costs associated with exit or disposal activities when they are incurred rather than at the date of a commitment to an exit or disposal plan. Examples of costs covered by this standard include lease termination costs and certain employee severance costs that are associated with a restructuring, discontinued operation, plant closing, or other exit or disposal activity. Previous accounting guidance was provided by EITF Issue No. 94-3, *Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)*. Statement 146 replaces Issue 94-3. The Company has applied Statement 146 in accounting for all exit or disposal activities initiated after December 31, 2002, resulting in total charges to cost of goods sold of $342 for the quarter ended March 30, 2003.

3. Inventories

Inventories at December 31, 2002 and March 30, 2003 are summarized as follows:

	2002	2003
Purchased parts and completed sub-assemblies	$47,686	$45,203
Work-in-process	6,967	8,044
Finished goods	12,728	9,067
	$67,381	$62,314

For the quarters ended March 31, 2002 and March 30, 2003, the Company recognized write-downs of excess and obsolete inventories of $963 and $673, respectively.

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4. Debt Financing

At December 31, 2002 and March 30, 2003, long-term debt consisted of a credit facility with Citibank that provides for a $75,000 revolving line of credit. Through March 30, 2003, the interest rate was the prime rate plus 2.00% (6.25% at December 31, 2002 and March 30, 2003) for Base Rate borrowings and the LIBOR rate plus 3.25% (weighted average rate of 4.7% at December 31, 2002 and 4.5% at March 30, 2003) for LIBOR Rate borrowings. The Company can periodically elect to use either the Base Rate or LIBOR rate in connection with borrowings under the line of credit. Total borrowings are subject to limitation based on a percentage of eligible accounts receivable, inventories, real estate, and equipment. Substantially all of the Company s assets are pledged as collateral for outstanding borrowings. The credit agreement limits or prohibits the Company from paying dividends, incurring additional debt, selling significant assets, or merging with other entities without the consent of the lenders.

The credit agreement also requires compliance with certain financial and non-financial covenants, including quarterly requirements related to tangible net worth; earnings before interest, taxes, depreciation and amortization (EBITDA); and limitations on the amount of capital expenditures. As a result of a substantial net loss in 2002, the Company would have violated the year-end restrictive covenants for EBITDA and tangible net worth. On March 31, 2003, Citibank agreed to a permanent waiver of the year-end covenant violations, as well as expected violations of the same covenants for the first quarter of 2003.

On April 11, 2003, the Company and Citibank agreed to an amendment that resulted in an increase of 0.5% from the rates shown above for both Base Rate and LIBOR borrowings, the calculation of the borrowing base was revised, and the maturity date was extended until April 2005. In addition, the Company is obligated to pay a commitment fee of 0.5% per annum of the unused portion of the credit facility up to $50,000, plus an unused commitment fee of 1.0% to the extent that the unused portion of the credit facility exceeds $50,000. During the first quarter of 2003, the Company also completed updated inventory and equipment appraisals for purposes of determining the borrowing base. After giving effect to these changes, the borrowing base calculation permitted total borrowings of approximately $46,900 as of April 11, 2003. After deducting the outstanding principal balance and an outstanding letter of credit, the Company had borrowing availability of approximately $29,500 as of April 11, 2003 under the amended credit agreement.

Under the Company s credit agreement and banking arrangements, the Company is not required to fund amounts for outstanding checks until the day that the checks are presented to the Company s bank for payment. Accordingly, the Company is not required to maintain cash balances in anticipation of funding requirements for outstanding checks, which results in a current liability for outstanding checks in excess of cash balances. Changes in the amount of outstanding checks in excess of cash balances are reflected as a financing activity in the accompanying statements of cash flows.

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(Dollars in Thousands, Except Per Share Amounts)

5. Loss Per Share

Basic loss per share excludes dilution for potential common shares and is computed by dividing net income or loss by the weighted average number of common shares outstanding for the period. Diluted loss per share reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock. Basic and diluted loss per share are the same for the quarters ended March 31, 2002 and March 30, 2003, as all potential common shares were antidilutive. As of March 30, 2003, common stock options and warrants that were excluded from the calculation of earnings per share amounted to an aggregate of 2,269,000 shares at exercise prices ranging from $3.74 to $57.24 per share.

6. Stock-Based Compensation

The Company accounts for stock-based compensation issued to employees using the intrinsic value method. Accordingly, compensation cost for stock options granted to employees is measured as the excess, if any, of the quoted market price of the Company s common stock at the measurement date (generally, the date of grant) over the amount an employee must pay to acquire the stock. For fixed awards of stock options with pro rata vesting, the Company utilizes the attribution method described in FASB Interpretation No. 28.

If compensation cost had been determined for all options granted to employees under the fair value method using an option pricing model, the Company s pro forma net loss and earnings (loss) per share (EPS) for the quarters ended March 31, 2002 and March 30, 2003, would have been as follows:

	2002		2003	
	Net Loss	**EPS**	**Net Loss**	**EPS**
Amounts reported	$(79,435)	$(2.90)	$(10,530)	$(0.38)
Add stock-based employee compensation recorded under the intrinsic value method	7		56	
Less stock-based employee compensation recorded under the fair value method	(629)		(953)	
Pro forma under fair value method	$(80,057)	$(2.92)	$(11,427)	$(0.42)

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

The following discussion of our financial condition and results of operations should be read in conjunction with our consolidated financial statements and the related notes, and the other financial information included in this report, as well as the information in our Annual Report on Form 10-K for the year ended December 31, 2002.

Statement Regarding Forward-Looking Statements

This report on Form 10-Q contains forward-looking statements regarding future events or our future financial and operational performance. Forward-looking statements include statements regarding markets for our products; trends in net sales, gross profits, and estimated expense levels; liquidity and anticipated cash needs and availability; and any statement that contains the words anticipate, believe, plan, estimate, expect, seek, and other similar expressions. The forward-looking statements included in this report reflect our current expectations and beliefs, and we do not undertake publicly to update or revise these statements, even if experience or future changes make it clear that any projected results expressed in this report, annual or quarterly reports to stockholders, press releases, or company statements will not be realized. In addition, the inclusion of any statement in this report does not constitute an admission by us that the events or circumstances described in such statement are material. Furthermore, we wish to caution and advise readers that these statements are based on assumptions that may not materialize and may involve risks and uncertainties, many of which are beyond our control, that could cause actual events or performance to differ materially from those contained or implied in these forward-looking statements. These risks and uncertainties include, but are not limited to, risks related to the realization of anticipated revenue, profitability, and synergies of the recent business combinations; the ability to meet cost estimates and achieve the expected benefits associated with planned restructuring activities; trends affecting our growth; and the business and economic risks described herein under Factors That May Affect Future Results.

Organization

Suntron Corporation is a provider of vertically integrated electronics manufacturing solutions, supplying high-mix services for the aerospace and defense, semiconductor capital equipment, industrial controls, instrumentation, medical, networking, and telecommunications industries. Our manufacturing services include printed circuit card assembly, cable and harness production, plastic injection molding, sheet metal, engineering services, and full systems integration, testing, and after-market repair and warranty services. High-mix manufacturing involves processing small lots in a flexible manufacturing environment. Our success in the marketplace is a direct result of our ability to provide intelligent solutions tailored to match customer requirements, while meeting the highest quality standards in the industry.

Information About Our Business

As an electronic manufacturing services company, many of our customers are original equipment manufacturers, or OEMs, that have designed their own products. Our customers request proposals that include key terms such as quality, delivery, and the price to purchase the materials and perform the manufacturing services to make one or more components or assemblies. Generally, the component or assembly that we manufacture is delivered to the customer where it is then integrated into their final product. We price new business with our customers by obtaining raw material quotes from our suppliers and then estimating the amount of labor and overhead that will be required to make the products.

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Before we begin a customer relationship, we typically enter into arrangements that are intended to protect us in case a customer cancels an order after we purchase the raw materials to fill that order. In these circumstances, the customer is generally required to purchase the materials or reimburse us if we incur a loss from liquidating the raw materials.

The electronics manufacturing services industry is extremely dynamic and our customers make frequent changes to their orders. The magnitude and frequency of these changes make it difficult to predict revenues beyond the next quarter, and even relatively short-term forecasts may prove inaccurate depending on changes in economic, political, and military factors, as well as unexpected customer requests to delay shipments near the end of our fiscal quarters. These changes in customer orders also cause substantial difficulties in managing inventories, which often leads to excess inventories and the need to recognize losses on inventories. However, from time to time, we may also have difficulties obtaining certain electronic components that are in short supply, which can result in a decision to purchase some materials before formal notice of demand is received from our customer. In addition, our inventories consist of over 150,000 different parts and many of these parts have limited alternative uses or markets, beyond the products that we manufacture for our customers. When we liquidate excess materials through an inventory broker or auction, we often realize less than the original cost of the materials, and in some cases we determine that there is no market for the excess materials.

The most common reasons we incur losses related to inventories are if we purchase more materials than are necessary to meet a customer s requirements or if we fail to act promptly to minimize losses once the customer communicates a cancellation. Occasionally it is not clear what action caused an inventory loss and there is a shared responsibility whereby our customers agree to negotiate a settlement with us. Accordingly, management continually evaluates inventory on-hand, forecasted demand, contractual protections, and net realizable values in order to determine whether an adjustment to the carrying amount of inventory is necessary. When the relationship with a customer terminates, we tend to be more vulnerable to inventory losses because the customer may be reluctant to accept responsibility for the remaining inventory if a product is at the end of its life cycle. We can also incur inventory losses if a customer becomes insolvent and the materials do not have alternative uses or markets into which we can sell them.

Critical Accounting Policies and Estimates

The discussion and analysis of our financial condition and results of operations is based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires that we make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. On an on-going basis, we evaluate our estimates, including those related to bad debts, inventories, property, plant and equipment, intangible assets, income taxes, warranty obligations, restructuring-related obligations, and litigation. We base our estimates on historical experience and on various other assumptions 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. We cannot assure you that actual results will not differ from those estimates. We believe the following critical accounting policies affect our more significant judgments and estimates used in the preparation of our consolidated financial statements.

Write-Downs for Obsolete and Slow-Moving Inventories. Our judgments about excess and obsolete inventories are especially difficult because (i) hundreds of different components may be associated with a single product we manufacture for a customer, (ii) we make numerous products for most of our customers, (iii) even though we are engaged in the electronic manufacturing services industry, most of our customers are engaged in diverse industries, and (iv) all of our customers experience dynamic business environments affected by a wide variety of economic, political, and regulatory factors. This complex environment results in positive and negative events that can change daily and which affect judgments about future demand for our manufacturing services and the amounts we can realize when it is not possible to liquidate inventories through production of finished products.

We frequently review customer demand to determine if we have excess raw materials that will not be consumed in production. In determining demand we consider firm purchase orders and forecasts of demand submitted by our customers. If we determine that excess inventories exist and that the customer is not contractually obligated for the excess inventories, we need to make judgments about whether unforecasted demand for those materials is likely to occur or the amount we would likely realize in the sale of this material through a broker or auction. If we determine that future demand from the customer is unlikely, we write down our inventories to the extent that the cost of the inventory exceeds the estimated market value.

If actual market conditions are less favorable than those projected by management, additional inventory write-downs may be required in future periods. Likewise, if we underestimate contractual recoveries from customers or future demand, hindsight may indicate that we over-reported our costs of goods sold in earlier periods, which results in the recognition of additional gross profit at the time the material is used in production and the related goods are sold. Therefore, although we make every effort to ensure the accuracy of our forecasts of future product demand, any significant unanticipated changes in demand or the outcome of customer negotiations with respect to the enforcement of contractual provisions, could have a significant impact on the value of our inventory and our reported operating results.

Allowance for Doubtful Accounts Receivable. We maintain allowances for doubtful accounts for estimated losses resulting from the inability of our customers to make required payments, as well as to provide for adjustments related to pricing and quantity differences. If the financial condition of our customers were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances would be required.

Impairment of Long-Lived Assets. When we undergo changes in our business, including the closure or relocation of facilities, we often have equipment and other long-lived assets that are no longer needed in continuing operations. When this occurs, we are required to estimate future cash flows and if such cash flows are less than the carrying value of the assets (or asset group, as applicable), we recognize impairment charges to reduce the carrying value to estimated fair value. The determination of future cash flows and fair value tend to be highly subjective estimates. When assets are held for sale and the actual market conditions deteriorate, or are less favorable than those projected by management, additional impairment charges may be required in subsequent periods.

Effective January 1, 2002, we were required to adopt a new accounting standard that changed the method for evaluating impairment of goodwill. In order to comply with this standard we engaged an independent business valuation firm to assist in determining the fair value of each reporting unit that had goodwill associated with it. The valuation of reporting units is a highly subjective process that can be influenced by a wide range of factors including historical and forecasted results for the reporting unit, interest rates, and political, regulatory, and economic conditions. Because of the volatility of these factors, a significant reduction in the value of a reporting unit may occur in a relatively short period of time, which could result in a material charge for impairment. Effective January 1, 2002, we implemented this new accounting standard and were required to recognize an impairment charge of $69.0 million related to the K*TEC reporting unit. We are required to evaluate potential impairment of goodwill related to other reporting units at least annually and, depending on changes in the fair value of those reporting units at future testing dates, we may need to recognize additional impairment losses that could have a material adverse impact on our results of operations.

Accrual of Lease Exit Costs. When we undertake restructuring activities and decide to close a plant that we occupy under a non-cancelable operating lease, we are required to estimate how long it will take to locate a new tenant to sublease the facility and to estimate the rate that we are likely to receive when a tenant is located. Accordingly, we will incur additional lease exit charges in future periods if our estimates of the rate or timing of sublease payments turns out to be less favorable than our current expectations. We also consider the estimated cost of building improvements, brokerage commissions, and any other costs we believe will be incurred in connection with the subleasing process. The precise outcome of most of these factors is difficult to predict. We review our estimates at least quarterly, including consultation with our commercial real estate advisors to assess changes in market conditions, feedback from parties that have expressed interest, and other information that we believe is relevant to most accurately reflect the expected outcome of obtaining a subtenant to lease the facility. Commercial real estate conditions are currently very poor in the areas that we are attempting to sublease closed facilities, and we believe our estimates have appropriately considered these conditions. As discussed under *Impact of Recently Issued Accounting Standards* on page 21, new accounting rules are effective for all restructuring activities after December 31, 2002.

For a detailed discussion on the application of these and other accounting policies, see Note 1 in our audited consolidated financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2002.

Overview of Statement of Operations

We recognize revenue when title is transferred to our customers, which predominantly occurs upon shipment from our facilities. Our gross sales are recorded net of customer discounts taken or expected to be taken.

Cost of goods sold includes materials, labor, and overhead expenses incurred in the manufacture of our products. Cost of goods sold also includes charges for obsolete and slow moving inventories and charges for impairment of long-lived assets used in our manufacturing operations. Many factors affect our gross margin, including capacity utilization, product mix, and production volume.

Selling, general, and administrative expenses primarily include the salaries for executive, finance, accounting, and human resources personnel; salaries and commissions paid to our internal sales force and external sales representatives and marketing costs; insurance expenses; depreciation expense related to assets not used in manufacturing activities; and professional fees for auditing and legal assistance and general corporate expenses.

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Merger transaction costs relate to costs incurred in connection with a business combination between EFTC Corporation and K*TEC Operating Company, L.L.C., which was consummated on February 28, 2002. The costs included fees primarily related to professional fees and printing costs for the combination and related Securities and Exchange Commission filings. The business combination was accounted for as a reorganization of entities under common control, and, accordingly, these costs were charged to operations in the period when the costs were incurred.

Related party fees include management fees and advisory fees paid to affiliates of our majority stockholder.

Interest expense relates to our senior credit facilities and other long-term debt obligations. Interest expense includes the amortization of debt issuance costs and unused commitment fees of 0.5% per annum that are charged for the portion of our $75 million credit facility that is not used from time to time.

Results of Operations

Our results of operations are affected by several factors, primarily the level and timing of customer orders (especially orders from our top three customers, Honeywell, Applied Materials, and Emulex). The level and timing of orders placed by a customer vary due to the customer s attempts to balance its inventory, changes in the customer s manufacturing strategy, and variation in demand for its products due to, among other things, product life cycles, competitive conditions, and general economic conditions. In the past, changes in orders from customers have had a significant effect on our quarterly results of operations. The following table sets forth certain operating data as a percentage of net sales for the quarters ended March 31, 2002 and March 30, 2003:

	2002	2003
Net sales	100.0%	100.0%
Cost of goods sold	102.8%	105.4%
Gross profit (loss)	(2.8)%	(5.4)%
Operating costs and expenses:		
Selling, general, and administrative	7.8%	7.0%
Related party management fees	0.3%	0.2%
Merger transaction costs	0.3%	%
Operating loss	(11.2)%	(12.6)%

Quarter Ended March 31, 2002 Compared to Quarter Ended March 30, 2003

Net Sales. Net sales decreased $12.4 million, or 13.4%, from $92.6 million for the first quarter of 2002 to $80.2 million for the first quarter of 2003. During the first quarter of 2003, we continued to be impacted adversely by significant downturns in the industries that many of our customers are engaged in, especially aerospace and defense. The decrease in net sales in 2003 was primarily attributable to an $18 million reduction in our net sales to Honeywell in the first quarter of 2003 compared to the first quarter of 2002. The decrease in net sales during the first quarter of 2003 was also attributable to a reduction from $7.0 million in the first quarter of 2002

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to $2.9 million in the first quarter of 2003, of excess inventories that were sold back to customers pursuant to contractual provisions of our customer agreements. These reductions in net sales were partially offset by $14 million of sales to new customers and an increase of $3 million in net sales related to the March 2002 acquisition of the assets of Midwestern Electronics, Inc.

For the first quarter of 2002, Honeywell, Applied Materials and Emulex accounted for 50%, 14% and 9%, respectively, of our net sales. For the first quarter of 2003, Honeywell, Applied Materials and Emulex accounted for 35%, 16% and 10%, respectively, of our net sales.

Gross Profit (Loss). Our gross profit deteriorated $1.7 million from a loss of $2.6 million in the first quarter of 2002 to a loss of $4.3 million in the first quarter of 2003. Similarly, gross profit as a percentage of net sales deteriorated from a loss of 2.8% of net sales in the first quarter of 2002 to a loss of 5.4% of net sales in the first quarter of 2003. The reduction in gross profit in the first quarter of 2003 is primarily attributable to fixed costs associated with several under-utilized manufacturing facilities.

Inventory write-downs decreased $0.3 million from $1.0 million, or 1.0% of net sales, in the first quarter of 2002 to $0.7 million, or 0.8% of net sales, in the first quarter of 2003. This reduction in inventory write-downs resulted primarily from our substantial efforts over the past year to improve our inventory management processes and to work more closely with our customers to minimize losses due to excess inventories. In 2002 and 2003, write-downs of excess inventories are related to a variety of customers for which we do not expect to realize the carrying value through production or other means of liquidation.

Selling, General, and Administrative Expenses. Selling, general, and administrative expenses (SG & A) decreased $1.6 million, or 22.2%, from $7.2 million in the first quarter of 2002 to $5.6 million in the first quarter of 2003. The decrease in SG & A during the first quarter of 2003 was primarily attributable to reductions in compensation and benefits of $0.5 million, bad debt expense of $0.7 million, and professional fees of $0.1 million.

Related Party Expenses. Related party expenses decreased $0.1 million, or 30.6%, from $0.3 million in the first quarter of 2002 to $0.2 million in the first quarter of 2003. Effective in the second quarter of 2002, management fees were revised to provide for a quarterly fee of $0.2 million.

Merger Transaction Costs. In the first quarter of 2002, we incurred costs, primarily for printing costs and professional fees, of $0.3 million related to the combination with K*TEC that was completed on February 28, 2002. This business combination was accounted for as a reorganization of entities under common control, and, accordingly, these costs were charged to operations when the costs were incurred.

Interest Expense. Interest expense decreased $0.7 million, or 61.1%, from $1.2 million in the first quarter of 2002 to $0.5 million in the first quarter of 2003, primarily due to a decrease in average outstanding borrowings. Our weighted average borrowings decreased from $35.8 million during the first quarter of 2002 to $14.4 million during the first quarter of 2003. Our weighted average interest rate also decreased from 8.2% in the first quarter of 2002 to 7.6% in the first quarter of 2003.

A portion of the purchase price for the October 2000 acquisition of K*TEC Electronics Holding Corporation was subject to a dispute that was expected to be resolved through

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arbitration proceedings. On May 7, 2002, the parties agreed to settle the dispute whereby the $12.2 million principal balance of a note payable to the former owner was reduced by $6.9 million, resulting in an adjusted principal balance of $5.3 million. In accounting for this settlement, the Company reduced the carrying amount of goodwill by $6.9 million and recognized a credit to operations of $1.0 million for accrued interest that was previously expensed and that was no longer payable due to this settlement.

Lower interest rates on the Company s revolving credit facilities in 2003 also contributed to the reduction in interest expense. The prime rate was approximately one-half percentage point lower in the first quarter of 2003 compared to the first quarter of 2002, and this also had a favorable impact because the interest rate on the revolving line of credit is a variable rate based on the prime and LIBOR rates. However, beginning in April 2003, the Company will be subject to an increase of 0.5% in both Base Rate and LIBOR Rates due to the amendment of our credit facility on April 11, 2003, as well as an increase in the fee charged for our credit facility to the extent that the unused portion exceeds $50 million.

Cumulative Effect of Change in Accounting for Goodwill. During the first quarter of 2002, the Company adopted the provisions of Statement of Financial Accounting Standards No. 142, which resulted in the requirement to perform a periodic impairment test, using a two-step process. The first step is to identify if potential impairment of goodwill exists. If impairment of goodwill is determined to exist, the second step of the goodwill impairment test measures the amount of the impairment loss, using a fair value-based approach.

The Company engaged an independent firm specializing in valuation services to assist in the determination if impairment of goodwill should be recognized under Statement 142. The Company concluded that goodwill related to the K*TEC reporting unit was impaired for the entire carrying value, which resulted in an impairment loss of $69.0 million. This impairment loss was recorded as a cumulative effect of a change in accounting principle.

Liquidity and Capital Resources

Cash Flows from Operating Activities. Net cash used by operating activities in the first quarter of 2003 was $9.0 million, compared with net cash provided by operating activities of $2.6 million in the first quarter of 2002. The difference between our net loss in the first quarter of 2003 of $10.5 million and $9.0 million of negative operating cash flow was primarily attributable to a reduction in inventories of $5.1 million, $5.2 million of depreciation and amortization expense, partially offset by an increase of $7.3 million in trade receivables, a decrease in accounts payable and other accrued liabilities of $1.1 million, and a reduction of $1.1 million in accrued severance, retention and lease exit costs.

Days sales outstanding (based on annualized net sales for the quarter and net trade receivables outstanding at the end of the quarter) increased to 41 days for the first quarter of 2003, compared to 39 days for the comparable period of 2002.

Inventories decreased 7.5% to $62.3 million at March 30, 2003, compared to $67.3 million at December 31, 2002. For the first quarter of 2003, inventory turns (i.e., annualized cost of goods sold divided by period end inventory) amounted to 5.4 times per year compared to 3.9 times per year for the comparable period in 2002.

Cash Flows from Investing Activities. Net cash used by investing activities in the first quarter of 2003 was $0.9 million compared with net cash used by investing activities of $5.9 million in the first quarter of 2002. Investing cash flows in 2003 consist of capital expenditures for new manufacturing equipment and leasehold improvements at our Olathe, Kansas facility. Investing cash flows in the first quarter of 2002 include the payment of approximately $5.5 million in March 2002 for the acquisition of the assets of Midwestern Electronics, Inc., and $0.5 million for other capital expenditures.

Cash Flows from Financing Activities. Net cash provided by financing activities in the first quarter of 2003 was $8.3 million, compared with net cash used by financing activities of $10.8 million in the first quarter of 2002. Financing cash flows in the first quarter of 2003 reflect net borrowings under our revolving line of credit of $7.9 million. During the first quarter of 2003, the Company also paid debt issuance costs of $0.2 million related to our amended credit facility with Citibank. During the first quarter of 2003, an increase in outstanding checks in excess of cash balances of $0.6 million contributed positively to cash flows from financing activities.

During the first quarter of 2002, financing cash flows reflect the net repayment of debt under revolving credit facilities of $16.1 million. The Company utilized temporary cash investments of approximately $14.0 million at the end of 2001 to repay outstanding debt during the first quarter of 2002. During the first quarter of 2002, an increase in outstanding checks in excess of cash balances of $5.4 million contributed positively to cash flows from financing activities.

Contractual Obligations. The following table summarizes our contractual obligations as of March 30, 2003 (Dollars in Thousands):

	Long-term Debt (Citibank)	Non-cancelable Operating Leases	Total
Year ending March 31:			
2004	$	$ 8,652	$ 8,652
2005		6,944	6,944
2006	18,960	6,064	25,024
2007		5,555	5,555
2008		2,672	2,672
After 2008		2,097	2,097
	$18,960	$31,984	$50,944

The amounts shown above for non-cancelable operating leases include $12.1 million, which has been included in the determination of our liability for lease exit costs which is recorded on our balance sheet at March 30, 2003. Accounting principles generally accepted in the United States require that we record a liability for future lease payments, net of estimated sublease rentals, for facilities that we have closed. Non-cancelable operating lease obligations (net of the accrued liability for lease exit costs) represent the only off-balance-sheet financing activities into which we have entered.

We believe we will be able to fund the non-cancelable operating lease obligations from operating cash flows during the periods that payments are required. If we have not repaid

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outstanding borrowings from cash flow that may be generated over the next three years, upon maturity of the Citibank credit facility in April 2005, we currently intend to enter into negotiations for a new credit agreement that provides for an extension of the maturity date. However, there can be no assurance that we will be successful in this regard.

Capital Resources. Our working capital at March 30, 2003 totaled $51.7 million compared to $50.4 million at December 31, 2002.

As a result of the substantial net loss in 2002, we would have violated year-end restrictive covenants for EBITDA and tangible net worth as contained in the credit agreement with Citibank. On March 31, 2003, Citibank agreed to a permanent waiver of the year-end covenant violations, as well as expected violations of the same covenants for the first quarter of 2003. In addition, on April 11, 2003, Citibank agreed to amend the credit facility to provide less stringent covenants for EBITDA and tangible net worth, and we believe we will be able to comply with the revised covenants. The amended facility continues to provide a revolving line of credit of up to $75.0 million, and the maturity date was extended until April 2005. Borrowings under the amended credit facility will bear interest at the prime rate plus 2.50% for Base Rate borrowings and the LIBOR rate plus 3.75% for LIBOR Rate borrowings. In addition, the Company is obligated to pay a commitment fee of 0.5% per annum of the unused portion of the credit facility up to $50,000, plus an unused commitment fee of 1.0% to the extent that the unused portion of the credit facility exceeds $50,000. The credit agreement also limits or prohibits us from paying dividends, incurring additional debt, selling significant assets, or merging with other entities without the consent of the lenders. Substantially all of our assets are pledged as collateral for outstanding borrowings.

Total borrowings are subject to limitation based on a percentage of eligible accounts receivable, inventories, real estate, and equipment. During the first quarter of 2003, updated inventory and equipment appraisals related to the borrowing base determinations were completed. After giving effect to the revised appraisals and other changes resulting from the April 2003 amendment, the borrowing base calculation would have permitted borrowings up to $46.9 million as of April 11, 2003. After deducting the outstanding principal balance and an outstanding letter of credit, we had borrowing availability of approximately $29.5 million as of April 11, 2003 under the amended credit agreement.

We believe that adequate capital resources are in place to fund our working capital and other cash requirements for the next 12 months. However, depending on the amount of capital resources that are devoted to any future acquisitions of businesses, and increased working capital requirements if sales levels increase significantly, we may need to seek additional funds through public or private debt or equity offerings, bank borrowings, or leasing arrangements.

The continued availability of our credit facility with Citibank is a critical assumption underlying our belief that adequate capital resources are currently in place to fund our planned activities for the next 12 months. The borrowing base calculation under this credit facility is based on a percentage of eligible receivables and inventories, plus the appraised value of certain real estate and equipment. Accordingly, our borrowing availability decreases as our net receivables and inventories decline. However, the borrowing base generally increases as our receivables and inventories increase. If our sales begin to increase rapidly, this credit facility is critical to enable us to finance the increased working capital requirements associated with growth.

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In order to ensure the continuing availability of funding under our credit facility, we are required to comply with certain financial and reporting covenants as discussed above. While the EBITDA financial covenant included in the April 2003 amended credit agreement is less stringent than the previous agreement, we will generally be required to demonstrate sequential quarterly improvements in our financial performance beginning in the third quarter of 2003. If we violate the financial covenants in the future, there can be no assurance that Citibank would waive our noncompliance. In these circumstances, Citibank could elect to withdraw the credit facility, which would have a material adverse effect on our liquidity and financial condition, resulting in the need to seek other sources of financing. There can be no assurance that we would be successful in securing additional financing, and even if we would be successful, the terms may be less favorable than we currently have with Citibank.

Impact of Recently Issued Accounting Standards

In August 2001, the Financial Accounting Standards Board (FASB) issued Statement No. 143, *Accounting for Asset Retirement Obligations*. This standard requires entities to record the fair value of a liability for an asset retirement obligation in the period in which it is incurred. When the liability is initially recorded, the entity capitalizes a cost by increasing the carrying amount of the related long-lived asset. Over time, the liability is accreted to its present value each period, and the capitalized cost is depreciated over the useful life of the related asset. Upon settlement of the liability, an entity either settles the obligation for its recorded amount or incurs a gain or loss upon settlement. This standard was adopted by the Company in the first quarter of 2003, and the initial application of Statement 143 did not have any impact on the Company s consolidated financial statements.

In July 2002, the FASB issued Statement No. 146, *Accounting for Costs Associated with Exit or Disposal Activities*. This standard requires companies to recognize costs associated with exit or disposal activities when they are incurred rather than at the date of a commitment to an exit or disposal plan. Examples of costs covered by this standard include lease termination costs and certain employee severance costs that are associated with a restructuring, discontinued operation, plant closing, or other exit or disposal activity. Previous accounting guidance was provided by EITF Issue No. 94-3, *Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)*. Statement 146 replaces Issue 94-3. Statement 146 is required to be applied prospectively to exit or disposal activities initiated after December 31, 2002.

Factors That May Affect Future Results

An investment in our common stock involves a high degree of risk. You should carefully consider the factors described below, in addition to those discussed elsewhere in this report, in analyzing an investment in our common stock. If any of the events described below occurs, our business, financial condition, and results of operations would likely suffer, the trading price of our common stock could fall, and you could lose all or part of the money you paid for our common stock. In addition, the following factors could cause our actual results to differ materially from those projected in our forward-looking statements, whether made in this Form 10-Q, our annual or quarterly reports to stockholders, future press releases, other SEC filings, or orally, whether in presentations, responses to questions, or otherwise. See Statement Regarding Forward-Looking Statements.

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We have experienced declining net sales.

As a result of the continuing soft demand in the end markets served by our customers, specifically aerospace and semiconductor capital equipment, our net sales have generally declined over the past two years from $197.9 million in the first quarter of 2001 to $78.3 million in the fourth quarter of 2002. For the first quarter of 2003, net sales amounted to $80.2 million but we may experience further declines for the remainder of 2003.

We are dependent upon the highly competitive electronics industry, and excess capacity or decreased demand for products produced by this industry could result in increased price competition as well as a decrease in our gross margins and unit volume sales.

Our business is heavily dependent on the electronics manufacturing services industry, which is extremely competitive and includes hundreds of companies. The contract manufacturing services we provide are available from many independent sources, and we compete with numerous domestic and foreign electronic manufacturing services firms, including Benchmark Electronics, Inc.; Celestica Inc; Flextronics International Ltd.; Jabil Circuit, Inc.; Manufacturers Services, Ltd.; Pemstar, Inc.; Plexus Corp.; Sanmina-SCI Corporation; SMTC Corporation; Solectron Corporation; Sypris Electronics, LLC; and others. Many of such competitors are more established in the industry and have greater financial, manufacturing or marketing resources than we do. We may be operating at a cost disadvantage as compared to our competitors that have greater direct buying power from component suppliers, distributors, and raw material suppliers and have lower cost structures. In addition, many of our competitors have a broader geographic presence, including manufacturing facilities in Asia, Europe, and South America.

We believe that the principal competitive factors in our targeted market are quality, reliability, ability to meet delivery schedules, technological sophistication, geographic location, and price. We also face competition from our current and potential customers, who are continually evaluating the relative merits of internal manufacturing versus contract manufacturing for various products. As stated above, the price of our services is often one of many factors that may be considered by prospective customers in awarding new business. We believe existing and prospective customers are placing greater emphasis on contract manufacturers that can offer manufacturing services in low cost regions of the world, such as certain countries in Asia. Accordingly, in situations where the price of our services is a primary driver in prospective customers decision to award new business, we currently believe we may have a competitive disadvantage in these circumstances.

A significant percentage of our net sales are generated from the aerospace, semiconductor capital equipment, industrial controls and instrumentation, medical equipment, networking and telecommunications equipment segments of the electronics industry, which is characterized by intense competition and significant fluctuations in product demand. Furthermore, these segments are subject to economic cycles and have experienced in the past, and are likely to experience in the future, recessionary economic cycles. A recession or any other event leading to excess capacity or a downturn in these segments of the electronics industry results in intensified price competition as well as a decrease in our unit volume sales and our gross margins.

We are dependent on the aerospace industry.

Our principal customer is engaged in the aerospace market. See We are dependent upon a small number of customers for a large portion of our net sales, and a decline in sales to major customers would harm our results of operations.   Consequently, a significant percentage of our net sales have been derived from the aerospace segment of the electronics industry. The September 11, 2001 terrorist attacks using hijacked commercial aircraft and the ensuing war on terrorism have resulted in a reduction in demand for our services, which has had an adverse impact on our results of operations over the past year. See   We have experienced declining net sales.   In addition, continuing tensions in the Middle East, including the war in Iraq, have resulted in higher oil prices, which could result in further reductions in demand for products of our aerospace customers, which would have a continuing negative impact on our results of operations.

We are dependent upon a small number of customers for a large portion of our net sales, and a decline in sales to major customers would harm our results of operations.

A small number of customers are responsible for a significant portion of our net sales. Sales to Honeywell, Applied Materials and Emulex represented approximately 42%, 22%, and 9%, respectively, of our net sales for the year ended December 31, 2002. For the first quarter of 2003, Honeywell, Applied Materials and Emulex accounted for 35%, 16%, and 10%, respectively, of our net sales. We expect a significant portion of our net sales will continue to be generated by a small number of customers.

Our customer concentration could increase or decrease depending on future customer requirements, which will depend in large part on market conditions in the electronics industry segments in which our customers participate. The loss of one or more major customers or a decline in sales to our major customers could significantly harm our business and results of operations.

If we are not able to expand our customer base, we will continue to depend upon a small number of customers for a significant percentage of our net sales. There can be no assurance that current customers, including Honeywell, Applied Materials, Emulex, or future customers will not terminate their manufacturing arrangements with us or significantly change, reduce, or delay the amount of manufacturing services ordered from us.

In addition, we generate significant accounts receivable in connection with providing services to our customers. If one or more of our significant customers were to become insolvent or were otherwise unable or unwilling to pay for our services, our results of operations would deteriorate substantially.

Our customers may cancel their orders, change production quantities, or delay production.

Electronics manufacturing service providers must provide increasingly rapid product turnaround for their customers. We generally do not obtain firm, long-term purchase commitments from our customers, and we expect to continue to experience reduced lead-times in customer orders. Customers may cancel their orders, change production quantities, or delay production for a number of reasons. Cancellations, reductions, or delays by a significant customer or by a group of customers would seriously harm our results of operations. When customer orders are changed or cancelled, we may be forced to hold excess inventories and incur carrying costs as a result of delays, cancellations, or reductions in orders or poor forecasting by our key customers.

In addition, we make significant decisions, including determining the levels of business that we seek and accept, production schedules, component procurement commitments, personnel needs, and other resource requirements based on estimates of customer production requirements. The short-term nature of our customers commitments to us, combined with the possibility of rapid changes in demand for their products, reduces our ability to estimate accurately future customer orders. In addition, because many of our costs and operating expenses are relatively fixed, a reduction in customer demand could harm our operating results.

Conversely, customers may on occasion require rapid increases in production. These situations often result in inefficiencies related to hiring and training workers, as well as incremental costs incurred to expedite the purchase and delivery of raw materials. Periods of rapid growth tend to stress our resources and we may not have sufficient capacity to meet our customers delivery requirements.

If we experience excess capacity due to variability in customer demand, our gross margins may fall.

We may schedule certain of our production facilities at less than full capacity to retain our ability to respond to additional quick turnaround orders. However, if these orders are not received, we may forego some production and could experience excess capacity. When we experience excess capacity, our sales revenue may be insufficient to fully cover our fixed overhead expenses and our gross margins will fall. Conversely, we may not be able to capture all potential revenue in a given period if our customers demands for quick turnaround services exceed our capacity during that period.

If we are unable to respond to rapid technological change and process development, we may not be able to compete effectively.

The market for our products and services is characterized by rapidly changing technology and continual implementation of new production processes. The future success of our business will depend in large part upon our ability to maintain and enhance our technological capabilities, to develop and market products that meet changing customer needs, and to successfully anticipate or respond to technological changes on a cost-effective and timely basis. We expect that the investment necessary to maintain our technological position will increase as customers make demands for products and services requiring more advanced technology on a quicker turnaround basis.

In addition, the electronics manufacturing services industry could encounter competition from new or revised manufacturing and production technologies that render existing manufacturing and production technology less competitive or obsolete. We may not be able to respond effectively to the technological requirements of the changing market. If we need new technologies and equipment to remain competitive, the development, acquisition and implementation of those technologies may require us to make significant capital investments.

We periodically address excess capacity issues through plant closures, which may result in significant charges.

When our net sales decline significantly, it is difficult to operate our plants profitably since it is not possible to eliminate most of our fixed costs. If we determine that the decline in sales is unlikely to be followed by a rapid recovery, we may determine that there are significant benefits to reducing our cost structure by closing plants and transferring existing business to other plants that are also operating below optimal capacity levels. In order to realize the long-term benefits of these actions, we usually incur substantial charges for impairment of assets,

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lease exit costs, and the payment of severance and retention benefits to affected employees. In addition to the up-front costs associated with these actions, the transition of inventory and manufacturing services to a different facility can result in quality and delivery issues that may have an adverse impact in retaining customers that are affected by the plant closure. Our results of operations could also be materially and adversely affected by our inability to timely sell or sublet closed facilities on expected terms, or otherwise achieve the expected benefits of our restructuring activities.

Operating in foreign countries exposes us to increased risks that could adversely affect our results of operations.

We currently have foreign operations in Mexico. We may in the future expand into other foreign countries. We have limited experience in managing geographically dispersed operations and in operating in foreign countries. Because of the scope of our international operations, we are subject to the following risks, which could adversely impact our results of operations:

- economic or political instability;
- transportation delays and interruptions;
- increased employee turnover and labor unrest;
- incompatibility of systems and equipment used in foreign operations;
- foreign currency exposure;
- difficulties in staffing and managing foreign personnel and diverse cultures; and
- less developed infrastructures.

In addition, changes in policies by the United States or foreign governments could negatively affect our operating results due to increased duties, increased regulatory requirements, higher taxation, currency conversion limitations, restrictions on the transfer of funds, the imposition of or increase in tariffs, and limitations on imports or exports. Also, we could be negatively affected if our host countries revise their policies away from encouraging foreign investment or foreign trade, including tax holidays.

If we are unsuccessful in managing future opportunities for growth, our results of operations will be harmed.

Our future results of operations will be affected by our ability to successfully manage future opportunities for growth. Rapid growth is likely to place a significant strain on our managerial, operational, financial, and other resources. If this growth materializes, it may require us to implement additional management information systems, to further develop our operating, administrative, financial, and accounting systems and controls and to maintain close coordination among our accounting, finance, sales and marketing, and customer service and support departments. In addition, we may be required to retain additional personnel to adequately support our growth. If we cannot effectively manage periods of rapid growth in our operations, we may not be able to continue to grow, or we may grow at a slower pace. Any failure to successfully manage growth and to develop financial controls and accounting and operating systems or to add and retain personnel that adequately support growth could harm our business and financial results.

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Our results of operations are affected by a variety of factors, which could cause our results of operations to fail to meet expectations.

Our results of operations have varied, and our results of operations may continue to fluctuate significantly from period to period, including on a quarterly basis. Our results of operations are affected by a number of factors, including:

- timing of orders from and shipments to major customers;
- mix of products ordered by major customers;
- volume of orders as related to our capacity at individual locations;
- pricing and other competitive pressures;
- component shortages, which could cause us to be unable to meet customer delivery schedules;
- our ability to minimize inventory obsolescence and bad debt expense risk;
- our ability to manage effectively inventory and fixed asset levels; and
- timing and level of goodwill and other long-lived asset impairments.

We are dependent on limited and sole source suppliers for electronic components and may experience component shortages, which would cause us to delay shipments to customers.

We are dependent on certain suppliers, including limited and sole source suppliers, to provide critical electronic components and other materials for our operations. At various times, there have been shortages of some of the electronic components we use, and suppliers of some components have lacked sufficient capacity to meet the demand for these components. For example, from time to time, some components we use, including semiconductors, capacitors, and resistors, have been subject to shortages, and suppliers have been forced to allocate available quantities among their customers. Such shortages have disrupted our operations in the past, which resulted in incomplete or late shipments of products to our customers. Our inability to obtain any needed components during future periods of allocations could cause delays in shipments to our customers. The inability to make scheduled shipments could in turn cause us to experience a shortfall in revenue. Component shortages may also increase our cost of goods due to premium charges we may pay to purchase components in short supply. Accordingly, even though component shortages have not had a lasting negative impact on our business, component shortages could harm our results of operations for a particular fiscal period due to the resulting revenue shortfall or cost increases and could also damage customer relationships over a longer-term period.

We depend on our key personnel and may have difficulty attracting and retaining skilled employees.

Our future success will depend to a significant degree upon the continued contributions of our key management, marketing, technical, financial, accounting and operational personnel, including James K. Bass, our President and Chief Executive Officer. The loss of the services of one or more key employees could have a material adverse effect on our results of operations. We also believe that our future success will depend in large part upon our ability to attract and retain additional highly skilled managerial and technical resources. Competition for such personnel is intense. There can be no assurance that we will be successful in attracting and retaining such personnel. In addition, recent and potential future facility shutdowns and workforce reductions may have a negative impact on employee recruiting and retention.

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Our manufacturing processes depend on the collective industry experience of our employees. If these employees were to leave and take this knowledge with them, our manufacturing processes may suffer and we may not be able to compete effectively.

We have no patent or trade secret protection for our manufacturing processes, but instead rely on the collective experience of our employees to ensure that we continuously evaluate and adopt new technologies in our industry. Although we are not dependent on any one employee or a small number of employees, if a significant number of employees involved in our manufacturing processes were to leave our employment and we are not able to replace these people with new employees with comparable experience, our manufacturing processes may suffer as we may be unable to keep up with innovations in the industry. As a result, we may not be able to continue to compete effectively.

Our failure to comply with the requirements of environmental laws could result in fines and revocation of permits necessary to our manufacturing processes.

Our operations are regulated under a number of federal, state, and foreign environmental and safety laws and regulations that govern, among other things, the discharge of hazardous materials into the air and water, as well as the handling, storage, and disposal of such materials. These laws and regulations include the Clean Air Act; the Clean Water Act; the Resource Conservation and Recovery Act; and the Comprehensive Environmental Response, Compensation, and Liability Act; as well as analogous state and foreign laws. Compliance with these environmental laws is a major consideration for us because our manufacturing processes use and generate materials classified as hazardous, such as ammoniacal etching solutions, copper, and nickel. In addition, because we use hazardous materials and generate hazardous wastes in our manufacturing processes, we may be subject to potential financial liability for costs associated with the investigation and remediation of our own sites or sites at which we have arranged for the disposal of hazardous wastes, if such sites become contaminated. Even if we fully comply with applicable environmental laws and are not directly at fault for the contamination, we may still be liable. The wastes we generate include spent ammoniacal etching solutions, solder stripping solutions, and hydrochloric acid solutions containing palladium; waste water that contains heavy metals, acids, cleaners, and conditioners; and filter cake from equipment used for on-site waste treatment. We have not incurred significant costs related to compliance with environmental laws and regulations in the prior three years, and we believe that our operations substantially comply with all applicable environmental laws. However, any material violations of environmental laws by us could subject us to revocation of our effluent discharge and other environmental permits. Any such revocations could require us to cease or limit production at one or more of our facilities. Even if we ultimately prevail, environmental lawsuits against us would be time consuming and costly to defend.

Environmental laws could also become more stringent over time, imposing greater compliance costs and increasing risks and penalties associated with violation. We operate in environmentally sensitive locations and are subject to potentially conflicting and changing regulatory agendas of political, business, and environmental groups. Changes or restrictions on discharge limits; emissions levels; or material storage, handling, or disposal might require a high level of unplanned capital investment or relocation. It is possible that environmental compliance costs and penalties from new or existing regulations may harm our business, financial condition, and results of operations.

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We may be subject to risks associated with acquisitions, and these risks could harm our results of operations.

In 2002, we completed two business combinations and we anticipate that we will seek to identify and acquire additional suitable businesses in the electronics manufacturing services industry. The long-term success of recent business combinations will depend on our ability to unite the business strategies, human resources and information technology systems of previously separate companies. The difficulties of combining operations include the necessity of coordinating geographically separated organizations and integrating personnel with diverse business backgrounds. Combining management resources will result in changes affecting all employees and operations. Differences in management approach and corporate culture may strain employee relations.

Future business combinations could cause certain customers to either seek alternative sources of product supply or service, or delay or change orders for products due to uncertainty over the integration of the two companies or the strategic position of the combined company. As a result, we may experience some customer attrition.

Acquisitions of companies and businesses and expansion of operations involve certain risks, including the following:

- the business fails to achieve anticipated revenue and profit expectations;
- the potential inability to successfully integrate acquired operations and businesses or to realize anticipated synergies, economies of scale, or other value;
- diversion of management s attention;
- difficulties in scaling up production and coordinating management of operations at new sites;
- the possible need to restructure, modify, or terminate customer relationships of the acquired business;
- loss of key employees of acquired operations; and
- the potential liabilities of the acquired businesses.

Accordingly, we may experience problems in integrating the operations associated with any future acquisition. We therefore cannot provide assurance that any future acquisition will result in a positive contribution to our results of operations. In particular, the successful combination with any businesses we acquire will require substantial effort from each company, including the integration and coordination of sales and marketing efforts. The diversion of the attention of management and any difficulties encountered in the transition process, including the interruption of, or a loss of momentum in, the activities of any business acquired, problems associated with integration of management information and reporting systems, and delays in implementation of consolidation plans, could harm our ability to realize the anticipated benefits of any future acquisition. In addition, future acquisitions may result in dilutive issuances of equity securities, the incurrence of additional debt, large one-time write-offs, and the creation of goodwill or other intangible assets that could result in increased impairment or amortization expense.

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Our level of indebtedness could adversely affect our financial viability, and the restrictions imposed by the terms of our debt instruments may severely limit our ability to plan for or respond to changes in our business.

As of March 30, 2003, we had outstanding bank debt of approximately $19.0 million. In addition, subject to the restrictions under our debt agreements, we may incur significant additional indebtedness from time to time to finance business acquisitions, capital expenditures, or for other purposes.

Significant levels of debt could have negative consequences. For example, it could:

- require us to dedicate a substantial portion of our cash flow from operations to service interest and principal repayment requirements, limiting the availability of cash for other purposes;
- increase our vulnerability to adverse general economic conditions by making it more difficult to borrow additional funds to maintain our operations if we suffer revenue shortfalls;
- limit our ability to attract new customers if we do not have sufficient liquidity to meet working capital needs; and
- hinder our flexibility in planning for, or reacting to, changes in our business and industry if we are unable to borrow additional funds to upgrade our equipment or facilities.

We may need additional capital in the future and it may not be available on acceptable terms, or at all.

While we believe our capital resources are currently adequate, we may need to raise additional funds for the following purposes:

- to fund our operations;
- to fund working capital requirements for future growth that we may experience;
- to enhance or expand the range of services we offer;
- to increase our promotional and marketing activities; or
- to respond to competitive pressures or perceived opportunities, such as investment, acquisition, and international expansion activities.

If such funds are not available when required or on acceptable terms, our business and financial results could suffer.

Our stock price may be volatile, and our stock is thinly traded, which could cause investors to lose all or part of their investments in our common stock.

The stock market has recently experienced volatility that has often been unrelated to the operating performance of any particular company or companies. If market or industry-based fluctuations continue, our stock price could decline regardless of our actual operating performance, and investors could lose a substantial part of their investments. Moreover, if an active public market for our stock is not sustained in the future, it may be difficult to resell our stock.

During 2002, the average number of shares of our common stock that traded on the NASDAQ exchange amounted to approximately 7,000 shares per day compared to 27,409,000

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issued and outstanding shares. When trading volumes are this low, a relatively small buy or sell order can result in a large percentage change in the trading price of our common stock, which may be unrelated to changes in our stock price that are associated with our operating performance.

The market price of our common stock will likely fluctuate in response to a number of factors, including the following:

- failure to meet the performance estimates of securities analysts;
- changes in estimates of our net sales and results of operations by securities analysts;
- announcements about the financial performance and prospects of the industries and customers we serve;
- announcements about the financial performance of our competitors in the electronic manufacturing services industry;
- the timing of announcements by us or our competitors of significant contracts or acquisitions; and
- general stock market conditions.

Our major stockholder controls us and our stock price could be influenced by actions taken by this stockholder. Additionally, this stockholder could prevent a change of control or other business combination, or could effect a short form merger without the approval of other stockholders.

Thayer-Blum owns approximately 90% of our common stock, and four of our nine directors are representatives of Thayer-Blum. The interests of Thayer-Blum may not always coincide with those of our other stockholders, particularly if Thayer-Blum decides to sell its controlling interest. In addition, Thayer-Blum will have sufficient voting power (without the approval of Suntron s other stockholders) to elect the entire Board of Directors of Suntron and, in general, to determine the outcome of various matters submitted to stockholders for approval, including fundamental corporate transactions. Thayer-Blum could cause us to take actions that we would not consider absent Thayer-Blum s influence, or could delay, deter, or prevent a change of control or other business combination that might otherwise be beneficial to our public stockholders.

In addition, Thayer-Blum could contribute its Suntron stock to a subsidiary corporation that, as a 90% stockholder, then would have the ability under Delaware law to merge with or into Suntron without the approval of the other Suntron stockholders. In the event of such a short-form merger, Suntron stockholders would have the right to assert appraisal/dissenters rights to receive cash in the amount of the fair market value of their shares in lieu of the consideration they would have otherwise received from the transaction.

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Item 3. Quantitative and Qualitative Disclosures about Market Risk

We have a revolving line of credit with Citibank, N.A. and the amended credit agreement provides for total borrowings up to $75 million. The interest rate under this agreement is based either on the prime rate or LIBOR rate, plus applicable margins. Therefore, as interest rates fluctuate, the Company may experience changes in interest expense that will impact financial results. The Company has not entered into any interest rate swap agreements, or similar instruments, to protect against the risk of interest rate fluctuations. Assuming outstanding borrowings of $75 million, if interest rates were to increase or decrease by one percentage point, the result would be an increase or decrease in annual interest expense of $750,000. Accordingly, significant increases in interest rates could have a material adverse effect on the Company s future results of operations.

Item 4. Controls and Procedures

As required by Rule 13a-15 under the Exchange Act, within the 90 days prior to the filing date of this report, the Company carried out an evaluation of the effectiveness of the design and operation of the Company s disclosure controls and procedures. This evaluation was carried out under the supervision and with the participation of the Company s management, including our Chief Executive Officer and our Chief Financial Officer. Based upon that evaluation, our Chief Executive Officer and our Chief Financial Officer concluded that the Company s disclosure controls and procedures are effective. There have been no significant changes in the Company s internal controls or in other factors that could significantly affect internal controls subsequent to the date the Company carried out its evaluation.

Disclosure controls and procedures are controls and other procedures that are designed to ensure that information required to be disclosed in Company reports filed or submitted under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission s rules and forms. Disclosure controls and procedures include controls and procedures designed to ensure that information required to be disclosed in Company reports filed under the Exchange Act is accumulated and communicated to management, including the Company s Chief Executive Officer and Chief Financial Officer as appropriate, to allow timely decisions regarding required disclosure.

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PART II. OTHER INFORMATION

Item 1. Legal Proceedings

Not Applicable.

Item 2. Changes in Securities and Use of Proceeds

Not Applicable.

Item 3. Defaults Upon Senior Securities

Not Applicable.

Item 4. Submission Of Matters To A Vote Of Security Holders

Not Applicable.

Item 5. Other Information

Not Applicable.

Item 6. Exhibits and Reports on Form 8-K

(a). Exhibits

The following exhibits are filed with this report:
Exhibit 10.19 Amended and Restated Credit Agreement dated April 11, 2003 between Suntron Corporation and Citicorp USA

Exhibit 99.1 Certificate of Chief Executive Officer

Exhibit 99.2 Certificate of Chief Financial Officer

(b). Reports on Form 8-K

Not Applicable.

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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.

	SUNTRON CORPORATION
	(Registrant)
Date: May 14, 2003	/s/ James K. Bass
	James K. Bass *Chief Executive Officer*
Date: May 14, 2003	/s/ Peter W. Harper
	Peter W. Harper *Chief Financial Officer*
Date: May 14, 2003	/s/ James A. Doran
	James A. Doran *Chief Accounting Officer*

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CERTIFICATION

I, James K. Bass certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Suntron Corporation;

2. Based on my knowledge, this Quarterly Report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this Quarterly Report;

3. Based on my knowledge, the financial statements, and other financial information included in this Quarterly Report, fairly present in all material respects the financial condition, results of operations, and cash flows of the registrant as of, and for, the periods presented in this Quarterly Report;

4. The registrant s other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and have:

a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this Quarterly Report is being prepared;

b) evaluated the effectiveness of the registrant s disclosure controls and procedures as of a date within 90 days prior to the filing date of this Quarterly Report (the Evaluation Date); and

c) presented in this Quarterly Report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

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

a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant s ability to record, process, summarize, and report financial data and have identified for the registrant s auditors any material weaknesses in internal controls; and

b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant s internal controls; and

6. The registrant s other certifying officer and I have indicated in this Quarterly Report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: May 14, 2003

/s/ James K. Bass

James K. Bass
Chief Executive Officer

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CERTIFICATION

I, Peter W. Harper, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Suntron Corporation;

2. Based on my knowledge, this Quarterly Report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this Quarterly Report;

3. Based on my knowledge, the financial statements, and other financial information included in this Quarterly Report, fairly present in all material respects the financial condition, results of operations, and cash flows of the registrant as of, and for, the periods presented in this Quarterly Report;

4. The registrant s other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and have:

a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this Quarterly Report is being prepared;

b) evaluated the effectiveness of the registrant s disclosure controls and procedures as of a date within 90 days prior to the filing date of this Quarterly Report (the Evaluation Date); and

c) presented in this Quarterly Report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;

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

a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant s ability to record, process, summarize, and report financial data and have identified for the registrant s auditors any material weaknesses in internal controls; and

b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant s internal controls; and

6. The registrant s other certifying officer and I have indicated in this Quarterly Report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: May 14, 2003

/s/ Peter W. Harper

Peter W. Harper
Chief Financial Officer

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