DATA I/O CORP
Form 10-Q
August 12, 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 **June 30, 2013**

or

( ) **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: **0-10394**

DATA I/O CORPORATION

(Exact name of registrant as specified in its charter)

Washington	91-0864123
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

6464 185th Ave NE, Suite 101, Redmond, Washington, 98052

(Address of principal executive offices, including zip code)

(425) 881-6444

(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.

Large accelerated filer __ Accelerated filer __ Non-accelerated filer __ Smaller reporting company X

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

Shares of Common Stock, no par value, outstanding as of August 1, 2013:

7,769,954

DATA I/O CORPORATION

FORM 10-Q
For the Quarter Ended June 30, 2013

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PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

DATA I/O CORPORATION
CONSOLIDATED BALANCE SHEETS
(in thousands, except share data)
(UNAUDITED)

	June 30, 2013	December 31, 2012
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	$10,588	$10,528
Trade accounts receivable, net of allowance for doubtful accounts of $92 and $89, respectively	3,204	2,648
Inventories	3,393	4,033
Other current assets	304	486
TOTAL CURRENT ASSETS	17,489	17,695
Property, plant and equipment – net	906	1,006
Intangible software technology – net	33	35
Other assets	85	86
TOTAL ASSETS	$18,513	$18,822
LIABILITIES AND STOCKHOLDERS’ EQUITY		
CURRENT LIABILITIES:		
Accounts payable	$1,117	$850
Accrued compensation	1,009	1,183
Deferred revenue	1,234	1,238
Other accrued liabilities	565	539
Accrued costs of business restructuring	332	25
Income taxes payable	6	23
TOTAL CURRENT LIABILITIES	4,263	3,858
Long-term other payables	393	219
COMMITMENTS	-	-
STOCKHOLDERS’ EQUITY		
Preferred stock -		
Authorized, 5,000,000 shares, including		

200,000 shares of Series A Junior Participating		
Issued and outstanding, none	-	-
Common stock, at stated value -		
Authorized, 30,000,000 shares		
Issued and outstanding, 7,769,954 shares as of June 30, 2013		
and 7,741,686 shares as of December 31, 2012	18,131	17,928
Accumulated earnings (deficit)	(5,549)	(4,466)
Accumulated other comprehensive income	1,275	1,283
TOTAL STOCKHOLDERS’ EQUITY	13,857	14,745
TOTAL LIABILITIES AND STOCKHOLDERS’ EQUITY	$18,513	$18,822

See notes to consolidated financial statements

DATA I/O CORPORATION
CONSOLIDATED STATEMENTS OF OPERATION
(in thousands, except per share amounts)
(UNAUDITED)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	**2012**	**2013**	**2012**
Net Sales	$5,271	$5,360	$10,029	$9,039
Cost of goods sold	2,332	2,419	4,549	4,157
Gross margin	2,939	2,941	5,480	4,882
Operating expenses:				
Research and development	1,117	1,427	2,321	2,819
Selling, general and administrative	1,785	1,996	3,592	4,245
Provision for business restructuring	642	-	642	-
Total operating expenses	3,544	3,423	6,555	7,064
Operating income (loss)	(605)	(482)	(1,075)	(2,182)
Non-operating income (expense):				
Interest income	56	174	74	207
Foreign currency transaction gain (loss)	(55)	(45)	(57)	(36)
Total non-operating income (expense)	1	129	17	171
Income (loss) before income taxes	(604)	(353)	(1,058)	(2,011)
Income tax (expense) benefit	(20)	296	(25)	276
Net income (loss)	($624)	($57)	($1,083)	($1,735)
Basic earnings (loss) per share	($0.08)	($0.01)	($0.14)	($0.21)
Weighted-average basic shares	7,762	7,734	7,756	8,250

See notes to consolidated financial statements

DATA I/O CORPORATION
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
(in thousands)
(UNAUDITED)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	**2012**	**2013**	**2012**
Net Income (loss)	($624)	($57)	($1,083)	($1,735)
Other comprehensive income:				
Foreign currency translation gain (loss)	71	(163)	(8)	(60)
Comprehensive income (loss)	($553)	($220)	($1,091)	($1,795)

See notes to consolidated financial statements

DATA I/O CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands, except share amounts)
(UNAUDITED)

	For the Six Months Ended June 30,	
	2013	**2012**
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income (loss)	($1,083)	($1,735)
Adjustments to reconcile net income (loss)		
to net cash provided by (used in) operating activities:		
Depreciation and amortization	343	649
Equipment transferred to cost of goods sold	(5)	185
Share-based compensation	206	281
Net change in:		
Trade accounts receivable	(559)	683
Inventories	640	(681)
Other current assets	182	143
Accrued cost of business restructuring	503	-
Accounts payable and accrued liabilities	99	(126)
Deferred revenue	2	(71)
Other long-term liabilities	(27)	20
Deposits and other long-term assets	1	(1)
Net cash provided by (used in) operating activities	302	(653)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of property, plant and equipment	(236)	(378)
Cash provided by (used in) investing activities	(236)	(378)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from issuance of common stock	5	6
Repurchase of common stock	(5)	(6,026)
Cash provided by (used in) financing activities	-	(6,020)
Increase/(decrease) in cash and cash equivalents	66	(7,051)
Effects of exchange rate changes on cash	(6)	(38)
Cash and cash equivalents at beginning of period	10,528	18,120
Cash and cash equivalents at end of period	$10,588	$11,031
Supplemental disclosure of non-cash financing activities:		
Cash paid during the year for:		
Income Taxes	($39)	($213)

See notes to consolidated financial statements

DATA I/O CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

NOTE 1 - FINANCIAL STATEMENT PREPARATION

Data I/O Corporation (“Data I/O”, “We”, “Our”, “Us”) prepared the financial statements as of June 30, 2013 and June 30, 2012 according to the rules and regulations of the Securities and Exchange Commission ("SEC"). These statements are unaudited but, in the opinion of management, include all adjustments (consisting of normal recurring adjustments and accruals) necessary to present fairly the results for the periods presented. The balance sheet at December 31, 2012 has been derived from the audited financial statements at that date. We have condensed or omitted certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America according to such SEC rules and regulations. Operating results for the three months and six months ended June 30, 2013 are not necessarily indicative of the results that may be expected for the year ending December 31, 2013. These financial statements should be read in conjunction with the annual audited financial statements and the accompanying notes included in our Form 10-K for the year ended December 31, 2012.

Revenue Recognition

We recognize revenue at the time the product is shipped. We have determined that our programming equipment has reached a point of maturity and stability such that product acceptance can be assured by testing at the factory prior to shipment and that the installation meets the criteria to be considered a separate element. These systems are standard products with published product specifications and are configurable with standard options. The evidence that these systems could be deemed as accepted was based upon having standardized factory production of the units, results from batteries of tests of product performance to our published specifications, quality inspections and installation standardization, as well as past product operation validation with the customer and the history provided by our installed base of products upon which the current versions were based. When arrangements include multiple elements, we recognize revenue when the criteria for revenue recognition have been met for each element individually, with multiple elements done on a pro-rata basis.

Installation that is considered perfunctory includes any installation that can be performed by other parties, such as distributors, other vendors, or in most cases the customers themselves. This takes into account the complexity, skill and training needed as well as customer expectations regarding installation. The revenue related to products requiring installation that is perfunctory is recognized at the time of shipment provided that persuasive evidence of an arrangement exists, shipment has occurred, the price is fixed or determinable, and collectability is reasonably assured.

We record revenue from the sale of service and update contracts as deferred revenue and we recognize it on a straight-line basis over the contractual period, which is typically one year. We establish a reserve for sales returns based on historical trends in product returns and estimates for new items. We recognize revenue when, the price is fixed or determinable, the buyer has paid or is obligated to pay and the obligation is not contingent on resale of the product, the buyer's obligation would not be changed in the event of theft, physical destruction or damage to the product, the buyer acquiring the product for resale has economic substance apart from us and we do not have significant obligations for future performance to directly bring about the resale of the product by the buyer.

Sales were recorded net of actual sales returns and changes to the associated sales return reserve. Sales return reserves were $60,000 and $60,000 at June 30, 2013 and December 31, 2012, respectively.

When we sell software separately, we recognize software revenue upon shipment provided that only inconsequential obligations remain on our part, substantive acceptance conditions, if any, have been met and when the fee is fixed and determinable and when collection is deemed probable.

Certain fixed-price engineering services contracts that require significant production or customization of software, are accounted for using the percentage-of-completion method. We use the percentage-of-completion method of accounting because it is the most accurate method to recognize revenue based on the nature and scope of certain of our fixed-price engineering services contracts. It is a better measure of periodic income results than other methods and it better matches revenue recognized with the cost incurred. Percentage-of-completion is measured based primarily on input measures such as hours incurred to date compared to estimated total hours at completion, with consideration given to output measures, such as contract milestones, when applicable. Significant judgment is required when estimating total hours and progress to completion on these arrangements which determines the amount of revenue we recognize as well as whether a loss is recognized if expected to be incurred upon project completion. Revisions to hour and cost estimates are incorporated in the period the amounts are recognized if the results of the period have not been reported; otherwise, the revision of estimates are recognized in the period in which the facts that give rise to the revision become known. No revenues were recorded using the percentage-of-completion method during the three months and six months ended June 30, 2013 and 2012, respectively.

We transfer certain products out of service from their internal use and make them available for sale. The products transferred are our standard products in one of the following areas: service loaners, rental or test units; engineering test units; or sales demonstration equipment. Once transferred, the equipment is sold by our regular sales channels as used equipment inventory. These product units often involve refurbishing and an equipment warranty, and are conducted as sales in our normal and ordinary course of business. The transfer amount is the product unit’s net book value and the sale transaction is accounted for as revenue and cost of goods sold.

Stock-Based Compensation Expense

We measure and recognize compensation expense as required for all share-based payment awards, including employee stock options and restricted stock awards, based on estimated fair values on the grant dates.

Income Tax

Historically when accounting for uncertainty in income taxes, we have not incurred any interest or penalties associated with tax matters and no interest or penalties were recognized during the three months and six months ended June 30, 2013. However, we have adopted a policy whereby amounts related to penalties associated with tax matters are classified as general and administrative expense when incurred and amounts related to interest associated with tax matters are classified as interest income or interest expense.

We have incurred net operating losses in the current and certain past years. We continue to maintain a valuation allowance for the full amount of the net deferred tax asset balance associated with our net operating losses and credit carryforwards, as sufficient uncertainty exists regarding our ability to realize such tax assets in the future. There was $132,000 and $117,000 unrecognized tax benefits related to uncertain tax positions and related valuation allowance as of June 30, 2013 and 2012, respectively.

Tax years that remain open for examination include 2009, 2010, 2011 and 2012 in the United States of America. In addition, tax years from 2000 to 2008 may be subject to examination in the event that we utilize the net operating losses and credit carryforwards from those years in our current or future year tax returns.

Recent Accounting Pronouncements

In July 2013, the FASB issued ASU 2013-11, *"Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists,"* ("ASU 2013-11"), an amendment to ASC 740, "Income Taxes." ASU 2013-11 clarifies that an unrecognized tax benefit, or a portion or an unrecognized tax benefit, should be presented in the financial statements as a reduction to a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward if such settlement is required or expected in the event the uncertain tax benefit is disallowed. In situations where a net operating loss carryforward, a similar tax loss, or a tax credit carryforward is not available at the reporting date under the tax law of the applicable jurisdiction or the tax law of the jurisdiction does not require, and the entity does not intend to use, the deferred tax asset for such purpose, the unrecognized tax benefit should be presented in the financial statements as a liability and should not be netted with the deferred tax asset. The amendments in ASU 2013-11 are effective for fiscal years, and interim periods within those years, beginning after December 15, 2013. Early adoption is permitted. The amendments should be applied prospectively to all unrecognized tax benefits that exist at the effective date. Retrospective application is permitted. We are currently evaluating the impact that the adoption will have on the determination or reporting of our financial results.

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In March 2013, the FASB issued ASU 2013-05, *“Parent’s Accounting for the Cumulative Translation Adjustment upon Derecognition of Certain Subsidiaries or Groups of Assets within a Foreign Entity or of an Investment in a Foreign Entity,”* (“ASU 2013-05”). The objective of ASU 2013-05 is to clarify the applicable guidance for the release into net income of the cumulative translation adjustment upon derecognition of a subsidiary or group of assets within a foreign entity. ASU 2013-05 is effective for annual and interim reporting periods beginning after December 15, 2013 with early adoption permitted. We are currently evaluating the impact that the adoption will have on the determination or reporting of our financial results.

In February 2013, the FASB issued ASU No. 2013-02, “*Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income.*” Under ASU 2013-02, an entity is required to provide information about the amounts reclassified out of Accumulated Other Comprehensive Income (“AOCI”) by component. In addition, an entity is required to present, either on the face of the financial statements or in the notes, significant amounts reclassified out of AOCI by the respective line items of net income, but only if the amount reclassified is required to be reclassified in its entirety in the same reporting period. For amounts that are not required to be reclassified in their entirety to net income, an entity is required to cross-reference to other disclosures that provide additional details about those amounts. ASU 2013-02 does not change the current requirements for reporting net income or other comprehensive income in the financial statements. ASU 2013-02 is effective for us on January 1, 2013. The adoption of this update did not have a material impact on our financial statements.

NOTE 2 – INVENTORIES

Inventories consisted of the following components:

	June 30, 2013	December 31, 2012
(in thousands)		
Raw material	$1,902	$2,166
Work-in-process	1,000	1,262
Finished goods	491	605
Inventories	$3,393	$4,033

NOTE 3 – PROPERTY, PLANT AND EQUIPMENT, NET

Property and equipment consisted of the following components:

	June 30, 2013	December 31, 2012
(in thousands)		
Leasehold improvements	$481	$481

Equipment	7,075	7,618
	7,556	8,099
Less accumulated depreciation	6,650	7,093
Property and equipment, net	$906	$1,006

NOTE 4 – BUSINESS RESTRUCTURING

As a result of the business downturn we experienced in the second half of 2011 and in 2012, as well as the uncertain business outlook at the time, we took restructuring actions in September 2012 to reduce quarterly operating expenses and production costs. These actions included reductions in personnel and the use of contractors, professionals, and consultants, as well as focusing our development efforts on a smaller number of projects. The net restructuring charge associated with these 2012 actions was $207,000 and was primarily related to severance. The remaining 2012 restructuring actions were completely paid out during the first quarter of 2013.

We took additional restructuring actions in the second quarter of 2013 to reduce our excess office space and eliminate certain job positions. In addition to these previously announced actions in April which resulted in restructuring costs of $525,000, additional personnel related actions were taken in June that increased the restructuring charge by $117,000 to a total $642,000 for the quarter. The positions eliminated will allow us to have the flexibility to add other critical positions or change fixed to variable costs through outsourcing.

The restructuring charges associated with the second quarter of 2013 actions are approximately $313,000 for personnel severance related costs and approximately $329,000 for lease abandonment space. These restructuring charges were recorded in the second quarter of 2013; however the $329,000 related to lease abandonments will continue to be paid over the term of the leases unless the applicable leases are renegotiated with the landlords or costs are partially offset by unanticipated subleases.

An analysis of the business restructuring is as follows:

	Reserve Balance Dec 31, 2011	2012 Expense	2012 Payments/ Write-Offs	Reserve Balance Dec 31, 2012	2013 Expense	2013 Payments/ Write-Offs	Reserve Balance Jun 30, 2013
(in thousands)							
Downsizing US operations:							
Employee severance	$0	$103	$103	$0	$302	$75	$227
Other costs	-	4	4	-	273	8	265
Downsizing foreign operations:							
Employee severance	-	57	32	25	20	45	-
Other costs	-	43	43	-	47	11	36
Total	$0	$207	$182	$25	$642	$139	$528

The portion of the reserve expected to be paid over the next twelve months is $332,000 while the long term liability is $196,000. The long term portion relates to the lease abandonment payments that are due in over one year.

NOTE 5 – OTHER ACCRUED LIABILITIES

Other accrued liabilities consisted of the following components:

	June 30, 2013	December 31, 2012
(in thousands)		
Product warranty	$287	$260
Sales return reserve	60	60
Other taxes	90	86
Other	128	133
Other accrued liabilities	$565	$539

The changes in Data I/O's product warranty liability for the six months ending June 30, 2013 are as follows:

	June 30, 2013
(in thousands)	
Liability, beginning balance	$260
Net expenses	216
Warranty claims	(216)
Accrual revisions	27
Liability, ending balance	$287

NOTE 6 – OPERATING LEASE COMMITMENTS

We have commitments under non-cancelable operating leases and other agreements, primarily for factory and office space, with initial or remaining terms of one year or more as follows:

For the years ending December 31:

	Operating Leases
(in thousands)	
2013 (remaining)	$588
2014	1,015
2015	840
2016	513
Total	$2,956

NOTE 7 – OTHER COMMITMENTS

We have purchase obligations for inventory and production costs as well as other obligations such as capital expenditures, service contracts, marketing, and development agreements. Arrangements are considered purchase obligations if a contract specifies all significant terms, including fixed or minimum quantities to be purchased, a pricing structure and approximate timing of the transaction. Most arrangements are cancelable without a significant penalty, and with short notice, typically less than 90 days. At June 30, 2013, the purchase commitments and other obligations totaled $1,212,000 and are expected to be paid over the next twelve months.

NOTE 8 – CONTINGENCIES

As of June 30, 2013, we were not a party to any legal proceedings, the adverse outcome of which in management’s opinion, individually or in the aggregate, would have a material adverse effect on our results of operations or financial position.

Indemnification Arrangements: We may, from time to time in the ordinary course of our business enter into contractual arrangements with third parties that include indemnification obligations. Under these contractual arrangements, we have agreed to defend, indemnify and/or hold the third party harmless from and against certain liabilities. These arrangements include indemnities in favor of customers in the event that our programming system products infringe a third party's intellectual property and indemnities in favor of our lessors in connection with facility leasehold liabilities that we may cause. In addition, we have entered into indemnification agreements with our directors and certain of our officers, and our bylaws contain indemnification obligations in favor of our directors, officers and agents. These indemnity arrangements may limit the type of the claim, the total amount that we can be required to be paid in connection with the indemnification obligation and the time within which an indemnification claim can be made. The duration of the indemnification obligation may vary, and for most arrangements, survives the agreement term and is indefinite. We believe that substantially all of our indemnity arrangements provide either for limitations on the maximum potential future payments we could be obligated to make, or for limitations on the types of claims and damages we could be obligated to indemnify, or both. However, it is not possible to determine or reasonably estimate the maximum potential amount of future payments under these indemnification obligations due to the varying terms of such obligations, a lack of history of prior indemnification claims, the unique facts and circumstances involved in each particular contractual arrangement and in each potential future claim for indemnification, and the contingency of any potential liabilities upon the occurrence of events that are not reasonably determinable. We have not had any requests for indemnification under these arrangements. Our management believes that any liability for these indemnity arrangements would not be material to our accompanying consolidated financial statements. We have not recorded any liabilities for these indemnification arrangements on our consolidated balance sheet as of June 30, 2013.

NOTE 9 – EARNINGS PER SHARE

Basic earnings per share is calculated based on the weighted average number of common shares outstanding during each period. Diluted earnings per share is calculated based on these same weighted average shares outstanding plus the effect of potential shares issuable upon assumed exercise of stock options based on the treasury stock method. Potential shares issuable upon the exercise of stock options are excluded from the calculation of diluted earnings per share to the extent their effect would be anti-dilutive.

The following table sets forth the computation of basic and diluted earnings per share:

	Three Months Ended	Six Months Ended

(in thousands except per share data)	June 30, 2013	June 30, 2012	June 30, 2013	June 30, 2012
Numerator for basic and diluted earnings (loss) per share:				
Net income (loss)	($624)	($57)	($1,083)	($1,735)
Denominator for basic earnings (loss) per share:				
weighted-average shares	7,762	7,734	7,756	8,250
Employee stock options and awards	-	-	-	-
Denominator for diluted earnings (loss) per share: adjusted weighted-average shares & assumed conversions of stock options	7,762	7,734	7,756	8,250
Basic and diluted earnings (loss) per share:				
Total basic earnings (loss) per share	($0.08)	($0.01)	($0.14)	($0.21)
Total diluted earnings (loss) per share	($0.08)	($0.01)	($0.14)	($0.21)

The earnings per share computation for the three months and six months ended June 30, 2013 and 2012 excludes the following options to purchase common stock, as their effect is anti-dilutive:

	Three Months Ended		Six Months Ended	
	June 30, 2013	June 30, 2012	June 30, 2013	June 30, 2012
Anti-dilutive options to purchase shares	910,392	1,086,892	990,998	905,571

NOTE 10 – SHARE-BASED COMPENSATION

For share-based awards granted, we have recognized compensation expense based on the estimated grant date fair value method. For these awards we have recognized compensation expense using a straight-line amortization method and reduced for estimated forfeitures.

The impact on our results of operations of recording share-based compensation, net of forfeitures, for the three months and six months ended June 30, 2013 and 2012, respectively, was as follows:

	Three Months Ended		Six Months Ended	
	June 30, 2013	June 30, 2012	June 30, 2013	June 30, 2012
(in thousands)				
Cost of goods sold	$13	$15	$24	$26
Research and development	28	34	48	60
Selling, general and administrative	95	101	134	195
Total share-based compensation	$136	$150	$206	$281
Impact on net earnings per share:				
Basic and diluted	($0.02)	($0.02)	($0.03)	($0.03)

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The fair value of share-based awards for employee stock options was estimated using the Black-Scholes valuation model. The following weighted average assumptions were used to calculate the fair value of stock options granted during the three months and six months ended June 30, 2013 and 2012:

	Three Months Ended		Six Months Ended	
	June 30, 2013	June 30, 2012	June 30, 2013	June 30, 2012
Risk-free interest rates	0.50%	0.61%	0.66%	0.62%
Volatility factors	0.54	0.53	0.54	0.53
Expected life of the option in years	4.00	4.00	4.00	4.00
Expected dividend yield	None	None	None	None

Stock option grants during the three months and six months ended June 30, 2013 and 2012 were as follows:

	Three Months Ended		Six Months Ended	
	June 30, 2013	June 30, 2012	June 30, 2013	June 30, 2012
Stock Options Granted	3,000	175,000	33,000	190,000

The remaining unamortized expected future compensation expense and remaining amortization period associated with unvested option grants and restricted stock awards at June 30, 2013 are:

	June 30, 2013
Unamortized future compensation expense	$1,102,965
Remaining weighted average amortization period in years	2.74

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

General

Forward-Looking Statements

This Quarterly Report on Form 10-Q includes forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. This Act provides a “safe harbor” for forward-looking statements to encourage companies to provide prospective information about themselves as long as they identify these statements as forward-looking and provide meaningful cautionary statements identifying important factors that could cause actual results to differ from the projected results. All statements other than statements of historical fact made in this Quarterly Report on Form 10-Q are forward-looking. In particular, statements herein regarding industry prospects or trends; expected revenues; expected level of expense; future results of operations; reversals of tax valuation allowances; restructuring implications; breakeven point, or financial position; changes in gross margin; economic conditions and capital spending outlook; market acceptance of our newly introduced or upgraded products; development, introduction and shipment of new products; sales channels and any other guidance on future periods are forward-looking statements. Forward-looking statements reflect management’s current expectations and are inherently uncertain. Although we believe that the expectations reflected in these forward-looking statements are reasonable, we cannot guarantee future results, levels of activity, performance, achievements, or other future events. Moreover, neither we nor anyone else assumes responsibility for the accuracy and completeness of these forward-looking statements. We are under no duty to update any of these forward-looking statements after the date of this report. The reader should not place undue reliance on these forward-looking statements. The discussions above and in the section in Item 1A., Risk Factors “Cautionary Factors That May Affect Future Results” in our Annual report on Form 10-K for the year ended December 31, 2012 describe some, but not all, of the factors that could cause these differences.

OVERVIEW

We have renewed our focus on managing the core programming business to return to profitability, while developing and enhancing products to drive future revenue and earnings growth. Our challenge continues to be operating in a cyclical and rapidly evolving industry environment. We are continuing our efforts to balance business geography shifts, increasing costs and strategic investments in our business with the level of demand and mix of business we expect. During the second quarter of 2013, we took the additional restructuring actions discussed below under “Business Restructuring Progress”.

We are focusing our research and development efforts in our strategic growth markets, namely new programming technology, automated programming systems for the manufacturing environment and software. We continue to focus on extending the capabilities and support for our product lines.

At the end of 2012, an impairment evaluation of our Azido software technology acquired in April of 2011 resulted in a $2.3 million write down of the investment. We are continuing the process of evaluating strategic alternatives for the Azido technology.

Our customer focus has been on strategic high volume manufacturers in key market segments like wireless and consumer electronics, automotive electronics, industrial controls and programming centers. Our product focus has been on automated programming systems, enhancing our programming technology and supporting the latest semiconductor devices, including NAND Flash, like e-MMC, and microcontrollers on our newer products.

BUSINESS RESTRUCTURING PROGRESS

As a result of the business downturn we experienced in the second half of 2011 and in 2012, as well as the uncertain business outlook at the time, we took restructuring actions in September 2012 to reduce quarterly operating expenses and production costs. These actions included reductions in personnel and the use of contractors, professionals, and consultants, as well as focusing our development efforts on a smaller number of projects. The net restructuring charge associated with these 2012 actions was $207,000 and was primarily related to severance. The remaining 2012 restructuring actions were completely paid out during the first quarter of 2013.

During the second quarter of 2013, we took additional restructuring actions to reduce our excess office space and eliminate certain job positions. In addition to these previously announced actions in April, which resulted in restructuring costs of $525,000, additional personnel related actions were taken in June that increased the restructuring charge by $117,000 to a total $642,000 for the quarter. The positions eliminated will allow us to have the flexibility to add other critical positions or change fixed to variable costs through outsourcing. The net effect of the space and personnel reductions, offset in part by the other planned additions, will be to reduce annual operating expenses by approximately $300,000 when fully implemented by the third quarter of 2013.

The restructuring charges associated with the second quarter of 2013 actions are approximately $313,000 for personnel severance related costs and approximately $329,000 for lease abandonment space. These restructuring charges were recorded in the second quarter of 2013; however the $329,000 related to lease abandonments will continue to be paid over the term of the leases unless the applicable leases are renegotiated with the landlords or costs are partially offset by unanticipated subleases.

cRITICAL aCCOUNTING pOLICY jUDGMENTS AND eSTIMATES

The preparation of financial statements in accordance with accounting principles generally accepted in the United States of America requires that we make estimates and judgments, which affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosures of contingent assets and liabilities. On an on-going basis, we evaluate our estimates, including those related to revenue recognition, estimating the percentage-of-completion on fixed-price professional engineering service contracts, sales returns, bad debts, inventories, investments, intangible assets, income taxes, warranty obligations, restructuring charges, contingencies such as litigation, and contract terms that have multiple elements and other complexities typical in the capital equipment industry. We base our estimates on historical experience and other assumptions that we believe are reasonable under the circumstances. Actual results may differ from these estimates under different assumptions or conditions.

We believe the following critical accounting policies affect the more significant judgments and estimates used in the preparation of our financial statements:

Revenue Recognition: We recognize revenue at the time the product is shipped. We have determined that our programming equipment has reached a point of maturity and stability such that product acceptance can be assured by testing at the factory prior to shipment and that the installation meets the criteria to be considered a separate element. These systems are standard products with published product specifications and are configurable with standard options. The evidence that these systems could be deemed as accepted was based upon having standardized factory production of the units, results from batteries of tests of product performance to our published specifications, quality inspections and installation standardization, as well as past product operation validation with the customer and the history provided by our installed base of products upon which the current versions were based. When arrangements include multiple elements, we recognize revenue when the criteria for revenue recognition have been met for each element individually, with multiple elements done on a pro-rata basis.

Installation that is considered perfunctory includes any installation that can be performed by other parties, such as distributors, other vendors, or in most cases the customers themselves. This takes into account the complexity, skill and training needed as well as customer expectations regarding installation. The revenue related to products requiring installation that is perfunctory is recognized at the time of shipment provided that persuasive evidence of an arrangement exists, shipment has occurred, the price is fixed or determinable, and collectability is reasonably assured.

We record revenue from the sale of service and update contracts as deferred revenue and we recognize it on a straight-line basis over the contractual period, which is typically one year. We establish a reserve for sales returns based on historical trends in product returns and estimates for new items. We recognize revenue when, the price is fixed or determinable, the buyer has paid or is obligated to pay and the obligation is not contingent on resale of the product, the buyer’s obligation would not be changed in the event of theft, physical destruction or damage to the product, the buyer acquiring the product for resale has economic substance apart from us and we do not have significant obligations for future performance to directly bring about the resale of the product by the buyer.

Sales were recorded net of actual sales returns and changes to the associated sales return reserve. Sales return reserves were $60,000 and $60,000 at June 30, 2013 and December 31, 2012, respectively.

When we sell software separately, we recognize software revenue upon shipment provided that only inconsequential obligations remain on our part, substantive acceptance conditions, if any, have been met and when the fee is fixed and determinable and when collection is deemed probable.

Certain fixed-price engineering services contracts that require significant production or customization of software are accounted for using the percentage-of-completion method. We use the percentage-of-completion method of accounting because it is the most accurate method to recognize revenue based on the nature and scope of certain of our fixed-price engineering services contracts. It is a better measure of periodic income results than other methods and it better matches revenue recognized with the cost incurred. Percentage-of-completion is measured based primarily on input measures such as hours incurred to date compared to estimated total hours at completion, with consideration given to output measures, such as contract milestones, when applicable. Significant judgment is required when estimating total hours and progress to completion on these arrangements which determines the amount of revenue we recognize as well as whether a loss is recognized if expected to be incurred upon project completion. Revisions to hour and cost estimates are incorporated in the period the amounts are recognized if the results of the period have not been reported; otherwise, the revision of estimates are recognized in the period in which the facts that give rise to the revision become known. No revenues were recorded using the percentage-of-completion method during the three months and six months ended June 30, 2013 and 2012, respectively.

We transfer certain products out of service from their internal use and make them available for sale. The products transferred are our standard products in one of the following areas: service loaners, rental or test units; engineering test units; or sales demonstration equipment. Once transferred, the equipment is sold by our regular sales channels as used equipment inventory. These product units often involve refurbishing and an equipment warranty, and are conducted as sales in our normal and ordinary course of business. The transfer amount is the product unit’s net book value and the sale transaction is accounted for as revenue and cost of goods sold.

Allowance for Doubtful Accounts: We base the allowance for doubtful accounts receivable on our assessment of the collectability of specific customer accounts and the aging of accounts receivable. If there is deterioration of a major customer’s credit worthiness or actual defaults are higher than historical experience, our estimates of the recoverability of amounts due to us could be adversely affected.

Inventory: Inventories are stated at the lower of cost or market. Adjustments are made to standard cost, which approximates actual cost on a first-in, first-out basis. We estimate reductions to inventory for obsolete, slow-moving, excess and non-salable inventory by reviewing current transactions and forecasted product demand. We evaluate our inventories on an item by item basis and record inventory adjustments accordingly. If there is a significant decrease in demand for our products or there is a higher risk of inventory obsolescence because of rapidly changing technology and customer requirements, we may be required to increase our inventory adjustments and our gross margin could be adversely affected.

Warranty Accruals: We accrue for warranty costs based on the expected material and labor costs to fulfill our warranty obligations. If we experience an increase in warranty claims, which are higher than our historical experience, our gross margin could be adversely affected.

Tax Valuation Allowances: Given the uncertainty created by our loss history, as well as the current uncertain economic outlook for our industry and capital spending, we expect to continue to limit the recognition of net deferred tax assets and accounting for uncertain tax positions and maintain the tax valuation allowances. At the current time, we expect, therefore, that reversals of the tax valuation allowance will take place only as we are able to take advantage of the underlying tax loss or other attributes in carry forward. The transfer pricing and expense or cost sharing arrangements are complex areas where judgments, such as the determination of arms-length arrangements, can be subject to challenges by different tax jurisdictions.

Share-based Compensation: We account for share-based awards made to our employees and directors, including employee stock option awards and restricted stock awards, using the estimated grant date fair value method of accounting. We estimate the fair value using the Black-Scholes valuation model, which requires the input of highly subjective assumptions, including the option's expected life and the price volatility of the underlying stock. The expected stock price volatility assumption was determined using the historical volatility of our common stock. Changes in the subjective assumptions required in the valuation model may significantly affect the estimated value of the awards, the related stock-based compensation expense and, consequently, our results of operations.

Results of Operations

Net Sales

	Three Months Ended			Six Months Ended		
Net sales by product line (in thousands)	June 30, 2013	Change	June 30, 2012	June 30, 2013	Change	June 30, 2012
Automated programming systems	$3,543	(1.3%)	$3,590	$6,484	15.4%	$5,620
Non-automated programming systems	1,728	(2.4%)	1,770	3,545	3.7%	3,419
Total programming systems	$5,271	(1.7%)	$5,360	$10,029	11.0%	$9,039

	Three Months Ended			Six Months Ended		
Net sales by location	June 30, 2013	Change	June 30, 2012	June 30, 2013	Change	June 30, 2012

(in thousands)						
United States	$501	(33.7%)	$756	$862	(29.7%)	$1,226
% of total	9.5%		14.1%	8.6%		13.6%
International	$4,770	3.6%	$4,604	$9,167	17.3%	$7,813
% of total	90.5%		85.9%	91.4%		86.4%

Net sales decreased slightly when compared to the second quarter of 2012. On a regional basis, net sales increased 27% in the Americas and 80% in Asia, while declining 60% in Europe compared to the second quarter of 2012. International sales were 90% of total sales for the second quarter of 2013 compared to 86% for the second quarter of 2012.

Orders for the second quarter of 2013 were $6.7 million, up 30%, compared with $5.2 million in the second quarter of 2012 and sequentially up 41% compared to the first quarter of 2013. The increase in orders was primarily due to a significant PS and FLX order we received from a manufacturer of consumer electronics and most of this order remained in backlog at the end of the quarter. On a regional basis, order bookings increased 41% in the Americas and 192% in Asia, while declining 54% in Europe compared to the second quarter of 2012. We ended the quarter with a backlog of $2.4 million, compared to $1.1 million at the end of the second quarter of 2012 and $0.9 million at December 31, 2012. The systems in backlog are scheduled to ship in the third and fourth quarter.

For the six months ending June 30, 2013, the sales increase compared to the same period of 2012, was primarily due to purchasing by wireless original equipment manufacturer ("OEM") and related electronics manufacturing service ("EMS") customers and a new consumer home electronics customer. For the six months ending June 30, 2013 compared to the same period of 2012, orders increased 22% primarily due to same reasons sales increased, as well as the significant PS and FLX order we received from a manufacturer of consumer electronics in the second quarter of 2013.

Gross Margin

	Three Months Ended			Six Months Ended		
	June 30, 2013	Change	June 30, 2012	June 30, 2013	Change	June 30, 2012
(in thousands)						
Gross margin	$2,939	(0.1%)	$2,941	$5,480	12.2%	$4,882
Percentage of net sales	55.8%		54.9%	54.6%		54.0%

Gross margin as a percentage of sales in the second quarter of 2013 was 55.8%, compared with 54.9% in the second quarter of 2012. The gross margin increase as a percentage of sales for the second quarter was primarily due to a favorable product mix and favorable variances. The favorable product mix was largely due to an increase in sales of RoadRunner systems, which have a higher gross margin. The significant backlog of PS and FLX systems at the end of the quarter, indicate that next quarter a lower gross margin may be expected due to a less favorable product mix with higher direct material costs.

For the first six months of 2013, the gross margin increase as a percentage of sales was primarily due to the increased sales volume in relation to fixed costs, as well as the same factors affecting the second quart