SOLITRON DEVICES INC
Form 10-Q
October 09, 2013

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

(Mark one)

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

For the quarterly period ended August 31, 2013

or

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

For the transition period from _______ to _______

Commission File No. 1-4978

SOLITRON DEVICES, INC.
(Exact Name of Registrant as Specified in Its Charter)

Delaware (State or Other Jurisdiction of Incorporation or Organization)	22-1684144 (I.R.S. Employer Identification No.)
3301 Electronics Way, West Palm Beach, Florida (Address of Principal Executive Offices)	33407 (Zip Code)

(561) 848-4311
(Registrant’s Telephone Number, Including Area Code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§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 x No ¨

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

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

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

The number of shares of the registrant's common stock, $0.01 par value, outstanding as of October 1, 2013 was 2,177,832.

SOLITRON DEVICES, INC.

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PART I – FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

SOLITRON DEVICES, INC.
CONDENSED BALANCE SHEETS
AS OF AUGUST 31, 2013 AND FEBRUARY 28, 2013

	(unaudited) August 31, 2013	February 28, 2013
	(in thousands, except for share and per share amounts)	
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	$711	$ 1,297
Treasury bills and certificates of deposit	6,015	5,173
Accounts receivable, less allowance for doubtful accounts of $2	656	1,081
Inventories, net (Note 5)	4,269	4,033
Prepaid expenses and other current assets	151	168
TOTAL CURRENT ASSETS	11,802	11,752
PROPERTY, PLANT AND EQUIPMENT, net	603	592
OTHER ASSETS	30	36
TOTAL ASSETS	$12,435	$ 12,380
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES		
Accounts payable – Post-petition	$363	$ 313
Accounts payable – Pre-petition	80	278
Customer deposits	296	271
Accrued expenses (Note 8)	469	722
TOTAL CURRENT LIABILITIES	1,208	1,584
LONG-TERM LIABILITIES, net of current portion	-	-
TOTAL LIABILITIES	1,208	1,584
COMMITMENTS AND CONTINGENCIES		
STOCKHOLDERS' EQUITY		
Preferred stock, $.01 par value, authorized 500,000 shares, none issued	-	-
Common stock, $.01 par value, authorized 10,000,000 shares, 2,177,832 shares issued and outstanding, net of 273,230 shares of treasury stock	23	23
Additional paid-in capital	2,743	2,743
Accumulated other comprehensive income	15	13
Retained earnings	8,721	8,292
Less treasury stock	(275)	(275)

TOTAL STOCKHOLDERS' EQUITY	11,227	10,796
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$12,435	$ 12,380

The accompanying notes are an integral part of the unaudited condensed financial statements.

SOLITRON DEVICES, INC.
CONDENSED STATEMENTS OF INCOME
FOR THE THREE AND SIX MONTHS ENDED AUGUST 31, 2013 AND AUGUST 31, 2012
(Unaudited, in thousands except for share and per share amounts)

	Three months		Six Months	
	2013	2012	2013	2012
NET SALES	$2,041	$1,965	$4,317	$4,033
Cost of Sales	1,547	1,541	3,217	3,144
Gross Profit	494	424	1,100	889
Selling, General and Administrative Expenses	322	261	767	576
Operating Income	172	163	333	313
Other income (Note 7)				
Other income	-	12	86	12
Interest Income	7	12	16	27
Total other income	7	24	102	39
Income before provision for income taxes	179	187	435	352
Provision for income taxes	(2)	(2)	(6)	(6)
Net Income	$177	$185	$429	$346
Other comprehensive income:				
Unrealized (loss)/gain on investments	(8)	-	2	-
Total comprehensive income	$169	$185	$431	$346
Income Per Share from operating income-Basic	$.08	$.07	$.15	$.15
Income Per Share from operating income-Diluted	$.07	$.07	$.14	$.14
Net Income Per Share-Basic	$.08	$.08	$.20	$.15
Net Income Per Share-Diluted	$.07	$.08	$.18	$.14
Weighted average shares outstanding-Basic	2,177,832	2,249,931	2,177,832	2,259,469
Weighted average shares outstanding-Diluted	2,402,491	2,461,104	2,403,041	2,472,495

The accompanying notes are an integral part of the unaudited condensed financial statements.

SOLITRON DEVICES, INC.
CONDENSED STATEMENTS OF CASH FLOWS
SIX MONTHS ENDED AUGUST 31, 2013 AND AUGUST 31, 2012

(Unaudited)

	2013	2012
	(in thousands)	
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$431	$346
Adjustments to reconcile net income to net cash provided by and (used in) operating activities:		
Depreciation and amortization	117	143
Decrease (increase) in operating assets:		
Accounts receivable	425	(94)
Inventories, net	(236)	(479)
Prepaid expenses and other current assets	17	(24)
Other assets	6	27
Increase (decrease) in operating liabilities:		
Accounts payable – Post-petition	50	105
Accounts payable – Pre-petition	(198)	(14)
Customer deposits	25	42
Accrued expenses	(253)	(115)
Long-term liabilities	-	(10)
Total adjustments	(47)	(419)
NET CASH PROVIDED BY/(USED IN) OPERATING ACTIVITIES	384	(73)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Sales of Treasury Bills and Certificates of Deposit	2,340	2,928
Purchases of Treasury Bills and Certificates of Deposit	(3,182)	(2,583)
Purchases of property, plant and equipment	(128)	(69)
NET CASH (USED IN) /PROVIDED BY INVESTING ACTIVITIES	(970)	276
CASH FLOWS FROM FINANCING ACTIVITIES:		
Purchase of treasury stock	-	(275)
Cash from exercise of employee stock options	-	7
NET CASH (USED IN) FINANCING ACTIVITIES	-	(268)
Net (decrease) in cash and cash equivalents	(586)	(65)
Cash and cash equivalents – beginning of the period	1,297	985
Cash and cash equivalents - end of the period	$711	$920

The accompanying notes are an integral part of the unaudited condensed financial statements.

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SOLITRON DEVICES, INC.
NOTES TO CONDENSED FINANCIAL STATEMENTS

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Operations and Activities
Solitron Devices, Inc., a Delaware corporation (the “Company” or “Solitron”), designs, develops, manufactures, and markets solid-state semiconductor components and related devices primarily for the military and aerospace markets. The Company was incorporated under the laws of the State of New York in 1959 and reincorporated under the laws of the State of Delaware in August 1987.

Basis of Presentation
The unaudited condensed financial statements have been prepared in accordance with United States generally accepted accounting principles (“GAAP”) for interim financial information and with the instructions to Form 10-Q and Article 8 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements.

The unaudited condensed financial information furnished herein reflects all adjustments, consisting of normal recurring items that, in the opinion of management, are necessary for a fair presentation of the Company’s financial position, results of operations and cash flows for the interim periods. The results of operations for the six months ended August 31, 2013 are not necessarily indicative of the results to be expected for the year ending February 28, 2014.

The information included in this Form 10-Q should be read in conjunction with the Company’s Annual Report on Form 10-K for the year ended February 28, 2013.

Cash and Cash Equivalents
Cash and cash equivalents include demand deposits and money market accounts.

Investment in Treasury Bills and Certificates of Deposit
Investment in treasury bills and certificates of deposit include treasury bills with maturities of one year or less, and certificates of deposit with maturities from one to three years, and is stated at market value.

All of the Company’s investments are classified as available-for-sale. As they are available for current operations, they are classified as current on the balance sheets. Investments in available-for-sale securities are reported at fair value with unrecognized gains or losses, net of tax, as a component of accumulated other comprehensive income and is included as a separate component of stockholders’ equity. The Company monitors its investments for impairment periodically and records appropriate reductions in carrying values when the declines are determined to be other-than-temporary.

Face Value as of 08/31/13	
Tbills	1,683,000
CD	4,330,000
	6,013,000

SOLITRON DEVICES, INC.
NOTES TO CONDENSED FINANCIAL STATEMENTS

As of August 31, 2013, contractual maturities of the Company's available-for-sale non-equity investments were as follows:

	Face value (In thousands)	Fair Value
Maturing within one year	$ 5,266,000	$ 5,267,188
Maturing in one to three years	747,000	747,443
	$ 6,013,000	$ 6,014,631

Fair Value of Financial Instruments
ASC Topic 820, "Fair Value Measurements and Disclosures" defines "fair value" as the price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. ASC 820 also sets forth a valuation hierarchy of the inputs (assumptions that market participants would use in pricing an asset or liability) used to measure fair value. This hierarchy prioritizes the inputs into the following three levels:

Level 1. Observable inputs that reflect unadjusted quoted prices for identical assets or liabilities traded in active markets.

Level 2. Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly.

Level 3. Inputs that are generally unobservable. These inputs may be used with internally developed methodologies that results in management's best estimate of fair value.

The Company's brokered Treasury bills and certificates of deposits are subject to level 1 fair value measurement.

The carrying amounts of the Company's short-term financial instruments, including accounts receivable, accounts payable, accrued expenses and other liabilities approximate their fair value due to the relatively short period to maturity for these instruments. The fair value of long-term debt is based on current rates at which the Company could borrow funds with similar remaining maturities, and the carrying amount of the long-term debt approximates fair value.

Accounts Receivable
Accounts receivable consists of unsecured credit extended to the Company's customers in the ordinary course of business. The Company reserves for any amounts deemed to be uncollectible based on past collection experiences and an analysis of outstanding balances, using an allowance account. The allowance amount was $2,000 as of August 31, 2013 and February 28, 2013.

Shipping and Handling
Shipping and handling costs billed to customers are recorded in net sales. Shipping costs incurred by the Company are recorded in cost of sales.

SOLITRON DEVICES, INC.
NOTES TO CONDENSED FINANCIAL STATEMENTS

Inventories
Inventories are stated at the lower of cost or market. Cost is determined using the "first-in, first-out" (FIFO) method. The Company buys raw material only to fill customer orders. Excess raw material is created only when a vendor imposes a minimum buy in excess of actual requirements. Such excess material will usually be utilized to meet the requirements of the customer's subsequent orders. If excess material is not utilized after two fiscal years, it is fully reserved. Any inventory item once designated as reserved is carried at zero value in all subsequent valuation activities.

The Company's inventory valuation policy is as follows:

Raw material /Work in process:	All material purchased, processed, and/or used in the last two fiscal years is valued at the lower of its acquisition cost or market. All material not purchased/used in the last two fiscal years is fully reserved.
Finished goods:	All finished goods with firm orders for later delivery are valued (material and overhead) at the lower of cost or market. All finished goods with no orders are fully reserved.
Direct labor costs:	Direct labor costs are allocated to finished goods and work in process inventory based on engineering estimates of the amount of man-hours required from the different direct labor departments to bring each device to its particular level of completion.

Revenue Recognition
Revenue is recognized in accordance with SEC Staff Accounting Bulletin No. 104, Revenue Recognition. This pronouncement requires that four basic criteria be met before revenue can be recognized: 1) there is evidence that an arrangement exists; 2) delivery has occurred; 3) the fee is fixed or determinable; and 4) collectability is reasonably assured. We recognize revenue upon determination that all criteria for revenue recognition have been met. The criteria are usually met at the time of product shipment. Shipping terms are generally FCA (Free Carrier) shipping point.

Financial Statement Estimates
The preparation of condensed financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates, and the differences could be material. Such estimates include depreciable life, valuation allowance, and allowance for inventory obsolescence.

Recent Accounting Pronouncements
No recent accounting pronouncements affecting the Company were issued by the Financial Accounting Standards Board or other standards-setting bodies.

2. ENVIRONMENTAL REGULATION

While the Company believes that it has the environmental permits necessary to conduct its business and that its operations conform to present environmental regulations, increased public attention has been focused on the environmental impact of semiconductor manufacturing operations. The Company, in the conduct of its manufacturing operations, has handled and does handle materials that are considered hazardous, toxic or volatile under federal, state and local laws and, therefore, is subject to regulations related to their use, storage, discharge and disposal. No assurance can be made that the risk of accidental release of such materials can be completely eliminated. In the event of a violation of environmental laws, the Company could be held liable for damages and the costs of remediation. In addition, the Company, along with the rest of the semiconductor industry, is subject to variable interpretations and governmental priorities concerning environmental laws and regulations.

SOLITRON DEVICES, INC.
NOTES TO CONDENSED FINANCIAL STATEMENTS

Environmental statutes have been interpreted to provide for joint and several liability and strict liability regardless of actual fault. There can be no assurance that the Company will not be required to incur costs to comply with, or that the operations, business or financial condition of the Company will not be materially adversely affected by current or future environmental laws or regulations.

3. ENVIRONMENTAL LIABILITIES

The Company entered into an Ability to Pay Multi-Site Settlement Agreement with the United States Environmental Protection Agency ("USEPA"), effective February 24, 2006 ("Settlement Agreement"), to resolve the Company's alleged liability to USEPA at five Superfund sites. The Company made payments to USEPA on February 14, 2013 and May 22, 2013 in the amounts of $10,000 and $7,710 respectively, that completed the Company's financial obligations under the Settlement Agreement. The Company has no further financial obligations to USEPA under the Settlement Agreement. In consideration of the payments made by the Company under the Settlement Agreement, USEPA agreed not to sue or take any administrative action against the Company with regard to any of the Superfund sites.

On March 27, 2013, the Company entered into a Settlement Agreement (the "Agreement") with FDEP, which resolved all of the Company's remaining obligations under a Consent Final Judgment previously entered into with the Florida Department of Environmental Protection ("FDEP"), dated October 21, 1993, and amended on September 27, 1995. Pursuant to the terms and conditions of the Agreement, the Company paid to FDEP the total sum of $165,000 ("Settlement Amount"), in full settlement of the Company's obligations under the Consent Final Judgment. Upon the Company's payment of the Settlement Amount to FDEP on March 29, 2013, FDEP released the Company from any remaining obligations under the Consent Final Judgment, as amended, as well as any remaining obligations of the Company to FDEP under the Company's Fourth Amended Joint Plan of Reorganization (the "Confirmed Plan"), confirmed by order of the United States Bankruptcy Court for the Southern District of Florida ("Bankruptcy Court") on August 20, 1993, in connection with the Company's bankruptcy proceeding filed in 1992. The Company has no further obligations to FDEP under the Confirmed Plan or the Consent Final Judgment, as amended.

On September 9, 2013, the Company received notice that the Company was named as a defendant in a Third Party Complaint filed by the Clarkstown Landfill Joint Defense Group ("JDG"). In the Third Party Complaint, the JDG contends that the Company is liable for an equitable share of the JDG's settlement payment to the New York State Department of Environmental Conservation ("NYSDEC") in connection with response costs incurred by NYSDEC to remediate the Clarkstown Landfill Site located in the Town of Clarkstown, Rockland County, New York (the "Clarkstown Landfill Site"). The JDG has offered to settle its claim against the Company for the sum of $125,000. The Company contends the JDG's claim derives from NYSDEC's claim against the Company as a result of the Company's alleged disposal of wastes at the Clarkstown Landfill Site prior to the closing of the Company's former Tappan facility in the mid-1980's, a claim that was discharged in bankruptcy as a result of the Bankruptcy Court's August 20, 1993 order. By letter dated September 11, 2013, the Company advised the JDG's attorney that any attempt to serve the Third Party Complaint on the Company would violate the express terms and conditions of the Bankruptcy Court's August 20, 1993 order and that the Company would seek a subsequent order from the Bankruptcy Court preventing the JDG from pursuing its claim against the Company.

4. EARNINGS PER SHARE

The shares used in the computation of the Company's basic and diluted earnings per common share were as follows:

	For the three months ended	For the six months ended

	August 31,		August 31,	
	2013	2012	2013	2012
Weighted average common shares outstanding	2,177,832	2,249,931	2,177,832	2,259,469
Dilutive effect of employee stock options	224,659	211,173	225,209	213,026
Weighted average common shares outstanding, assuming dilution	2,402,491	2,461,104	2,403,041	2,472,495

SOLITRON DEVICES, INC.
NOTES TO CONDENSED FINANCIAL STATEMENTS

Weighted average common shares outstanding, assuming dilution, include the incremental shares that would be issued upon the assumed exercise of stock options. For the three-month periods ended August 31, 2013 and August 31, 2012 respectively, 12,300 and 13,500 shares underlying the Company's stock options were excluded from the calculation of diluted earning per share because the exercise prices of the stock options were greater than or equal to the average price of the common shares, and therefore their inclusion would have been anti-dilutive.

These options could be dilutive in the future if the average share price increases and is greater than the exercise price of these options.

5. INVENTORIES

As of August 31, 2013, inventories consist of the following:

	Gross	Reserve	Net
Raw Materials	$ 1,908,000	$ (348,000)	$ 1,560,000
Work-In-Process	3,429,000	(1,243,000)	2,186,000
Finished Goods	1,203,000	(680,000)	523,000
Totals	$ 6,540,000	$ (2,271,000)	$ 4,269,000

As of February 28, 2013, inventories consist of the following:

	Gross	Reserve	Net
Raw Materials	$ 2,131,000	$ (372,000)	$ 1,759,000
Work-In-Process	3,339,000	(1,206,000)	2,133,000
Finished Goods	750,000	(609,000)	141,000
Totals	$ 6,220,000	$ (2,187,000)	$ 4,033,000

6. INCOME TAXES

At August 31, 2013, the Company has net operating loss carryforwards of approximately $15,161,000 that expire through 2031. Such net operating losses are available to offset future taxable income, if any. As the utilization of such net operating losses for tax purposes is not assured, the deferred tax asset has been fully reserved through the recording of a 100% valuation allowance. Should a cumulative change in the ownership of more than 50% occur within a three-year period, there could be an annual limitation on the use of the net operating loss carryforwards.

Total net deferred taxes are comprised of the following at August 31, 2013 and February 28, 2013:

Deferred Tax Asset (Liability):	8/31/13	2/28/13
Current		
Allowance for doubtful accounts	$ 1,000	$ 1,000
Inventory allowance	863,000	831,000
Section 263A capitalized costs	389,000	389,000
Total current deferred tax assets	1,253,000	1,221,000
Valuation allowance	(1,253,000)	(1,221,000)
	$ 0	$ 0

Long-term				
Loss carryforwards	$	5,330,000	$	5,330,000
Depreciation		(71,000)		(58,000)
Total long-term deferred tax assets		5,259,000		5,272,000
Valuation allowance		(5,259,000)		(5,272,000)
	$	0	$	0

SOLITRON DEVICES, INC.
NOTES TO CONDENSED FINANCIAL STATEMENTS

The change in the valuation allowance on deferred tax assets is due principally to the utilization of the net operating loss for the period ended August 31, 2013 and the year ended February 28, 2013. A reconciliation of the U.S. federal statutory tax rate to the Company's effective tax rate for the quarter ended August 31, 2013 and for the year ended February 28, 2013 is as follows:

	8/31/13		2/28/13	
U.S. federal statutory rate	34.0	%	34.0	%
Change in valuation allowance	(34.0	)	(34.0	)
Alternative minimum taxes	2.5		1.0	
Effective income tax rate	2.5	%	1.0	%

7. OTHER INCOME

The $7,000 of other income reflected in the unaudited condensed statements of income for the quarter ended August 31, 2013 consists of interest income on investment in treasury bills and certificates of deposit. The $24,000 of other income reflected in the condensed statements of income for the quarter ended August 31, 2012 consists of $12,000 of interest income on investment in treasury bills net of changes in market value plus $12,000 of income from receivables adjustments.

8. ACCRUED EXPENSES

As of August 31, 2013 and February 28, 2013, accrued expenses and other liabilities consisted of the following:

	8/31/13	2/28/13
Payroll and related employee benefits	$ 385,000	$ 451,000
Income taxes	16,000	11,000
Property taxes	29,000	7,000
Environmental liabilities	-	125,000
Other liabilities	39,000	128,000
	$ 469,000	$ 722,000

9. EXPORT SALES AND MAJOR CUSTOMERS

Revenues from domestic and export sales to unaffiliated customers for the three months ended August 31, 2013 are as follows:

Geographic Region	Power Transistors	Hybrids	Field Effect Transistors	Power MOSFETS	Totals
Europe and Australia	$7,000	$63,000	$0	$18,000	$88,000
Canada and Latin America	7,000	0	3,000	0	10,000
Far East and Middle East	6,000	0	1,000	98,000	105,000
United States	389,000	873,000	99,000	477,000	1,838,000
Totals	$409,000	$936,000	$103,000	$593,000	$2,041,000

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SOLITRON DEVICES, INC.
NOTES TO CONDENSED FINANCIAL STATEMENTS

Revenues from domestic and export sales to unaffiliated customers for the three months ended August 31, 2012 are as follows:

Geographic Region	Power Transistors	Hybrids	Field Effect Transistors	Power MOSFETS	Totals
Europe and Australia	$0	$0	$11,000	$0	$11,000
Canada and Latin America	7,000	0	7,000	0	14,000
Far East and Middle East	0	0	3,000	63,000	66,000
United States	407,000	856,000	134,000	477,000	1,874,000
Totals	$414,000	$856,000	$155,000	$540,000	$1,965,000

Revenues from domestic and export sales are attributed to global geographic region according to the location of the customer's primary manufacturing or operating facilities.

For the quarter ended August 31, 2013, sales to the Company's top two customers consisted of the following:

Customer	% of Sales	
Raytheon Company	49	%
Lockheed Martin Corporation	11	%
	60	%

For the quarter ended August 31, 2012, sales to the Company's top two customers consisted of the following:

Customer	% of Sales	
Raytheon Company	34	%
United States Government	21	%
	55	%

10. MAJOR SUPPLIERS

For the quarter ended August 31, 2013, purchases from the Company's top two vendors consisted of the following:

Vendor	% of Purchases	
Egide, USA	44	%
Air Products, Inc.	9	%
	53	%

For the quarter ended August 31, 2012, purchases from the Company's top two vendors consisted of the following:

Vendor	% of Purchases	
WUXI Streamtek Ltd.	19	%
Aotco Metal Finishing	13	%

	32	%

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SOLITRON DEVICES, INC.
NOTES TO CONDENSED FINANCIAL STATEMENTS

11. COMMITMENTS AND CONTINGENCIES

Future minimum lease payments for the Company's manufacturing facility are as follows:

Fiscal Year Ending February 28/29	Amount
2014	197,000
2015	403,000
2016	415,000
2017	355,000
Total	$ 1,370,000

Item 2. MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Overview:

Solitron Devices, Inc., a Delaware corporation (the “Company” or “Solitron”), designs, develops, manufactures and markets solid-state semiconductor components and related devices primarily for the military and aerospace markets. The Company manufactures a large variety of bipolar and metal oxide semiconductor (“MOS”) power transistors, power and control hybrids, junction and power MOS field effect transistors and other related products. Most of the Company’s products are custom made pursuant to contracts with customers whose end products are sold to the United States government. Other products, such as Joint Army/Navy transistors, diodes and Standard Military Drawings voltage regulators, are sold as standard or catalog items.

The following discussion and analysis of factors which have affected the Company's financial position and operating results during the periods included in the accompanying unaudited condensed financial statements should be read in conjunction with the Financial Statements and the related Notes to Financial Statements and Management’s Discussion and Analysis of Financial Condition and Results of Operations included in the Company’s Annual Report on Form 10-K for the year ended February 28, 2013 and the Condensed Financial Statements and the related Notes to unaudited Condensed Financial Statements included in Item 1 of this Quarterly Report on Form 10-Q.

Significant Accounting Policies:

The discussion and analysis of our financial condition and results of operations are based upon the unaudited condensed financial statements included in Item 1 of this Quarterly Report on Form 10-Q which are prepared in accordance with accounting principles generally accepted in the United States. Preparing financial statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue, and expenses. These estimates and assumptions are affected by management’s application of accounting policies. Our critical accounting policies include cash and cash equivalents, investment in Treasury bills and certificates of deposit, accounts receivable, shipping and handling, and inventories. A discussion of all of these critical accounting policies can be found in Note 1 of the “Notes To Financial Statements” in Item 8 of our Annual Report on Form 10-K for the fiscal year ended February 28, 2013.

Trends and Uncertainties:

During the three months ended August 31, 2013, the Company’s book-to-bill ratio was approximately 1.14 as compared to approximately 1.44 for the three months ended August 31, 2012, reflecting a decrease in the volume of orders booked. The Company does not believe that, in most years, the year-to-year change in the book-to-bill ratio indicates a specific trend in the demand for the Company’s products. Generally, the intake of orders over the last twenty four months has varied greatly as a result of the fluctuations in the general economy, variations in defense spending on programs the Company supports, and the timing of contract awards by the Department of Defense and subsequently by its prime contractors, which is expected to continue over the next twelve to twenty four months. The Company continues to identify means intended to reduce its variable manufacturing costs to offset the potential impact of low volume of orders to be shipped. However, should order intake fall drastically in the coming periods, the Company might be required to implement further cost cutting or other downsizing measures to continue profitable business operations.

Inventories

Inventories are stated at the lower of cost or market. Cost is determined using the “first-in, first-out” (FIFO) method. The Company buys raw material only to fill customer orders. Excess raw material is created only when a vendor imposes a minimum buy in excess of actual requirements. Such excess material will usually be utilized to meet the requirements of the customer’s subsequent orders. If excess material is not utilized after two fiscal years it is fully reserved. Any inventory item once designated as reserved is carried at zero value in all subsequent valuation activities.

The Company’s inventory valuation policy is as follows:

Raw material /Work in process:	All material purchased, processed and/or used in the last two fiscal years is valued at the lower of its acquisition cost or market. All material not purchased/used in the last two fiscal years is fully reserved for.
Finished goods:	All finished goods with firm orders for later delivery are valued (material and overhead) at the lower of cost or market. All finished goods with no orders are fully reserved.
Direct labor costs:	Direct labor costs are allocated to finished goods and work in process inventory based on engineering estimates of the amount of man hours required from the different direct labor departments to bring each device to its particular level of completion.

Results of Operations-Three Months Ended August 31, 2013 Compared to Three Months Ended August 31, 2012:

Net sales for the three months ended August 31, 2013 increased 4% to $2,041,000 as compared to $1,965,000 for the three months ended August 31, 2012. This increase was primarily attributable to an increase in the value of orders that were shipped in accordance with customer requirements.

Cost of sales for the three months ended August 31, 2013 increased to $1,547,000 from $1,541,000 for the three months ended August 31, 2012, primarily due to a higher level of shipments. Expressed as a percentage of sales, cost of sales decreased to 76% from 78% for the same period in 2012. This decrease in percentage was due primarily to lower raw material cost as a result of precious metal recovery and a higher amount of net sales as described above.

Gross profit for the three months ended August 31, 2013 increased to $494,000 from $424,000 for the three months ended August 31, 2012, primarily due to an increase in net sales and lower raw material cost as mentioned above. Accordingly, gross margins on the Company’s sales increased to 24% for the three months ended August 31, 2013 in comparison to 22% for the three months ended August 31, 2012.

For the three months ended August 31, 2013, the Company shipped 30,191 units as compared to 75,556 units shipped during the same period of the prior year. It should be noted that since the Company manufactures a wide variety of products with an average sales price ranging from less than one dollar to several hundred dollars, such periodic variations in the Company’s volume of units shipped should not be regarded as a reliable indicator of the Company’s performance.

For the three months ended August 31, 2013, the Company’s backlog of open orders increased 5% to $6,127,000 as compared to the backlog of open orders of $5,863,000 as of May 31, 2013. Also, for the three months ended August 31, 2013, the Company’s backlog of open orders decreased 31% as compared to the backlog of open orders of $8,840,000 as of August 31, 2012. Changes in backlog reflect changes in the intake of orders and in the delivery requirements of customers.

The Company has experienced a decrease of 18% to $2,319,000 in the level of bookings during the three months ended August 31, 2013 as compared to the same period in the prior year. The decrease in bookings for the three months ended August 31, 2013 is principally a result of a decrease in the placement of orders by key customers, resulting in a decrease in the monetary value of, and timing differences in, the placement of contracts by the Department of Defense and its prime contractors.

Selling, general, and administrative expenses increased to $322,000 for the three months ended August 31, 2013 from $261,000 for the same period in the prior year. The increase reflects higher legal fees and expenses associated with our annual meeting. During the three months ended August 31, 2013, selling, general, and administrative expenses as a percentage of net sales increased to 16% as compared to 13% for the three months ended August 31, 2012.

Operating income for the three months ended August 31, 2013 increased to $172,000 as compared to $163,000 for the three months ended August 31, 2012. This increase is due primarily to higher net sales and lower cost of materials as a result of precious metal recovery.

The Company recorded other income of $7,000 for the three months ended August 31, 2013 as compared to $24,000 for the three months ended August 31, 2012. Other income for the three months ended August 31, 2013 includes $7,000 of interest income on investment in treasury bills and certificates of deposit. Other income for the three months ended August 31, 2012 includes $12,000 of interest income on investment in treasury bills and certificates of deposit, net of changes in market value, and $12,000 of income from a non-recurring adjustment to accounts receivable. The decrease in interest income is due primarily to a decrease in interest rates on invested funds.

Net income for the three months August 31, 2013 decreased to $177,000 as compared to $185,000 for the same period in 2012. This decrease is due primarily to increased selling, general, and administrative expenses as outlined above.

Results of Operations-Six Months Ended August 31, 2013 Compared to Six Months Ended August 31, 2012:

Net sales for the six months ended August 31, 2013 increased 7% to $4,317,000 as compared to $4,033,000 for the six months ended August 31, 2012. This increase was primarily attributable to an increase in the value of orders that were shipped in accordance with customer requirements.

Cost of sales for the six months ended August 31, 2013 increased to $3,217,000 from $3,144,000 for the six months ended August 31, 2012. Expressed as a percentage of sales, cost of sales decreased to 75% as compared to 78% for the same period in 2012. This decrease in percentage was due primarily to lower raw material cost as a result of precious metal recovery and a higher amount of net sales as described above.

Gross profit for the six months ended August 31, 2013 increased to $1,100,000 from $889,000 for the six months ended August 31, 2012, primarily due to an increase in net sales and lower raw material cost as mentioned above. Gross margins on the Company’s sales increased to 25% as compared to 22% for the same period in 2012.

For the six months ended August 31, 2013, the Company shipped 56,021 units as compared to 112,732 units shipped during the same period of the prior year. It should be noted that since the Company manufactures a wide variety of products with an average sales price ranging from less than one dollar to several hundred dollars, such periodic variations in the Company’s volume of units shipped should not be regarded as a reliable indicator of the Company’s performance.

For the six months ended August 31, 2013, the Company’s backlog of open orders decreased 20% to $6,127,000 as compared to the backlog of open orders of $7,685,000 as of February 28, 2013. Also, for the six months ended August 31, 2013, the Company’s backlog of open orders decreased 31% as compared to the backlog of open orders of $8,841,000 as of August 31, 2012. Changes in backlog resulted from changes in the intake of orders and in the delivery dates required by customers.

The Company has experienced a decrease of 60% to $2,774,000 in the level of bookings during the six months ended August 31, 2013 when compared with the six months ended August 31, 2012. The decrease occurred principally a result of a decrease in the placement of orders by key customers, resulting in a decrease in the monetary value of, and timing differences in, the placement of contracts by the Department of Defense and its prime contractors.

Selling, general, and administrative expenses increased to $767,000 for the six months ended August 31, 2013 from $576,000 for the same period in the prior year, primarily due to higher legal fees associated with a shareholder lawsuit and expenses associated with our annual meeting. During the six months ended August 31, 2013, selling, general, and administrative expenses as a percentage of net sales increased to 18% as compared to 14% for the six months ended August 31, 2012.

Operating income for the six months ended August 31, 2013 increased to $333,000 from $313,000 for the six months ended August 31, 2012. This increase is due primarily to higher net sales and lower cost of materials as a result of precious metal recovery.

The Company recorded other income of $102,000 for the six months ended August 31, 2013 as compared to other income of $39,000 for the six months ended August 31, 2012. Included in other income for the six months ended August 31, 2013 was $90,000 of income from cancellation of debt and $16,000 of interest income on investment in treasury bills and certificates of deposit partially offset by $4,000 of other expense. Included in other income for the six months ended August 31, 2012 was $27,000 of interest income on investment in treasury bills and certificates of deposit, net of changes in market value, and $12,000 of income from receivables adjustments.

Net income for the six months ended August 31, 2013 increased to $429,000 from $346,000 for the same period in 2012. This increase is due primarily to higher net sales, lower cost of materials, and an increase in other income as outlined above.

Liquidity and Capital Resources:

Operating Activities:
Net cash provided by operating activities was $384,000 for the six months ended August 31, 2013 primarily reflecting net income of $431,000.

Net cash used in operating activities was $73,000 for the six months ended August 31, 2012 primarily reflecting net income of $346,000 offset by an increase of $479,000 to net inventories.

Investing Activities:
Net cash used in investing activities was $970,000 for the six months ended August 31, 2013 primarily reflecting $842,000 in investments in treasury bills and certificates of deposit and $128,000 in purchases of property, plant and equipment.

Net cash provided by investing activities was $276,000 for the six months ended August 31, 2012 primarily reflecting a net decrease of $345,000 in investments in treasury bills and certificates of deposit offset by $69,000 in purchases of property, plant and equipment.

Financing Activities:
There was no net cash used in financing activities for the six months ended August 31, 2013.

Net cash used in financing activities was $268,000 for the six months ended August 31, 2012 primarily reflecting a $275,000 purchase of treasury stock offset by $7,000 from stock option exercises by the Company's employees.

Subject to the following discussion, the Company expects its sole source of liquidity over the next twelve months to be cash from operations. The Company anticipates that its capital expenditures required to sustain operations will be approximately $150,000 during the balance of the current fiscal year and will be funded from operations.

Based upon (i) management's best information as to current national defense priorities, future defense programs, as well as management's expectations as to future defense spending, (ii) the market trends signaling a declining level of bookings, but with an increase in the cost of raw materials and operations that will result in the potential erosion of profit levels and continued price pressures due to more intense competition, and (iii) the continued competition in the defense and aerospace market, the Company believes that it will have sufficient cash on hand to satisfy its operating needs during the next twelve months and at the current level of payments to its pre-bankruptcy creditors. However, due to the level of current backlog and projected new order intake (due to the status of the general economy and the shift to Commercial Off –The-Shelf (COTS) by the defense industry), the Company might be required to take cost cutting and productivity enhancing activity to assure its continued profitability.

Over the long-term, based on these factors and at the current level of bookings, costs of raw materials and services, profit margins and sales levels, the Company believes that it will generate sufficient cash from operations to satisfy its operating needs and the level of payments to pre-bankruptcy creditors it has maintained over the last eighteen years. In the event that bookings in the long-term decline significantly below the level experienced during the previous two fiscal years, the Company may be required to implement further cost-cutting or other downsizing measures to continue its business operations. Such cost-cutting measures could inhibit future growth prospects. In appropriate situations, the Company may seek strategic alliances or joint ventures with others or acquisitions in order to maximize marketing potential and utilization of existing resources to provide further opportunities for growth.

At August 31, 2013, February 28, 2013 and August 31, 2012, the Company had cash and cash equivalents of approximately $711,000, $1,297,000 and $920,000, respectively. The cash decrease for the six months ended August 31, 2013 was primarily due to the purchase of treasury bills and certificates of deposit.

At August 31, 2013, February 28, 2013 and August 31, 2012, the Company had investments in treasury bills and certificates of deposit of approximately $6,015,000, $5,173,000 and $6,269,000, respectively.

At August 31, 2013, the Company had working capital of $10,594,000 as compared with a working capital at August 31, 2012 of $9,804,000. At February 28, 2013, the Company had a working capital of $10,168,000. The $426,000 increase for the six months ended August 31, 2013 was due primarily to the $429,000 of net income for the period.

Off-Balance Sheet Arrangements:

The Company has not engaged in any off-balance sheet arrangements.

Forward Looking Statements:

Some of the statements in this Quarterly Report on Form 10-Q are "forward-looking statements," as that term is defined in the Private Securities Litigation Reform Act of 1995. These forward-looking statements include statements regarding our business, financial condition, results of operations, strategies or prospects. You can identify forward-looking statements by the fact that these statements do not relate strictly to historical or current matters. Rather, forward-looking statements relate to anticipated or expected events, activities, trends or results. Because forward-looking statements relate to matters that have not yet occurred, these statements are inherently subject to risks and uncertainties. Many factors could cause our actual activities or results to differ materially from the activities and results anticipated in forward-looking statements. These factors include those described under the caption "Risk Factors" in our Annual Report on Form 10-K for the year ended February 28, 2013, including those identified below. We do not undertake any obligation to update forward-looking statements, except as required by law.

Some of the factors that may impact our business, financial condition, results of operations, strategies or prospects include:

- Our complex manufacturing processes may lower yields and reduce our revenues.
- Our business could be materially and adversely affected if we are unable to obtain qualified supplies of raw materials, parts and finished components on a timely basis and at a cost-effective price.
- We are dependent on government contracts, which are subject to termination, price renegotiations and regulatory compliance, which can increase the cost of doing business and negatively impact our revenues.
- Changes in government policy or economic conditions could negatively impact our results.
- Our inventories may become obsolete and other assets may be subject to risks.
- Environmental regulations could require us to incur significant costs.
- Our business is highly competitive, and increased competition could reduce gross profit margins and the value of an investment in our Company.
- Downturns in the business cycle could reduce the revenues and profitability of our business.
- Our operating results may decrease due to the decline of profitability in the semiconductor industry.
- Uncertainty of current economic conditions, domestically and globally, could continue to affect demand for our products and negatively impact our business.
- Cost reduction efforts may be unsuccessful or insufficient to improve our profitability and may adversely impact productivity.
- We may not achieve the intended effects of our new business strategy, which could adversely impact our business, financial condition and results of operations.
- Our inability to introduce new products could result in decreased revenues and loss of market share to competitors; new technologies could also reduce the demand for our products.
- Loss of, or reduction of business from, substantial clients could hurt our business by reducing our revenues, profitability and cash flow.
- A shortage of three-inch silicon wafers could result in lost revenues due to an inability to build our products.
- The nature of our products exposes us to potentially significant product liability risk.
- We depend on the recruitment and retention of qualified personnel, and our failure to attract and retain such personnel could seriously harm our business.
- Provisions in our charter documents and rights agreement could make it more difficult to acquire our Company and may reduce the market price of our stock.
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Natural disasters, like hurricanes, or occurrences of other natural disasters whether in the United States or internationally may affect the markets in which our common stock trades, the markets in which we operate and our profitability.

- Failure to protect our proprietary technologies or maintain the right to use certain technologies may negatively affect our ability to compete.
- We cannot promise that we will have sufficient capital resources to make necessary investments in manufacturing technology and equipment.
- We may make substantial investments in plant and equipment that may become impaired.
- While we attempt to monitor the credit worthiness of our customers, we may be at risk due to the adverse financial condition of one or more customers.
- Our international operations expose us to material risks, including risks under U.S. export laws.
- Security breaches and other disruptions could compromise the integrity of our information and expose us to liability, which could cause our business and reputation to suffer.
- The price of our common stock has fluctuated widely in the past and may fluctuate widely in the future.
- Compliance with new regulations regarding the use of "conflict minerals" could limit the supply and increase the cost of certain metals used in manufacturing our products.

ITEM 4. CONTROLS AND PROCEDURES

Our Evaluation of Disclosure Controls and Procedures

The Company carried out an evaluation, under the supervision and with the participation of its management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of our disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e), and 15d-15(e)) as of the end of the period covered by this Quarterly Report. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective as of the end of the period covered by this Quarterly Report.

Changes in Internal Control over Financial Reporting

Based on an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, there has been no change in our internal control over financial reporting during our last fiscal quarter identified in connection with that evaluation, that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II– OTHER INFORMATION

ITEM 6. EXHIBITS:

Exhibits

31	Certification of Chief Executive Officer and Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32	Certification of Chief Executive Officer and Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema
101.CAL	XBRL Taxonomy Extension Calculation Linkbase
101.DEF	XBRL Taxonomy Extension Definition Linkbase
101.LAB	XBRL Taxonomy Label Linkbase
101.PRE	XBRL Taxonomy Presentation Linkbase

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.

SOLITRON DEVICES, INC.

Date: October 9, 2013

/s/ Shevach Saraf
Shevach Saraf
Chairman, President,
Chief Executive Officer,
Treasurer and Chief Financial Officer
(Principal Executive and Financial Officer)

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