CVD EQUIPMENT CORP
Form 10-Q
November 14, 2016

**UNITED STATES SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

Form 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2016

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

For the transition period from ____ to _____

Commission file number: 1-16525

**CVD EQUIPMENT CORPORATION**

*(Exact Name of Registrant as specified in its charter)*

| | |
|---|---|
| **New York** | **11-2621692** |
| ***(State or Other Jurisdiction of Incorporation or Organization)*** | ***(I.R.S. Employer Identification No.)*** |

**355 South Technology Drive Central Islip, New York**

**11722**
***(Address of principal executive offices)***

(631) 981-7081
**(Registrant's telephone number, including area code)**

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

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

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

| | | |
|---|---|---|
| Large accelerated filer | | Accelerated filer |
| Non-accelerated filer | (Do not check if a smaller reporting company) | Smaller reporting company |

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date: 6,324,180 shares of Common Stock, $0.01 par value at November 7, 2016.

**CVD EQUIPMENT CORPORATION AND SUBSIDIARY**

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PART 1 – FINANCIAL INFORMATION

CVD EQUIPMENT CORPORATION AND SUBSIDIARIES

Consolidated Balance Sheets

(Unaudited)

| | September 30, 2016 | December 31, 2015 |
|---|---|---|
| ASSETS | | |
| Current Assets: | | |
| Cash and cash equivalents | $16,636,744 | $13,073,331 |
| Accounts receivable, net | 7,160,443 | 3,091,251 |
| Costs and estimated earnings in excess of billings on contracts in progress | 3,159,828 | 4,635,018 |
| Inventories | 3,050,758 | 2,986,430 |
| Restricted cash - current | --- | 200,000 |
| Deferred income taxes – current | 825,215 | 398,009 |
| Other current assets | 258,020 | 167,056 |
| Total Current Assets | 31,091,008 | 24,551,095 |
| Property, plant and equipment, net | 14,217,902 | 14,793,923 |
| Construction in progress | 56,946 | 33,306 |
| Deferred income taxes – non-current | 2,016,239 | 1,606,830 |
| Restricted cash – non-current | --- | 200,000 |
| Other assets | 75,469 | 86,215 |
| Intangible assets, net | 46,349 | 60,335 |
| Total Assets | $47,503,913 | $41,131,704 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Current Liabilities: | | |
| Accounts payable | $298,834 | $308,004 |
| Accrued expenses | 1,271,934 | 3,445,880 |
| Current maturities of long-term debt | 300,000 | 580,000 |
| Billings in excess of costs and estimated earnings on contracts in progress | 9,130,870 | --- |
| Deferred revenue | 149,652 | 307,683 |
| Total Current Liabilities | 11,151,290 | 4,641,567 |
| Long-term debt, net of current portion | 3,040,508 | 3,265,508 |
| Total Liabilities | 14,191,798 | 7,907,075 |

| | | |
|---|---|---|
| Commitments and Contingencies | ---- | ---- |
| | | |
| Stockholders' Equity | | |
| Common stock - $0.01 par value – 10,000,000 shares authorized; issued and outstanding, 6,324,180 at September 30, 2016 and 6,198,135 at December 31, 2015 | 63,242 | 61,981 |
| Additional paid-in-capital | 23,900,179 | 22,895,202 |
| Retained earnings | 9,348,694 | 10,267,446 |
| Total Stockholders' Equity | 33,312,115 | 33,224,629 |
| | | |
| Total Liabilities and Stockholders' Equity | $47,503,913 | $41,131,704 |

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

CVD EQUIPMENT CORPORATION AND SUBSIDIARIES

Consolidated Statements of Operations

(Unaudited)

| | Three Months Ended September 30, 2016 | Three Months Ended September 30, 2015 | Nine Months Ended September 30, 2016 | Nine Months Ended September 30, 2015 |
|---|---|---|---|---|
| Revenue | $4,883,511 | $10,645,824 | $13,630,726 | $30,772,421 |
| Cost of revenue | 3,192,345 | 6,520,341 | 9,912,207 | 18,730,107 |
| Gross profit | 1,691,166 | 4,125,483 | 3,718,519 | 12,042,314 |
| Operating expenses | | | | |
| Research and development | 150,257 | 75,484 | 304,591 | 545,246 |
| Selling and shipping | 261,006 | 312,400 | 805,681 | 900,120 |
| General and administrative | 1,675,163 | 1,871,818 | 5,145,343 | 6,007,553 |
| Litigation settlement | --- | 995,000 | --- | 995,000 |
| Gain on settlement | --- | --- | (628,905) | --- |
| Total operating expenses | 2,086,426 | 3,254,702 | 5,626,710 | 8,447,919 |
| Operating (loss)/income | (395,260) | 870,781 | (1,908,191) | 3,594,395 |
| Other income (expense) | | | | |
| Interest income | 7,054 | 5,894 | 20,582 | 17,708 |
| Interest expense | (19,153) | (22,042) | (61,608) | (70,907) |
| Other income | 118,645 | -- | 123,093 | 781 |
| Total other income/(expense) | 106,546 | (16,148) | 82,067 | (52,418) |
| (Loss)/income before income taxes | (288,714) | 854,633 | (1,826,124) | 3,541,977 |
| Income tax (benefit)/expense | (203,310) | 43,550 | (907,372) | 727,759 |
| Net (loss)/income | $(85,404) | $811,083 | $(918,752) | $2,814,218 |
| Basic (loss)/income per common share | $(0.01) | $0.13 | $(0.15) | $0.46 |
| Diluted (loss)/income per common share | $(0.01) | $0.13 | $(0.15) | $0.45 |
| Weighted average common shares Outstanding-basic | 6,323,039 | 6,171,086 | 6,269,102 | 6,169,836 |
| Net effect of potential common share issuance: | | | | |
| Stock options | --- | 94,119 | --- | 111,516 |

| | | | | |
|---|---|---|---|---|
| Weighted average common shares Outstanding-diluted | 6,323,039 | 6,265,205 | 6,269,102 | 6,281,353 |

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

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CVD EQUIPMENT CORPORATION AND SUBSIDIARIES

Consolidated Statements of Cash Flows

(Unaudited)

| | Nine Months Ended September 30, 2016 | 2015 |
|---|---|---|
| Cash flows from operating activities: | | |
| Net (loss)/income | $(918,752) | $2,814,218 |
| Adjustments to reconcile net (loss)/income to net cash provided by operating activities: | | |
| Stock-based compensation expense | 544,238 | 556,593 |
| Depreciation and amortization | 618,227 | 636,236 |
| Deferred tax benefit | (836,615) | (331,750) |
| Provision for doubtful accounts | 39,313 | 32,063 |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | (4,108,505) | 1,376,880 |
| Costs and estimated earnings in excess of billings on contracts in progress | 1,475,190 | (13,308) |
| Inventories, net | (64,328) | 1,195,169 |
| Income taxes - current | | 511,158 |
| Other current assets | (22,669) | 90,355 |
| Increases/(decreases) in operating liabilities: | | |
| Accounts payable and accrued expenses | (2,251,405) | 741,707 |
| Current maturities of long-term debt | (280,000) | (35,000) |
| Billings in excess of costs and estimated earnings on contracts in progress | 9,130,870 | (575,482) |
| Accrued litigation settlement | --- | (4,925,000) |
| Deferred revenue | (158,031) | (254,058) |
| Total adjustments | 4,086,285 | (994,437) |
| Net cash provided by operating activities | 3,167,533 | 1,819,781 |
| | | |
| Cash flows from investing activities: | | |
| Release of restricted cash | 200,000 | 200,000 |
| Capital expenditures | (42,670) | (212,594) |
| Deposits | 1,550 | --- |
| Net cash provided by/(used in) investing activities | 158,880 | (12,594) |
| | | |
| Cash flows from financing activities: | | |
| Net proceeds from stock options exercised | 462,000 | -- |
| Payments of long-term debt | (225,000) | (505,000) |
| Net cash provided by/(used in) financing activities | 237,000 | (505,000) |
| | | |
| Net increase in cash and cash equivalents | 3,563,413 | 1,302,187 |
| Cash and cash equivalents at beginning of period | 13,073,331 | 11,966,863 |
| | | |
| Cash and cash equivalents at end of period | $16,636,744 | $13,269,050 |

| | | |
|---|---|---|
| Supplemental disclosure of cash flow information: | | |
| Income taxes paid | $101,352 | $427,078 |
| Interest paid | $61,608 | $70,907 |

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

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**CVD EQUIPMENT CORPORATION AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**September 30, 2016**

**(Unaudited)**

NOTE 1: BASIS OF PRESENTATION

The accompanying unaudited consolidated financial statements for CVD Equipment Corporation and Subsidiaries (collectively, "the Company") have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and with the instructions to Form 10-Q and Article 8 of Regulation S-X. They do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary in order to make the interim financials not misleading have been included and all such adjustments are of a normal recurring nature. The operating results for the three and nine months ended September 30, 2016 are not necessarily indicative of the results that can be expected for the year ending December 31, 2016.

The balance sheet as of December 31, 2015 has been derived from the audited consolidated financial statements at such date, but does not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. For further information, please refer to the consolidated financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2015, including the accounting policies followed by the Company as set forth in Note 2 to the consolidated financial statements contained therein.

All material intercompany transactions have been eliminated in consolidation.

NOTE 2: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Revenue Recognition

Revenues from product and service sales, including those based on time and materials type contracts, are recognized when persuasive evidence of an arrangement exists, product delivery has occurred or services have been rendered, pricing is fixed or determinable, and collection is reasonably assured. Service sales revenues, principally representing repair, maintenance and engineering activities are recognized over the contractual period or as services are rendered.

**CVD EQUIPMENT CORPORATION AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**September 30, 2016**

**(Unaudited)**

NOTE 2: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

Revenues from fixed price contracts are recognized on the percentage of completion method, measured on the basis of incurred costs to estimated total costs for each contract. This "cost to cost" method is used because management considers it to be the best available measure of progress on these contracts.

Contract costs include all direct material and labor costs and those indirect costs related to contract performance, such as indirect labor, supplies, tools, repairs and depreciation costs.

Selling, general and administrative costs are charged to expense as incurred. Provisions for estimated losses on contracts in progress are made in the period in which such losses are determined. Changes in job requirements, job conditions, and estimated profitability, and final contract settlements may result in revisions to costs and income and are recognized in the period in which the revisions are determined.

The asset, "Costs and estimated earnings in excess of billings on contracts in progress," represents revenues recognized in excess of amounts billed.

The liability, "Billings in excess of costs and estimated earnings on contracts in progress," represents amounts billed in excess of revenues recognized.

Recent Accounting Pronouncements

In May 2014, The Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2014-09, "Revenue from Contracts with Customers" (Topic 606), which changes the criteria for recognizing revenue.

The standard requires an entity which recognizes revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The standard requires a five-step process for recognizing revenues including identifying the contract with the customer, identifying the performance obligations in the contract, determining the transaction prices, allocating the transaction price to the performance obligations in the contract, and recognizing revenue when (or as) the entity satisfies a performance obligation. Publicly-traded companies were initially required to adopt the ASU for reporting periods beginning after December 15, 2016; however, the FASB, in August 2015, then issued ASU No. 2015-14 to defer the mandatory effective date of ASU 2014-09 for all entities by one year. Currently companies may choose among different transition alternatives. Management is currently evaluating the impact that ASU 2014-09 will have on the Company’s consolidated financial statements and have not yet determined which method of adoption will be selected.

**CVD EQUIPMENT CORPORATION AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**September 30, 2016**

**(Unaudited)**

NOTE 2: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

In July 2015, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) 2015-11, "*Simplifying the Measurement of Inventory.*" This update requires an entity that determines the cost of inventory by methods other than last-in, first-out (LIFO) and the retail inventory method (RIM) to measure inventory at the lower of cost and net realizable value. ASU 2015-11 is effective for annual reporting periods, and interim periods therein, beginning after December 15, 2016. Prospective application is required. Early application is permitted as of the beginning of the interim or annual reporting period. The Company does not expect that the adoption of this guidance will have a significant impact on the Company's Consolidated Financial Statements.

In November 2015, the Financial Accounting Standards Board (“FASB”) issued accounting Standards Update (“ASU”) 2015-17, *Balance Sheet Classification of Deferred Taxes*.” This update requires an entity to classify deferred tax liabilities and assets as noncurrent within a classified statement of financial position. ASU 2015-17 is effective for annual reporting periods, and interim periods therein, beginning after December 15, 2016. This update may be applied either prospectively to all deferred tax liabilities and assets or retrospectively to all periods presented. Early application is permitted as of the beginning of the interim or annual reporting period. The Company does not expect that the adoption of this guidance will have a significant impact on the Company’s Consolidated Financial Statements.

In February 2016 the FASB issued a new standard which requires a lessee to recognize on its balance sheet the assets and liabilities associated with the rights and obligations created by leases with terms that exceed twelve months. Leases will continue to be classified as either financing or operating, with classification affecting the recognition, measurement and presentation of costs and cash flows arising from a lease. The new guidance is effective for interim and annual reporting periods beginning after December 15, 2018 and requires a modified retrospective approach to adoption for lessees related to capital and operating leases existing at, or entered into after, the earliest comparative period presented in the financial statements, with certain practical expedients available. Early adoption is permitted. We are currently evaluating the effect that this new standard will have on our condensed consolidated financial statements.

In March 2016, the FASB issued an amendment which simplifies several aspects of the accounting for employee share-based payment transactions, including the accounting for income taxes, forfeitures and statutory tax withholding requirements, classification of awards as either equity or liabilities, as well as classification in the statement of cash flows. This amendment is effective for prospective interim and annual reporting periods beginning after December 15, 2016. We plan on adopting this amendment at that time and are currently evaluating its effect on our condensed consolidated financial statements.

NOTE 3: CONCENTRATION OF CREDIT RISK

Financial instruments that potentially subject the Company to concentrations of credit risk consist of cash and cash equivalents and accounts receivable. The Company places its cash equivalents with high credit-quality domestic financial institutions and invests its excess cash primarily in savings accounts and money market instruments. The Company performs periodic evaluations of the relative credit standing of all such institutions as it seeks to maintain stability and liquidity. Cash and cash investments at September 30, 2016 and December 31, 2015, exceeded the Federal Deposit Insurance Corporation (“FDIC”) limits by $15.0 million and $12.0 million respectively. The Company sells products and services to various companies across several industries in the ordinary course of business. The Company performs ongoing credit evaluations to assess the probability of accounts receivable collection based on a number of factors, including past transaction experience, evaluation of their credit history and review of the invoicing terms of the contract to determine the financial strength of its customers. The Company also maintains allowances for anticipated losses.

**CVD EQUIPMENT CORPORATION AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**September 30, 2016**

**(Unaudited)**

NOTE 4: CONTRACTS IN PROGRESS

Costs and estimated earnings in excess of billings on contracts in progress are summarized as follows:

| | September 30, 2016 | December 31, 2015 |
|---|---|---|
| Costs incurred on contracts in progress | $4,847,325 | $7,695,281 |
| Estimated earnings | 14,091,572 | 7,635,114 |
| | 18,938,897 | 15,330,395 |
| Less: Billings to date | (24,909,939) | (10,695,377) |
| | $(5,971,042) | $4,635,018 |
| Included in accompanying balance sheets under the following captions: | | |
| Costs and estimated earnings in excess of billings on contracts in progress | $3,159,828 | $4,635,018 |
| Billings in excess of costs and estimated earnings on contracts in progress | (9,130,870) | --- |
| | $(5,971,042) | $4,635,018 |

NOTE 5: INVENTORIES

Inventories are stated at the lower of cost or net realizable value computed on a first-in, first-out basis and consist of the following:

| | September 30, 2016 | December 31, 2015 |
|---|---|---|
| Raw materials | $2,862,560 | $2,718,328 |
| Work-in-process | 123,972 | 174,698 |

| | | |
|---|---|---|
| Finished goods | 64,226 | 93,404 |
| Totals | $3,050,758 | $2,986,430 |

NOTE 6: ACCOUNTS RECEIVABLE

Accounts receivable are presented net of an allowance for doubtful accounts of approximately $58,000 and $19,000 as of September 30, 2016 and December 31, 2015, respectively. The allowance is based on prior experience and management's evaluation of the collectability of accounts receivable. Management believes the allowance is adequate. However, future estimates may change based on changes in future economic conditions.

**CVD EQUIPMENT CORPORATION AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**September 30, 2016**

**(Unaudited)**

NOTE 7: DEBT

The Company has a revolving credit facility with HSBC Bank, USA, N.A. ("HSBC") providing up to $7 million, although the Company has never utilized this facility. This credit facility remains available until September 1, 2018. The credit facility also contains certain financial covenants, all of which the Company was in compliance with at September 30, 2016. On August 1, 2016 the Company made the final payment on a $2.1 million term loan that was initially entered into in August 2011. The balance on that term loan at December 31, 2015 was $280,000.

Borrowings under the term loan were initially collateralized by $1,000,000 restricted cash deposits and reduced on each anniversary of the closing date, August 5th by $200,000, provided that, so long as no event of default had occurred and was continuing. The restricted balance which was $200,000 on December 31, 2015 and is reported as a separate line item on the consolidated balance sheet was completely released on May 5, 2016.

Pursuant to the terms of an Accommodation Agreement, we entered into a loan agreement with HSBC in the amount of $6 million, the proceeds of which were used to finance a portion of the purchase price of our headquarters in Central Islip, New York. The loan is secured by a mortgage against our Central Islip facility. The loan is payable in 120 consecutive equal monthly installments of principal of $25,000 plus interest thereon and a final balloon payment. Interest accrues on the loan, at our option, at the variable rate of LIBOR plus 1.75% which was 2.1765 and 2.0670% at September 30, 2016 and December 31, 2015 respectively. The outstanding principal balances on the loan at September 30, 2016 and December 31, 2015 were $3.3 and $3.6 million. The loan matures on March 15, 2022.

NOTE 8: STOCK-BASED COMPENSATION EXPENSE

During the three and nine months ended September 30, 2016 and September 30, 2015, the Company recorded compensation expense as part of general administrative expense, of $198,000 and $544,000 and $186,000 and $557,000 respectively, for the cost of employee and director services received in exchange for equity instruments based on the grant-date fair value of those instruments. This expense was recorded based upon the guidance of ASC 718, "Compensation-Stock Compensation."

**CVD EQUIPMENT CORPORATION AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**September 30, 2016**

**(Unaudited)**

NOTE 9: INCOME TAXES

The provision for income taxes includes the following:

| | Nine Months Ended September 30, | |
|---|---|---|
| | 2016 | 2015 |
| Current: | | |
| Federal | $(71,070 ) | $1,043,650 |
| State | 314 | 15,859 |
| Total Current Provision | (70,756 ) | 1,059,509 |
| Deferred: | | |
| Federal | $(836,616) | $(331,750 ) |
| State | ---- | --- |
| Total deferred | (836,616) | (331,750 ) |
| Income tax expense/(benefit) | $(907,372) | $727,759 |

Tax Rate Reconciliation

The reconciliation between the Company's effective tax rate on income from continuing operations and the statutory rate is as follows:

| | Nine Months Ended September 30, | |
|---|---|---|
| | 2016 | 2015 |
| Income tax benefit at federal statutory rate [34%] | $(620,882) | $1,204,274 |
| Change in capitalized inventory (Section 263A) | | |
| Change in other accruals | (13,537 ) | 32,217 |

| | | |
|---|---|---|
| Difference between tax and book depreciation | 50,213 | (24,312 ) |
| Stock-based compensation | (48,993 ) | (39,234 ) |
| Research and development credits | (203,103) | (973,649 ) |
| Domestic production activities deduction | --- | (109,989 ) |
| Net operating loss carryforward | --- | 954,581 |
| Tax carryback | --- | (511,158 ) |
| Provision for tax return true up | (71,070 ) | 195,029 |
| Income tax expense | $(907,372) | $727,759 |

NOTE 10: EARNINGS PER SHARE

Basic earnings per share are computed by dividing net earnings available to common shareholders (the numerator) by the weighted average number of common shares (the denominator) for the period presented. The computation of diluted earnings per share is similar to basic earnings per share, except that the denominator is increased to include the number of additional common shares that would have been outstanding if the potentially dilutive common shares had been issued.

**CVD EQUIPMENT CORPORATION AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**September 30, 2016**

**(Unaudited)**

NOTE 10: EARNINGS PER SHARE (continued)

Stock options to purchase 159,730 shares of common stock were outstanding and 79,730 were exercisable during the three and nine months ended September 30, 2016. Stock options to purchase 259,730 shares were outstanding and 147,230 were exercisable during the three and nine months ended September 30, 2015. For the three and nine months ended September 30, 2016, none of the outstanding options were included in the earnings per share calculation as their effect would have been antidilutive. For the three and nine months ended September 30, 2015, all outstanding options were included in the diluted earnings per share calculation because the average market price was higher than the exercise price.

The potentially dilutive common shares from warrants and options are calculated in accordance with the treasury stock method, which assumes that proceeds from the exercise of all warrants and options are used to repurchase common stock at market value. The amount of shares remaining after the proceeds are exhausted represents the potential dilutive effect of the securities.

NOTE 11: SEGMENT REPORTING

The Company operates through two (2) segments, CVD and SDC. The CVD division, which operates out of Central Islip, New York, is utilized for silicon, silicon germanium, silicon carbide and gallium arsenide processes. SDC is the Company’s ultra-high purity manufacturing division in Saugerties, New York. The respective accounting policies of CVD and SDC are the same as those described in the summary of significant accounting policies (see Note 2). The Company evaluates performance based on several factors, of which the primary financial measure is income or (loss) before taxes.

**CVD EQUIPMENT CORPORATION AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**September 30, 2016**

**(Unaudited)**

NOTE 11: SEGMENT REPORTING (continued)

Three Months

Ended September 30,

| | CVD | SDC | Eliminations * | Consolidated |
|---|---|---|---|---|
| 2016 | | | | |
| Assets | $46,147,895 | $4,316,826 | $(2,960,808) | $47,503,913 |
| Revenue | $4,253,544 | $846,696 | $(216,729) | $4,883,511 |
| Pretax (loss) | (180,638) | (108,076) | | (288,714) |
| 2015 | | | | |
| Assets | $41,587,898 | $3,826,352 | $(2,039,829) | $43,374,421 |
| Revenue | $9,373,890 | $1,445,257 | $(173,323) | $10,645,824 |
| Pretax income | 687,094 | 167,539 | | 854,633 |
| December 31, 2015 | | | | |
| Assets | $39,529,971 | $3,619,304 | $(2,017,571) | $41,131,704 |

Nine Months

Ended September 30,

| | CVD | SDC | Eliminations * | Consolidated |
|---|---|---|---|---|
| 2016 | | | | |
| Revenue | $11,589,421 | $2,352,384 | $(311,079) | $13,630,726 |

| | | | | |
|---|---|---|---|---|
| Pretax income | (1,544,278 ) | (281,846 ) | | (1,826,124 ) |
| | | | | |
| 2015 | | | | |
| Revenue | $27,921,375 | $4,676,210 | $(1,825,164 ) | $30,772,421 |
| Pretax income | 2,322,739 | 1,219,238 | | 3,541,977 |

*All elimination entries represent intersegment revenues eliminated in consolidation for external financial reporting.

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

*Except for historical information contained herein, this "Management's Discussion and Analysis of Financial Condition and Results of Operations" contains forward-looking statements within the meaning of the U.S. Private Securities Litigation Reform Act of 1995, as amended. These statements involve known and unknown risks, uncertainties and other factors which may cause the actual results, performance, or achievements of the Company to be materially different from any future results, performance, or achievements expressed or implied by such forward-looking statements. These forward-looking statements were based on various factors and were derived utilizing numerous important assumptions and other important factors that could cause actual results to differ materially from those in the forward-looking statements. Important assumptions and other factors that could cause actual results to differ materially from those in the forward-looking statements, include but are not limited to: competition in the Company's existing and potential future product lines of business; the Company's ability to obtain financing on acceptable terms if and when needed; uncertainty as to the Company's future profitability, uncertainty as to the future profitability of acquired businesses or product lines, uncertainty as to any future expansion of the Company. Other factors and assumptions not identified above were also involved in the derivation of these forward-looking statements and the failure of such assumptions to be realized as well as other factors may also cause actual results to differ materially from those projected. The Company assumes no obligation to update these forward looking statements to reflect actual results, changes in assumptions or changes in other factors affecting such forward-looking statements. Past results are no guaranty future performance. You should not place undue reliance on any forward-looking statements, which speak only as of the dates they are made. When used with this Report, the words "believes," "anticipates," "expects," "estimates," "plans," "intends," "will" and similar expressions are intended to identify forward-looking statements.*

**Results of Operations**

***Three Months Ended September 30, 2016 vs. Three Months Ended September 30, 2015***

| | Three Months Ended September 30, 2016 | September 30, 2015 | Change | % Change |
|---|---|---|---|---|
| (In thousands) | | | | |
| Orders | $5,020 | $ 2,863 | $2,157 | 75.3 |
| Order Backlog | 31,811 | 11,487 | 20,324 | 176.9 |
| | | | | |
| Revenue | | | | |
| CVD (net of eliminations) | $4,254 | $ 9,373 | $(5,119 ) | (54.6 ) |
| SDC (net of eliminations) | 630 | 1,273 | (643 ) | (50.5 ) |
| Total Revenue | 4,884 | 10,646 | (5,762 ) | (54.1 ) |
| | | | | |
| Cost of Goods Sold | 3,192 | 6,520 | (3,328 ) | (51.0 ) |
| | | | | |
| Gross Profit | 1,691 | 4,126 | (2,435 ) | (59.0 ) |
| Gross Margin | 34.6 % | 38.8 % | | |
| | | | | |
| Research and development | 150 | 75 | 75 | 100.0 |
| Selling and shipments | 261 | 312 | (51 ) | (16.3 ) |
| General and administrative | 1,675 | 1,872 | (197 ) | (10.5 ) |
| Loss on litigation settlement | --- | 995 | (995 ) | (100.0 ) |
| Total operating expenses | 2,086 | 3,254 | (1,168 ) | (35.9 ) |
| | | | | |
| Operating (loss)/income | (395 ) | 872 | (1,267 ) | (145.3 ) |
| | | | | |
| Other income/(expense) | 106 | (16 ) | 122 | 762.5 |
| | | | | |
| (Loss)/income before taxes | (289 ) | 856 | (1,145 ) | (133.8 ) |
| | | | | |
| Income tax (benefit)/expense | (204 ) | 44 | (248 ) | 563.6 |
| | | | | |
| Net (loss)/income | (85 ) | 812 | (897 ) | (110.5 ) |

***<u>Orders/Order Backlog</u>***

During the three months ended September 30, 2016, we received $5.0 million in new orders, compared to $2.9 million in new orders received during the three months ended September 30, 2015, an increase of $2.1 million or 75.3%. This resulted in a backlog of $31.8 million as of September 30, 2016 compared to $11.5 million as of September 30, 2015. The timing of the receipt of an order is subject to various factors, most of which are not under our control. As a result, our order levels from period to period, tend to be uneven. Order levels attained in one three month period are not necessarily indicative of order levels that will be attained in future periods. $27.1 million or 85.2% of the backlog at September 30, 2016 is a result of multiple orders from one customer compared to $6.1 million or 53.0% at September 30, 2015. However only 8% of the orders received during the three months ended September 30, 2016 were from this customer. Although timing for completion of the backlog varies depending on the product mix and can be as long as two years, we believe a significant portion of our current backlog will be completed within the next twelve months. Included in the backlog are all accepted purchase orders, less any amounts which have been previously billed or recognized as a component of our percentage-of-completion calculations. Management utilizes the order backlog to assist it in gauging projected revenues and profits; however, it does not provide an assurance of future achievement of revenues or profits as, for example, order cancellations or delays are possible.

***Revenue***

Our revenue for the three months ended September 30, 2016 was $4.9 million compared to $10.6 million for the three months ended September 30, 2015, resulting in a decrease of 54.1%. This decrease was primarily attributable to the protracted negotiations with our customer, a major aviation component supplier, which caused a delay in receiving a large anticipated follow-on order. This customer, from which we have secured multiple orders, represented $2.1 million or 42.9% of our revenue for the three months ended September 30, 2016 compared to $5.3 million or 50.0% of our revenue from that same customer for the three months ended September 30, 2015.

Revenue from the SDC division (net of intercompany eliminations) for the three months ended September 30, 2016 decreased by 50.5% to $630,000 compared to $1,273,000 for the three months ended September 30, 2015 based on the work performed on the decreased level of order activity as discussed above.

***Gross Profit***

We generated a gross profit of $1.7 million with a gross profit margin of 34.6% for the three months ended September 30, 2016 compared to a gross profit of $4.1 million and a gross profit margin of 38.8% for the three months ended September 30, 2015. The reduced gross profit and gross margin was the result of the lower revenue and the costs associated with maintaining production staff in anticipation of the large follow-on order from our largest customer.

***Research and Development, Selling, General and Administrative Expenses***

Internal research and development expenses for the three months ended September 30, 2016 amounted to $150,000 compared to $75,000 for the three months ended September 30, 2015, as we increased the level of investment in research and development for our products.

Selling and shipping expenses for the three months ended September 30, 2016 was $261,000 compared to $312,000 for the three months ended September 30, 2015 which represented 5.3% and 2.9% of our revenue for the respective periods. This decrease was attributable to a reduction in personnel.

We incurred approximately $1.7 million of general and administrative expenses or 34.7% of our revenue for the three months ended September 30, 2016 compared to approximately $1.9 million or 17.6% of our revenue during the three months ended September 30, 2015. The decrease in absolute dollars was primarily attributable to a decrease in legal fees in the current period as compared to the prior year which was the result of the settlement of certain legal matters during the period (See below, Litigation Settlement).

***Operating (loss)/income***

As a result of the aforementioned, we incurred a loss from operations of $395,000 for the three months ended September 30, 2016 compared to income from operations of $871,000 for the three months ended September 30, 2015.

***Other income/(expense)***

During the three months ended September 30, 2016, we received a payment from our insurance company on a property damage claim the exceeded the repair costs by $119,000.

***Income Taxes***

For the three months ended September 30, 2016, we did not incur any current income tax expense and recorded $204,000 of deferred tax benefits primarily due to the tax loss that we incurred during the period. Current income tax expense for the three months ended September 30, 2015 was $44,000 as we utilized certain research and development credits that were available to us to minimize taxes.

***Net (loss)/income***

We reported a net loss of $85,000 or ($0.01) per share basic and diluted for the three months ended September 30, 2016, compared to net income of $812,000 or $0.13 per share basic and diluted for the three months ended September 30, 2015.

***Nine Months Ended September 30, 2016 vs. Nine Months Ended September 30, 2015***

| | September 30, 2016 | September 30, 2015 | Change | % Change |
|---|---|---|---|---|
| (In thousands) | | | | |
| Orders | $ 39,183 | $ 21,186 | $ 17,997 | 84.9 |
| Order Backlog | 31,811 | 11,487 | 20,324 | 176.9 |
| | | | | |
| Revenue | | | | |
| CVD (net of eliminations) | $ 11,584 | $ 27,910 | $ (16,326) | (58.5) |
| SDC (net of eliminations) | 2,047 | 2,862 | (815) | (28.5) |
| Total Revenue | 13,631 | 30,772 | (17,141) | (55.7) |
| | | | | |
| Cost of Goods Sold | 9,912 | 18,730 | (8,818) | (47.1) |
| | | | | |
| Gross Profit | 3,719 | 12,042 | (8,323) | (69.1) |
| Gross Margin | 27.3 % | 39.1 % | | |
| | | | | |
| Research and development | 305 | 545 | (240) | (44.0) |
| Selling and shipping | 806 | 900 | (94) | (10.4) |
| General and administrative | 5,145 | 6,008 | (863) | (14.4) |
| Loss on litigation settlement | --- | 995 | (995) | (100.0) |
| Gain on settlement | (629) | --- | (629) | |
| Total operating expenses | 5,627 | 8,448 | (2,821) | (33.4) |
| | | | | |
| Operating (loss)/income | (1,908) | 3,594 | (5,502) | (153.1) |
| | | | | |
| Other income/(expense) | 82 | (52) | 134 | 257.7 |
| | | | | |
| (Loss)/income before taxes | (1,826) | 3,542 | (5,368) | (151.6) |
| | | | | |
| Income tax (benefit)/expense | (908) | 728 | 1,636 | 224.7 |
| | | | | |
| Net (loss)/income | (918) | 2,814 | (3,732) | (132.6) |

***Orders/Order Backlog***

During the nine months ended September 30, 2016, we received $39.2 million in new orders compared to $21.2 million in new orders received during the nine months ended September 30, 2015 an increase of $18.0 million or 84.9%. This resulted in a backlog of $31.8 million as of September 30, 2016 compared to $11.5 million as of September 30, 2015. The timing of the receipt of an order is subject to various factors, most of which are not under our control. As a result, our order levels from period to period, tend to be uneven. Order levels attained in one period are not necessarily indicative of order levels that will be attained in future periods**.** The backlog on September 30, 2016 consists of multiple orders totaling $27.1 million from one customer, or 85.2% of our backlog compared to $6.1 million or 53.0% from that same customer on September 30, 2015 and $29.5 million or 90.8% at June 30, 2016.

***Revenue***

Our revenue for the nine months ended September 30, 2016, totaled $13.6 million, a decrease of $17.2 million or 55.7% compared to $30.8 million for the nine months ended September 30, 2015. This decrease was primarily attributable to the protracted negotiations with our customer, a major aviation component supplier, which caused a delay in receiving a large anticipated follow-on order. One customer from which we have secured multiple orders represented $8.3 million or 61.0% of our revenue for the nine months ended September 30, 2016 compared to $18.6 million or 60.4% of our revenue for the nine months ended September 30, 2015.

Non-intercompany revenue from the SDC division for the nine months ended September 30, 2016 decreased by 28.5% to $2.0 million compared to $2.9 million for the nine months ended September 30, 2015 based on work performed on the decreased level of order activity and reduced backlog as discussed above.

***Gross Profit***

During the nine months ended September 30, 2016, we generated a gross profit of $3.7 million resulting in a gross profit margin of 27.3% as compared to the nine months ended September 30, 2015 when our gross profit was $12.0 million with a gross margin of 39.1%**.** The decrease in gross margin we are currently experiencing is the result of lower revenues and the costs associated with maintaining production staff in anticipation of the large follow-on order from our largest customer which was discussed above.

***Research and Development, Selling and General and Administrative Expenses***

Internal research and development expenses for the nine months ended September 30, 2016 were $305,000 compared to $545,000 for the nine months ended September 30, 2015. The Company had temporarily curtailed independent research and development activities during the first six months of the current year, however, it has now expanded those activities during the third quarter of 2016.

Selling and shipping expenses for the nine months ended September 30, 2016 and 2015 were $806,000 and $900,000, respectively.

General and administrative expenses totaled $5.1 million and $6.0 million for the nine months ended September 30, 2016 and 2015, respectively, a decrease of 14.4%. The decrease is primarily attributable to a reduction in legal costs during the current period as compared to the nine months ended September 30, 2015.

***Gain on Settlement***

The Company has included in its financial statements for the nine months ended September 30, 2016, the results of a negotiated reduction to legal fees and expenses previously accrued in connection with the settlement of the Taiwan Glass litigation. The final negotiated sum was $1.1 million, resulting in a reduction of the amount that was previously billed and accrued and a gain on the statement of operations of $629,000 during the period.

***Litigation Settlement***

Pursuant to a settlement agreement, in September, 2015, the Company paid the sum of $995,000 to Development Specialists, Inc., an Illinois corporation, solely in its capacity as assignee for the benefit of creditors of CM Manufacturing, Inc., f/k/a Stion Corporation, a Delaware corporation in full settlement and satisfaction of all claims asserted in a previously disclosed proceeding. Each party released all claims of any nature which it had against the other.

***Operating (Loss)/Income***

As a result of the decreased revenues, we incurred a loss from operations of $1.9 million for the nine months ended September 30, 2016 compared to income from operations of $3.6 million for the nine months ended September 30, 2015.

***Other Income/(Expenses)***

During the nine months ended September 30, 2016, we received a payment from our insurance company on a property damage claim the exceeded the repair costs by $119,000.

***Income Taxes***

For the nine months ended September 30, 2016, we did not incur any current income tax expense, received a refund of $71,000 as a result of an overpayment on the 2015 federal corporate tax return and recorded $837,000 of deferred tax benefits primarily due to the tax loss we incurred for the current period. Current income tax expenses for the nine months ended September 30, 2015 amounted to $700,000.

***Net (Loss)/Income***

We reported a net loss of $0.9 million or ($0.15) per share basic and diluted for the nine months ended September 30, 2016 compared net income of $2.8 million or $0.46 per share basic and $0.45 per share diluted for the nine months ended September 30, 2015.

***Inflation***

Inflation has not materially impacted the operations of our Company.

***Liquidity and Capital Resources***

As of September 30, 2016 and December 31, 2015, our working capital was $19.9 million. As of September 30, 2016 our cash and cash equivalents were $16.6 million, compared to $13.1 million at December 31, 2015, an increase of $3.5 million. This increase was primarily the result of customer payments on outstanding balances during this nine month period.

Accounts receivable, net, as of September 30, 2016 and December 31, 2015 were $7.2 million and $3.1 million respectively. One customer represented 84% and 40% of the balances on September 30, 2016 and December 31, 2015, respectively.

At September 30, 2016, the number of full time employees decreased to 177 employees compared to 192 at December 31, 2015.

We believe that our cash and cash equivalents position and cash flow from operations will be sufficient to meet our working capital and capital expenditure requirements for the next twelve months.

We may also raise additional funds in the event we determine in the future to effect one or more acquisitions of businesses, technologies or products. In addition, we may elect to raise additional funds even before we need them if the conditions for raising capital are favorable. Any equity or equity-linked financing could be dilutive to existing shareholders.

***Off-Balance Sheet Arrangements.***

We have no off-balance sheet arrangements at this time.

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

Not applicable.

**Item 4. Controls and Procedures**.

Evaluation of Disclosure Controls and Procedures

We maintain a system of disclosure controls and procedures (as defined in Rule 13a-15(e) under the Exchange Act). As required by Rule 13a-15(b) under the Exchange Act, management of the Company, under the direction of our Chief Executive Officer and Chief Financial Officer, reviewed and performed an evaluation of the effectiveness of design and operation of the Company's disclosure controls and procedures (as defined in Rule 13a-15(e) under the Exchange Act) as of the end of the period covered by this Quarterly Report on Form 10-Q (the "Report").

Based on that review and evaluation, the Chief Executive Officer and Chief Financial Officer, along with our management, have determined that as of the end of the period covered by the Report on Form 10-Q, the disclosure controls and procedures were and are effective to provide reasonable assurance that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms and were effective to provide reasonable assurance that such information is accumulated and communicated to our management, including our principal executive officer and principal financial officer, as appropriate to allow timely decisions regarding disclosures.

Changes in Internal Controls

There were no changes in our internal controls over financial reporting as defined in Rule 13a-15(f) or Rule 15d-15(f) under the Exchange Act that occurred during the most recent fiscal quarter that have materially affected, or are reasonably likely to materially affect, the internal controls over financial reporting.

Limitations on the Effectiveness of Controls

We believe that a control system, no matter how well designed and operated, cannot provide absolute assurance that the objectives of the control systems are met, and no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within a company have been detected.

**CVD EQUIPMENT CORPORATION**

**PART II**

**OTHER INFORMATION**

**Item 1. Legal Proceedings.**

None.

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

None.

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

None.

**Item 4. Mine Safety Disclosures.**

Not Applicable.

**Item 5. Other Information.**

None.

**Item 6. Exhibits**

The exhibits below are hereby furnished to the SEC as part of this report:

| | |
|---|---|
| 31.1* | Certification of Leonard A. Rosenbaum, Chief Executive Officer, dated November 14, 2016. |
| 31.2* | Certification of Glen R. Charles, Chief Financial Officer, dated November 14, 2016. |
| 32.1* | Certification of Leonard A. Rosenbaum, Chief Executive Officer, dated November 14, 2016, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |
| 32.2* | Certification of Glen R. Charles, Chief Financial Officer, dated November 14, 2016, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes- Oxley Act of 2002. |
| 101.INS** | XBRL Instance. |
| 101.SCH** | XBRL Taxonomy Extension Schema. |
| 101.CAL** | XBRL Taxonomy Extension Calculation |
| 101.DEF** | XBRL Taxonomy Extension Definition. |
| 101.LAB** | XBRL Taxonomy Extension Labels. |
| 101.PRE** | XBRL Taxonomy Extension Presentation. |

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*Filed herewith

**Pursuant to Rule 406T of Regulation S-T, these interactive data files are deemed not to be filed or part of a registration statement or prospectus for purposes of Section 11 or 12 of the Securities Act of 1933, as amended, are deemed not filed for purposes of Section 18 of the Securities Act of 1934, as amended, and otherwise not subject to liability under these sections.

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, this 14th day of November 2016.

CVD EQUIPMENT CORPORATION

By: /s/ Leonard A. Rosenbaum
Leonard A. Rosenbaum
Chief Executive Officer, President and Chairman
(Principal Executive Officer)

By: /s/ Glen R. Charles
Glen R. Charles
Chief Financial Officer
(Principal Financial and Accounting Officer)

EXHIBIT INDEX

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