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SPECTRUM CONTROL INC
Form 10-K
February 28, 2001

Securities and Exchange Commission
Washington, D.C. 20549

Form 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934
For the fiscal year ended November 30, 2000

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 0-8796

Spectrum Control, Inc.

(a Pennsylvania Corporation)
(I.R.S. Employer Identification No. 25-1196447)
8031 Avonia Road, Fairview, Pennsylvania 16415
Telephone 814-835-1650

Securities registered pursuant to Section 12(b) of the Act:
None

Securities registered pursuant to Section 12(g) of the Act:

| Title of each class | Name of each exchange on which registered |
|-----------------------------|---|
| Common Stock - No Par Value | The Nasdaq Stock Market |

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, and (2) has been subject to such filing requirements for the past 90 days. Yes X No ____.

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K .

At February 1, 2001, the aggregate market value of voting Common Stock held by non-affiliates of the registrant based on a closing price of \$9.875 was \$108,495,000. Shares of Common Stock held by each officer and director and by each person who owns 5% or more of the outstanding Common Stock of the Company

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have been excluded because such persons may be deemed to be affiliates.

As of February 1, 2001, the registrant had outstanding 13,417,488 shares of Common Stock, no par value.

Documents incorporated by reference

Portions of the registrant's Proxy Statement for the annual meeting of shareholders to be held April 2, 2001 are incorporated by reference into Part III of this Form 10-K.

PART I

ITEM 1. BUSINESS

Except for the historical information contained herein, the following discussion contains forward-looking statements that involve risks and uncertainties. The Company intends these forward-looking statements to qualify for the safe harbor from liability established by the Private Securities Litigation Reform Act of 1995. These forward-looking statements include, but are not limited to, descriptions of management's expectations regarding the future markets for the Company's products, future operating performance, and other future plans and objectives. Words such as "expect", "anticipate", "believe", "intend", and variations of such words identify forward-looking statements. These forward-looking statements are only predictions and are not guarantees of future performance. Actual results or events may differ materially from historical results or those suggested by these forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, those discussed in this section, as well as in the section entitled "Management's Discussion and Analysis of Financial Condition and Results of Operations" in this report.

GENERAL

Spectrum Control, Inc. and its subsidiaries (hereinafter referred to as "we", "us", or the "Company") design, manufacture and market a broad line of control products and systems. The Company was founded as a solutions-oriented company, designing and manufacturing products to suppress or eliminate electromagnetic interference ("EMI"). The Company has adapted its core EMI filter technology into a complete line of capacitors, filters, filtered arrays, and filtered connectors. In recent years, the Company has expanded its focus by developing new lines of power products (commercial custom assemblies, military/aerospace multisection assemblies, power distribution units, power entry modules, and power line filters), microwave/wireless products (coaxial ceramic bandpass filters, duplexers, and dielectric resonators), and specialty ceramic products. In fiscal year 2000, we developed and introduced an advanced systems product offering to become a provider of more complex management systems, including a line of digital radio-frequency control equipment for remote and automatic electronic systems management. The Company's products are used in virtually all industries worldwide, including telecommunications, aerospace, military, medical, computer, and industrial controls.

The need for EMI products results from the increasing dependency of our society on electronic equipment of various kinds, including wireless communication systems. This equipment both emits, and is sensitive to, random electromagnetic waves over a broad spectrum of wave lengths, which can interfere with and degrade the performance of other electronic equipment. The Company's EMI products are designed to suppress the emission of unwanted waves or to reduce their strength to an innocuous level, by reflecting them from one

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component to another in series or by converting their energy into heat which is then dissipated.

Spectrum Control, Inc. was incorporated in Pennsylvania in 1968. The Company's Interconnect Products Division, which manufactures various EMI filter products, is located in Fairview, Pennsylvania. The Company's Power Technologies Group operates manufacturing facilities in Erie, Pennsylvania and Wesson, Mississippi. Currently, the Company manufactures its microwave/wireless product offerings at facilities in Elizabethtown, Pennsylvania. The Company's executive offices are located in Fairview, Pennsylvania.

Spectrum Control Technology, Inc., a wholly-owned subsidiary, maintains a facility in New Orleans, Louisiana, with advanced manufacturing equipment designed for the production of ceramic capacitors, resonators, and specialty ceramic products. Presently, this subsidiary primarily manufactures ceramic discoidal and tubular capacitors used in the Company's EMI filter products.

Spectrum Control, GmbH, a wholly-owned subsidiary of the Company located in Schwabach, Germany, acts as a distributor for the Company's products in the European market.

Spectrum Control de Mexico, a wholly-owned subsidiary of the Company located in Juarez, Mexico, commenced operations in June 2000 as the Company's low-cost manufacturing center. Currently, this subsidiary manufactures various EMI products.

MARKETS

The Company's products are utilized in numerous applications including industrial equipment, instrumentation, computers, automotive, and medical equipment. The Company's primary markets, however, are telecommunications equipment and military/aerospace.

TELECOMMUNICATIONS EQUIPMENT

For the past several years the telecommunications industry has experienced significant worldwide growth. This growth has primarily resulted from increased business and consumer demand for wireless communication services and Internet access. Cost reductions and performance improvements in such wireless communication products as cellular, personal communication services ("PCS"), and satellite-based voice and data systems have also contributed to this growth. As demand for wireless communication services grows, service providers are expanding associated infrastructure. Wireless communication systems can offer the functional advantages of wired communication systems without the costly and time consuming development of an extensive wired infrastructure. The relative advantages of wireless and wired communication systems with respect to cost, transmission quality, reliability and other factors depend on the specific applications for which such systems are used and the existence of a wired or wireless infrastructure already in place. The factors responsible for the market's growth, coupled with regulatory changes in the United States and abroad as well as advances in wireless communication technology, have led to significant growth in existing wireless telecommunication systems and the emergence of new wireless applications.

The products designed and manufactured by the Company support a wide range of digital wireless communication protocols, systems and standards including PCS, Code Division Multiple Access ("CDMA"), Global System for Mobile Communications ("GSM"), Time Division Multiple Access ("TDMA"), and Third Generation Wireless ("3G").

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Worldwide demand for integrated voice, data and video communications services is also growing rapidly. The volume of high-speed data traffic across global communications networks has grown dramatically as the public Internet and private business intranets have become essential for daily communications and electronic commerce. The number of persons using the Internet to buy and sell goods and services is expected to grow rapidly. Servicing the increasing demand for higher bandwidth content and applications requires cost-effective and high-speed connections, which are often unavailable or inadequate over existing wire-based networks. For many users, wireless communications provide an advantageous access solution for high-speed Internet multimedia services. This is underscored by the increasing number of wireless subscribers worldwide.

A typical mobile or fixed wireless communications system comprises a geographic region containing a number of cells, each of which contains one or more base stations, which are linked in a network to form a service provider's coverage area. Each base station houses the equipment that receives incoming telephone calls from the switching offices of the local wire-based telephone company and broadcasts calls to the wireless users within the cell. A base station can process a fixed number of radio channels through the use of multiple transceivers, power amplifiers and tunable filters, along with an antenna to transmit and receive signals to and from the wireless user. The Company provides discrete EMI filters, filtered arrays, filtered connectors, and power products to original equipment manufacturers ("OEM") of base station equipment. In addition, the Company's products are used in numerous other telecommunication applications including fiber optic networks and switching equipment, wireless modems and LANs, Internet servers and global positioning systems. Using our solutions-oriented approach, we provide our OEM customers with products tailored to their specific transmission needs, anticipating and solving system architecture and performance.

Approximately 64% of the Company's total revenue during fiscal year 2000 was derived from sales of its products to OEM customers in the telecommunication industry. Most of these products are custom designed not only to conform to the specifications and requirements of the particular customer, but also to meet the performance and quality standards set by the agency or other governmental body whose regulations are applicable to the specific equipment or usage involved. A significant reduction in orders from such customers would have a materially adverse effect on the Company's business.

MILITARY/AEROSPACE

Military forces worldwide are dependent on sophisticated electronic equipment. Military aircraft and naval vessels generally contain extensive communication equipment, electronic countermeasure equipment for defense against enemy weapons, and radar systems. The Company provides low pass filters and multisection assemblies to major equipment manufacturers for installation into these systems. The Company's customers, in turn, sell their equipment to major aerospace manufacturers or directly to governments.

In fiscal year 2000, military/aerospace sales accounted for approximately 17% of the Company's total sales. The Company does not expect such sales to increase from the levels achieved in the 2000 fiscal year due to reductions in funding for new programs. While the Company has developed and will continue to develop products for military/aerospace programs, there can be no assurance that sales to such customers will not decrease in the future.

PRODUCTS

The Company's products are organized into two groups: the Signal Products Group and the Power Technologies Group. Within the Signal Products

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Group, product offerings include various interconnect filter products, microwave/wireless products, and specialty ceramic components. The Power Technologies Group includes numerous power management and conditioning products and advanced systems.

INTERCONNECT FILTER PRODUCTS

Control of unwanted electromagnetic waves is accomplished through various combinations of EMI suppression devices. The EMI suppression devices produced by the Company include those that are utilized as circuit components and whose function is to permit the desired frequencies to pass through a circuit while rejecting or preventing the unwanted signals. The majority of these products are composed of either reactive (reflecting energy) or loss (dissipating energy) elements or at times, combinations of the two. These products can be utilized as individual components or combined in various configurations to provide the amount of EMI control needed. The Company's interconnect products include discrete EMI filters, filtered arrays, and filtered connectors.

DISCRETE EMI FILTERS

The Company's discrete EMI filter offerings include hermetically sealed and resin sealed/solder-in filters and capacitors. The Company's hermetically sealed filters are primarily used in military/secure communications, aerospace, rocket ignitors, power supplies, signal lines, and certain medical equipment. Resin sealed/solder-in filters are used in a wide range of products including telecommunications equipment, transceivers, and industrial control systems.

FILTERED ARRAYS

The Company's filtered array products consist of various filter plate assemblies. Filter plates are predominantly utilized in telecommunication equipment including wireless base stations, linear power amplifiers, and cellular microcell repeaters. This product offering often provides an economical method of meeting electromagnetic compatibility ("EMC") requirements.

FILTERED CONNECTORS

The Company offers a range of custom connectors, datacomm interconnects, and D-Subminiature Connectors. These filtered connectors are used in numerous applications including telecommunications equipment, cellular base stations, secured communications, industrial process equipment, and certain personal computers.

During the year ended November 30, 2000, approximately 71% of the Company's total revenue was generated from the sale of interconnect filter products.

MICROWAVE/WIRELESS PRODUCTS

The Company manufactures and sells coaxial ceramic resonators, bandpass filters, and duplexers. These products primarily serve the communications industry with applications in cellular telephones and base stations, satellite transceivers, wireless modems and LANS, and CATV.

During the year ended November 30, 2000, approximately 2% of the Company's total revenue was generated from the sale of microwave/wireless products.

SPECIALTY CERAMIC COMPONENTS

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Spectrum Control Technology, Inc., a wholly-owned subsidiary of the Company, manufactures and sells a broad range of specialty ceramic capacitors including tubular and discoidal, single-layer microwave, temperature compensating, high voltage, switch-mode, and high Q capacitors. These products are primarily used in testing and measurement instruments, high frequency power supplies, RF amplifiers, and other communications equipment.

During the year ended November 30, 2000, approximately 2% of the Company's total revenue was generated from the sale of specialty ceramic components.

POWER PRODUCTS

The Company's power product offerings currently include commercial custom assemblies, multisection filters, power entry modules, power distribution units, single line filters, and other power management and conditioning products. The Company's multisection products primarily serve the military/aerospace market with applications in satellite communications, electronic warfare, and ground/air weapon systems. Other power products are principally used in communications equipment, including telecommunication racks, wireless base stations, Internet servers, and networks.

During the year ended November 30, 2000, approximately 25% of the Company's total revenue was generated from the sale of power products.

ADVANCED SYSTEMS

In fiscal 2000, we completed the development of our new advanced systems product offering. Our initial advanced systems offering is a line of digital radio-frequency control equipment designed to monitor various functions and equipment and provide automatic management, as well as remote management, through wireless or external communication links. These remote management systems incorporate highly flexible software that will enable our customers to control and monitor their systems from remote locations.

Based on our internal market analysis, we believe that the primary markets for these systems include wireless base station infrastructure systems, fire and "911" security systems, remote battery back-up or UPS server systems, sonet switching systems and LAN/WAN network systems. We expect to receive our first customer orders for these complex power management systems early in fiscal 2001.

OPERATING SEGMENTS

The Company was founded as a solutions-oriented company, designing and manufacturing products to suppress or eliminate EMI. In recent years, the Company has broadened its focus and product lines to become a control products and systems company, providing a wide range of components and systems used to condition, regulate, transmit, receive, or govern electronic performance. In fiscal year 2000, the Company realigned its business segments to better reflect its current strategic focus.

The Company's current operations are primarily conducted in two segments: signal products and power products. The Company's Signal Products Group manufactures a broad range of EMI filters, filtered arrays, filtered connectors, wireless products (coaxial ceramic resonators, bandpass filters, patch antennas, and duplexers), and specialty ceramic capacitors. The Power Technologies Group currently manufactures various power management and conditioning products including power line filters and power entry modules. The reportable segments are each managed separately because they manufacture and

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sell distinct products with different production processes.

The Company evaluates performance and allocates resources to its operating segments based upon numerous factors, including segment income or loss before income taxes. The accounting policies of the reportable segments are the same as those utilized in the preparation of the Company's consolidated financial statements. However, substantially all of the Company's selling expenses, general and administrative expenses, and nonoperating expenses are not allocated to the Company's reportable operating segments and, accordingly, these expenses are not deducted in arriving at segment income or loss. In addition, reportable assets are comprised solely of property, plant, equipment, and inventories.

Prior period amounts in the following tables have been restated to correspond with the new business segment presentation. For each period presented, the accounting policies and procedures used to determine segment income have been consistently applied.

For the years ended November 30, 2000, 1999 and 1998, reportable segment information is as follows (in thousands):

| 2000 ---- | Signal Products ----- | Power Products ----- | Total ----- |
|-------------------------------------|-----------------------------|----------------------------|----------------|
| Revenue from unaffiliated customers | \$98,983 | \$33,656 | \$132,639 |
| Depreciation expense | 3,655 | 729 | 4,384 |
| Segment income | 27,748 | 8,840 | 36,588 |
| Segment assets | 36,562 | 8,525 | 45,087 |
| Capital expenditures | 4,846 | 1,469 | 6,315 |

| 1999 ---- | Signal Products ----- | Power Products ----- | Tot ----- |
|-------------------------------------|-----------------------------|----------------------------|--------------|
| Revenue from unaffiliated customers | \$64,866 | \$32,863 | \$97,729 |
| Depreciation expense | 2,781 | 674 | 3,455 |
| Segment income | 17,235 | 7,739 | 24,974 |
| Segment assets | 33,670 | 8,752 | 42,422 |
| Capital expenditures | 1,949 | 1,640 | 3,589 |

| 1998 ---- | Signal Products ----- | Power Products ----- | Tot ----- |
|-------------------------------------|-----------------------------|----------------------------|--------------|
| Revenue from unaffiliated customers | \$43,633 | \$16,235 | \$59,868 |
| Depreciation expense | 2,716 | 499 | 3,215 |
| Segment income | 13,167 | 3,509 | 16,676 |
| Segment assets | 21,224 | 5,715 | 26,939 |
| Capital expenditures | 1,723 | 1,186 | 2,909 |

For the years ended November 30, 2000, 1999 and 1998,

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reconciliations of reportable segment information to the Company's consolidated financial statements are as follows (in thousands):

| | | | |
|--------------------------------------|----------|----------|----------|
| Depreciation expense | 2000 | 1999 | |
| ----- | ---- | ---- | |
| Total depreciation expense | | | |
| for reportable segments | \$4,384 | \$3,455 | \$3, |
| Unallocated amounts: | | | |
| Depreciation expense related to | | | |
| selling, general and administrative | | | |
| activities | 373 | 464 | |
| | ---- | ---- | |
| Consolidated depreciation expense | \$4,757 | \$3,919 | \$3, |
| | ===== | ===== | ===== |
| | | | |
| Income before provision | | | |
| for income taxes | 2000 | 1999 | 1998 |
| ----- | ---- | ---- | ---- |
| Total income for reportable segments | \$36,588 | \$24,974 | \$16,676 |
| Unallocated amounts: | | | |
| Selling, general and | | | |
| administrative expense | (20,138) | (14,810) | (10,214) |
| Interest expense | (1,788) | (1,420) | (228) |
| Other income | 657 | 96 | 85 |
| | ---- | ---- | ---- |
| Consolidated income before | \$15,319 | \$ 8,840 | \$ 6,319 |
| provision for income taxes | ===== | ===== | ===== |
| | | | |
| Assets | 2000 | 1999 | 1998 |
| ----- | ---- | ---- | ---- |
| Total assets for reportable segments | \$45,087 | \$42,422 | \$26,939 |
| Unallocated amounts: | | | |
| Cash and cash equivalents | 5,977 | 538 | 739 |
| Accounts receivable | 23,831 | 19,330 | 10,162 |
| Goodwill | 14,893 | 14,225 | 2,547 |
| Other assets | 5,435 | 6,039 | 3,752 |
| | ---- | ---- | ---- |
| Total consolidated assets | \$95,223 | \$82,554 | \$44,139 |
| | ===== | ===== | ===== |
| | | | |
| Capital expenditures | 2000 | 1999 | 1998 |
| ----- | ---- | ---- | ---- |
| Total capital expenditures for | | | |
| reportable segments | \$ 6,315 | \$ 3,589 | \$ 2,909 |
| Capital expenditures related | | | |
| to the Company's selling, | | | |
| general and administrative | | | |
| activities | 590 | 1,383 | 384 |

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| | | | |
|---|----------------------------|----------------------------|----------------------------|
| Total consolidated capital expenditures | ----- \$ 6,905 ===== | ----- \$ 4,972 ===== | ----- \$ 3,293 ===== |
|---|----------------------------|----------------------------|----------------------------|

The Company has operations in the United States, Mexico and Germany. Sales are attributed to individual regions based upon the operating location responsible for the sale. The Company transfers products from one geographic region for resale in another. These transfers are priced to provide both areas with an equitable share of the overall profit. The geographic distribution of sales, operating income and long-lived assets for 2000, 1999 and 1998 is as follows (in thousands):

| 2000 ----- | North America ----- | Europe ----- |
|-------------------------------------|---------------------------|-----------------|
| Revenue from unaffiliated customers | \$113,585 | \$19,054 |
| Operating income | 16,102 | 348 |
| Long-lived assets: | | |
| Property, plant and equipment | 23,391 | 99 |
| Intangible assets | 15,290 | - |
| 1999 ----- | North America ----- | Europe ----- |
| Revenue from unaffiliated customers | \$ 82,662 | \$15,067 |
| Operating income | 9,688 | 476 |
| Long-lived assets: | | |
| Property, plant and equipment | 21,241 | 125 |
| Intangible assets | 14,940 | - |
| 1998 ----- | North America ----- | Europe ----- |
| Revenue from unaffiliated customers | \$ 50,864 | \$ 9,004 |
| Operating income | 5,984 | 478 |
| Long-lived assets: | | |
| Property, plant and equipment | 16,188 | 101 |
| Intangible assets | 2,941 | - |

The Company expects that international sales will continue to account for a significant portion of its total sales. There can be no assurance, however, that the Company will be able to maintain or increase international demand for the Company's products or that the Company will be able to

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effectively meet that demand. The Company's international sales are denominated in several different currencies including U.S. Dollars, British Pounds, and the Euro. An increase in the value of these currencies relative to other foreign currencies could make the Company's products more expensive and, therefore, potentially less competitive in those markets. Additional risks inherent in the Company's international business activities include potentially adverse tax consequences, repatriation of earnings, and the burdens of complying with a variety of foreign laws. There can be no assurance that such factors will not have an adverse effect on the Company's future results of operations.

In 2000 and 1999, the Company's largest single customer (Lucent Technologies) represented 20% and 18%, respectively, of total consolidated net sales. The Company's second largest customer (Nortel Networks) represented 13% of total consolidated net sales in 2000 and 6% in 1999. Sales to each of these customers consist of signal and power products.

PRODUCTION

The Company substantially relies on its internal manufacturing capabilities for production of its control products and systems. The Company's Ceramic Components Division in New Orleans, Louisiana, designs and manufactures various ceramic components including tubular capacitors, discoidal capacitors, and resonators. The tubular and discoidal capacitors are primarily utilized in the manufacture of electronic filter products at the Company's Interconnect Products Division in Fairview, Pennsylvania and its low-cost manufacturing center in Juarez, Mexico. Coaxial ceramic dielectric resonators are principally used in the manufacture of bandpass filters and duplexers at the Company's facilities in Elizabethtown, Pennsylvania. Assembly of power products is performed by the Company's Power Technologies Group at facilities in Erie, Pennsylvania and Wesson, Mississippi. The design and manufacture of the Company's new advanced systems products will be incubated at its facilities in Erie and Fairview, Pennsylvania. Although the Company produces a standardized line of products for sale from inventory or through distributors, most orders require relatively short production runs of custom designed components.

The Company purchases brass bushings, castings, miniature metal stampings, as well as other hardware used in the assembly and production of its products. These items are available from numerous sources. The principal raw materials used by the Company in the manufacture of ceramic capacitors and resonators are barium titanate ceramic, silver, palladium, and platinum. Precious metals are available from many sources; however, their prices may be subject to significant fluctuations and such fluctuations may have a material and adverse affect on the Company's operating results.

The Company's customers demand a high level of quality. As a result, the Company maintains an extensive quality control system designed to meet the requirements of sophisticated defense and commercial communications products. The Company has been approved by defense customers under the requirements of the U.S. military quality system, which approval is also often accepted by commercial customers. In addition, the Company's Interconnect Products Division, Power Products Division, and Ceramic Components Division have achieved and maintain ISO 9001 certification.

In recent years, a majority of the Company's capital investment has been expended to establish new production lines, increase capacity, and improve manufacturing processes. There can be no assurance that the Company can continue to make such investments in a timely manner so as to take advantage of market demand.

SALES AND DISTRIBUTION

The Company sells its products primarily through manufacturers'

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representatives, managed by the Company's internal sales force, and distribution. The Company maintains representatives throughout North America and Europe, and portions of South America, Asia and the Middle East. To enhance our product development and offerings for our largest customers, the Company maintains key account managers. These key account managers oversee the marketing and selling of our full range of product offerings and design capabilities to these customers. The Company also maintains within its sales organization employees dedicated to new business development as well as additional employees dedicated to distribution sales management. In fiscal 2000, approximately 19% of the Company's consolidated sales was through distribution. Domestic distribution is done through various national and regional distributors. International distribution is done through the Company's wholly-owned German subsidiary, Spectrum Control GmbH.

During fiscal year 2000, the Company sold its products to approximately 1,600 accounts. Sales of products to the Company's top ten customers represented 57% (\$75.5 million) of total consolidated net sales in 2000. The Company's largest single customer, an original equipment manufacturer of telecommunications equipment, represented 20% in 2000, 18% in 1999, and 11% in 1998 of total consolidated net sales. The Company's second largest single customer represented 13% of total consolidated net sales in 2000, and 6% in 1999 and 1998. All of the Company's major customers are unaffiliated with Spectrum Control, Inc. and its subsidiaries.

Shipments are made by common carrier. Most of the Company's signal products are either small or miniaturized and light weight. Accordingly, shipping charges for these products are not significant to the Company's business. However, transportation costs for the Company's power products and advanced systems may be significant. Accordingly, shipping charges and delivery time for these products may affect the Company's ability to compete for business, particularly in international markets.

No material portion of the Company's business is subject to renegotiation of profits or termination of contracts or sub-contracts at the election of the U.S. Government.

BACKLOG

The Company's backlog, which consists of purchase orders by customers, totaled approximately \$65.0 million at November 30, 2000 and \$50.0 million at November 30, 1999. It is anticipated that approximately 90% of the Company's backlog as of November 30, 2000 will be shipped within one year. Annual requirement contracts are taken into backlog only to the extent that orders are actually released thereunder. Although the terms and conditions contained in the Company's quotation forms place certain restrictions on a customer's right to cancel, purchase orders generally provide for cancellation. In practice, the Company negotiates each cancellation and schedule change based on the cost it has incurred prior to such occurrence. The Company expects to continually reduce its average lead time (the length of time from the receipt of a customer order to shipment of finished product to the customer). As a result, the Company's backlog may decrease in the future due to reduced lead times.

EMPLOYEES

As of November 30, 2000, the Company had a total of 1,724 employees, including 89 in sales, marketing and customer support; 127 in engineering and product development; 1,433 in manufacturing; and 75 in finance and administration. The Company's future success depends in significant part upon the continued service of its key technical and senior management personnel and its continued ability to attract and retain highly qualified technical and managerial personnel. Competition for such personnel is intense, and there can

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be no assurance that the Company can retain its key managerial and technical employees or that it can attract, assimilate, or retain other highly qualified technical and managerial personnel in the future. None of the Company's employees is represented by a labor union. The Company has not experienced any work stoppages and considers its relations with its employees to be good.

PROPRIETARY RIGHTS

The Company relies on trade secrets, know-how, and to a lesser extent patents, to establish and protect proprietary rights to technologies and products. Trade secrets and know-how are protected through confidentiality agreements and internal procedures. In connection with the manufacture and sale of control products and systems, the Company owns numerous United States and foreign patents and has certain patents pending. None of these patents and patent applications are critical to the Company's business. The Company's policy is to file patent applications to protect proprietary technology, inventions and improvements. There can be no assurance that patents will issue from any of the Company's pending applications or that any claims allowed from existing or pending patents will be sufficiently broad to protect the Company's technology. While the Company intends to protect its intellectual property rights vigorously, there can be no assurance that any patents held by the Company will not be challenged, invalidated or circumvented, or the rights granted thereunder will provide competitive advantages to the Company.

The Company holds nineteen (19) United States patents and forty-four (44) foreign patents relating to polymer multilayer technology. The Company has entered into several agreements regarding licensing the technology covered by these patents. However, it is not known what commercial value, if any, these patents and related licenses may have.

GOVERNMENT REGULATIONS

The Company's products are incorporated into communications systems which are subject to various FCC regulations. Regulatory changes, including changes in the allocation of available frequency spectrum, could significantly impact the Company's operations by restricting development efforts by the Company's customers, obsoleting current products or increasing the opportunity for additional competition. Changes in, or the failure by the Company to comply with, applicable domestic and international regulations could have an adverse effect on the Company's business, operating results and financial condition. In addition, the increasing demand for wireless communications has exerted pressure on regulatory bodies worldwide to adopt new standards for such products and services, generally following extensive investigation of and deliberation over competing technologies. The delays inherent in this government approval process may cause the cancellation, postponement or rescheduling of the installation of communications systems by the Company's customers, which in turn may have a material adverse effect on the sale of products by the Company to such customers.

In order to qualify as an approved supplier of EMI products for use in equipment purchased by the military services or aerospace programs, the Company is required to meet the applicable portions of the quality specifications and performance standards designed by the Air Force, the Army, and the Navy. The Company's products must also conform to the specifications of the Defense Electronic Supply Center for replacement parts supplied to the military. To the extent required, the Company meets or exceeds all of these specifications.

The Company is subject to numerous federal, state and local regulations relating to air and water quality, the disposal of hazardous waste materials, safety, and health. Compliance with applicable environmental

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regulations has not significantly changed the Company's competitive position, capital spending, or earnings in the past and the Company does not presently anticipate that compliance with such regulations will change its competitive position, capital spending, or earnings for the foreseeable future. The Company continuously monitors regulatory matters and believes that it is currently in compliance in all material respects with applicable environmental laws and regulations.

COMPETITION

The markets for the Company's products are intensely competitive and are characterized by price erosion, technological change, and product obsolescence. The principal competitors of our Signal Products Group include AVX Corporation, Amphenol Corporation, Conec Corporation, ITT Canon, an ITT Industries Company, and Tusonix, Inc. The primary competitors of our Power Technologies Group include Corcom, a division of CII Technologies, Delta Group Electronics, Inc., Schaffner Holder AG and Captor Technology Company Ltd. We expect the major competitors of our advanced systems products to include Astec America, Inc., Peco II, Inc., Dataprobe, Inc., Western Telematic, Inc. and Dantel, Inc. Many of the Company's current and potential competitors have significantly greater financial, technical, manufacturing, and marketing resources than the Company. These competitors may be able to engage in sustained price reductions in the Company's primary markets to gain market share. Furthermore, the Company currently supplies control products and systems to large OEM customers that are continuously evaluating whether to manufacture their own products and systems or purchase them from outside sources.

The Company believes that its ability to compete in its current markets depends on factors both within and outside the Company's control, including the timing and success of new product introductions by the Company and its competitors, availability of ceramic and assembly manufacturing capability, the Company's ability to support decreases in selling price through operating cost reductions, adequate sources of raw materials, product quality, and general economic conditions. There can be no assurance that the Company will be able to compete successfully in the future.

RESEARCH AND DEVELOPMENT

The Company's position as a leading designer, developer and manufacturer of signal and power products is largely the result of a long history of technological innovation. The Company's research and development efforts are focused on expanding the Company's materials technology, improving existing product offerings, developing new product offerings, and designing specialized production equipment to improve manufacturing efficiencies. As of November 30, 2000, the Company employed 127 individuals in engineering and product development. In addition to their design and development activities, the engineering staff participates with the Company's marketing department in proposal preparation and applications support for customers. Research and development expense amounted to \$1,535,000 in 2000, \$1,184,000 in 1999, and \$961,000 in 1998.

OTHER MATTERS

The business of the Company is not subject to any significant seasonal fluctuations.

The Company does not believe that it has any special practices or special conditions affecting working capital items that are significant for an understanding of its business.

ITEM 2. PROPERTIES

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The Company's principal manufacturing and office facilities as of November 30, 2000 are as follows:

| LOCATION | FUNCTION | APPROXIMATE SQUARE FEET OF FLOOR AREA | OWNERSHIP |
|--|-------------------------------|---|-----------|
| 8061 Avonia Road Fairview, PA | Manufacturing, EMI Testing | 38,000 | Owned |
| 6000 West Ridge Road Erie, PA | Manufacturing | 41,000 | Owned |
| 4100 Michoud Blvd. New Orleans, LA | Manufacturing | 100,000 | Owned |
| 3053 Hwy. 51N Wesson, MS | Manufacturing | 50,000 | Owned |
| 1593 Mount Joy St. Elizabethtown, PA | Manufacturing | 26,000 | Owned |
| 1595 Mount Joy St. Elizabethtown, PA | Manufacturing | 35,000 | Owned |
| Boulevard Zaragoza 2910 Ciudad Juarez, Mexico | Manufacturing | 46,000 | Rented |
| 8031 Avonia Road Fairview, PA | Corporate Offices | 10,000 | Owned |

(1) The Company's manufacturing and office space is considered adequate for its existing requirements and its projected business needs.

(2) In addition to the facilities described above, the Company leases certain sales office and warehousing space.

ITEM 3. LEGAL PROCEEDINGS

The Company is not currently involved in any litigation of a material nature.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

No matters were submitted to a vote of security holders during the quarter ended November 30, 2000.

PART II

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ITEM 5. MARKET FOR THE REGISTRANT'S COMMON STOCK AND RELATED STOCKHOLDER

MATTERS

The Company's Common Stock is traded on the NASDAQ Stock Market under the symbol SPEC. The high and low sales prices for the Common Stock for each quarter during fiscal years 2000 and 1999 are set forth below.

| | High | Low |
|----------------|----------|---------|
| Fiscal 2000 | | |
| First quarter | \$ 15.81 | \$ 9.13 |
| Second quarter | 17.25 | 8.13 |
| Third quarter | 20.25 | 10.38 |
| Fourth quarter | 19.25 | 11.94 |
| | | |
| | High | Low |
| Fiscal 1999 | | |
| First quarter | \$ 4.94 | \$ 3.66 |
| Second quarter | 6.63 | 4.00 |
| Third quarter | 7.44 | 5.88 |
| Fourth quarter | 11.63 | 6.44 |

At February 1, 2001, the Company had 13,408,488 shares of Common Stock outstanding, which were held by approximately 1,900 registered stockholders. In recent years, the Company has not paid cash dividends on its Common Stock. While subject to periodic review, the current policy of the Board of Directors is to retain all earnings to provide funds for the continued growth of the Company.

ITEM 6. SELECTED FINANCIAL DATA

| | Years Ended November | | |
|------------------------|------------------------------|-----------|---------|
| | (Amounts in Thousands Except | | |
| | 2000 | 1999 | 1998 |
| | ---- | ---- | ---- |
| Operating Data | | | |
| Net sales | \$ 132,639 | \$ 97,729 | \$ 59,8 |
| Gross margin | 37,932 | 27,912 | 18,2 |
| Income from operations | 16,450 | 10,164 | 6,4 |
| Interest expense | 1,788 | 1,420 | 2 |

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| | | | |
|---|-----------|-----------|---------|
| Income before provision for income taxes | 15,319 | 8,840 | 6,3 |
| Net income | 9,503 | 5,470 | 3,9 |
| Earnings per common share: | | | |
| Basic | 0.81 | 0.50 | 0. |
| Diluted | 0.79 | 0.49 | 0. |
| Weighted average common shares outstanding: | | | |
| Basic | 11,694 | 10,905 | 10,9 |
| Diluted | 11,980 | 11,051 | 11,0 |
| Financial Position | | | |
| Working capital | \$ 42,962 | \$ 23,989 | \$ 18,6 |
| Total assets | 95,223 | 82,554 | 44,1 |
| Long-term debt | 2,107 | 19,011 | 2,5 |
| Stockholders' equity | 76,546 | 39,135 | 33,7 |

ITEM 7. Management's Discussion and Analysis of Financial Condition and

----- Results of Operations -----

Overview

We were founded as a solutions-oriented company, designing and manufacturing products to suppress or eliminate electromagnetic interference ("EMI"). In recent years, we broadened our focus and product lines to become a control products and systems company, providing a wide range of components and systems used to condition, regulate, transmit, receive, or govern electronic performance. Although our components and systems are used in many industries worldwide, our largest market is the telecommunications industry. In 2000, approximately 64% of our sales were to customers in the telecommunications industry. Our products are used in numerous telecommunications systems including wireless base stations, fiber optic networks and switching equipment, wireless modems and LANs, Internet servers, and global positioning systems. Our growth is being primarily driven by the expansion of the wireless and fiber optic networking segments of the telecommunications industry, the increasing electronic content and complexity of many end-products and the positive impact of our strategic acquisitions.

Our operations are primarily conducted in two business segments: signal products and power products. Our Signal Products Group manufactures a broad line of discrete EMI filters, filtered arrays, filtered connectors, wireless products (coaxial ceramic resonators, patch antennas, bandpass filters, and duplexers), and specialty ceramic capacitors (single layer, temperature compensating, high voltage, and switch mode). Our Power Technologies Group currently manufactures various power management and conditioning products including power distribution units, power line filters, and power entry modules. Recently, our Power Technologies Group developed and introduced an advanced systems product offering to become a provider of more complex power management systems, including a line of digital radio-frequency control equipment for remote and automatic electronic systems management.

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On March 26, 1999, we acquired substantially all of the assets of the Signal Conditioning Products Division ("SCPD") of AMP Incorporated ("AMP"). AMP is a world leader in the manufacture of electrical, electronic, fiber optic and wireless interconnection devices and systems. Through SCPD, AMP manufactured and sold a broad line of EMI filter products with annual sales of approximately \$30.0 million. The acquisition was accounted for as a purchase and, accordingly, the results of operations of the acquired business have been included in our financial statements since the date of acquisition.

Forward-Looking Information

The following discussion includes certain "forward-looking statements" within the meaning of the federal securities laws, including statements regarding: (1) our belief as to our future operating margins, (2) our anticipated capital expenditures and research and development expenses, (3) our expected future operating requirements and financing needs and (4) our anticipated manufacturing capacity expansion. The words "believe", "expect", "anticipate" and similar expressions identify forward-looking statements. These forward-looking statements are subject to certain risks and uncertainties which could cause actual results to differ materially from historical results or those anticipated. Factors that could cause or contribute to such differences include those discussed in "Risk Factors That May Affect Future Results", as well as those discussed elsewhere herein. Readers are cautioned not to place undue reliance on these forward-looking statements.

Management's Discussion and Analysis of Financial Condition and Results of Operations (Continued)

Results of Operations

The following table sets forth certain financial data, as a percentage of net sales, for the years ended November 30, 2000, 1999, and 1998:

| | 2000 ---- | 1999 ---- |
|---|---------------|---------------|
| Net sales | 100.0% | 100.0% |
| Cost of products sold | 71.4 ---- | 71.4 ---- |
| Gross margin | 28.6 | 28.6 |
| Selling, general and administrative expense | 16.2 ---- | 18.2 ---- |
| Income from operations | 12.4 | 10.4 |
| Other income (expense) | | |
| Interest expense | (1.3) | (1.5) |
| Other income and expense, net | 0.5 ---- | 0.1 ---- |
| Income before provision for income taxes | 11.6 | 9.0 |
| Provision for income taxes | 4.4 ---- | 3.4 ---- |
| Net income | 7.2% ===== | 5.6% ===== |

2000 Compared to 1999

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Net Sales

Consolidated 2000 net sales increased by \$34.9 million, or 35.7%, from 1999. Sales of signal products amounted to \$99.0 million in 2000, an increase of \$34.1 million compared to 1999. Of this increase, approximately \$9.0 million was generated from the sale of SCPD products. The remaining \$25.1 million increase in signal product sales principally reflects higher shipment levels for EMI low pass filters, filtered arrays, and filtered connectors. Among other applications, these components are used in various telecommunication equipment including fiber optic networks, wireless base stations, power amplifiers, and transceivers. Sales of power products increased by \$800,000 in 2000, primarily reflecting additional shipments of power distribution units and single line filters. These power products are principally used in telecommunications equipment, including high-end Internet servers and networks. Selling prices were relatively stable throughout 2000. Overall demand for our products was strong throughout the year with total customer orders of \$151.8 million received in 2000, an increase of \$32.0 million, or 26.7%, from 1999.

Gross Margin

Gross margin was \$37.9 million, or 28.6% of sales in 2000, compared to \$27.9 million, or 28.6% of sales in 1999. In April 1999, we commenced a program to integrate SCPD into our Signal Products Group. This integration, which included relocating SCPD manufacturing operations and redesigning certain SCPD products and production processes, was completed in May 2000. With the completion of this integration, operating efficiencies and manufacturing yields improved during the second half of 2000. In June 2000, we commenced manufacturing operations in our new 46,000 square foot facility in Juarez, Mexico. Production in this leased facility is expected to be phased in throughout fiscal 2001. In November 2000, we completed the construction of a 26,000 square foot addition to our Wesson, Mississippi facility. This facility will be utilized in the manufacturing of our power product offerings.

Management's Discussion and Analysis of Financial Condition and Results of

Operations (Continued)

In addition to increasing our manufacturing capacity, we believe these new facilities will improve our operating efficiencies and lower our overall production costs. Accordingly, we expect gross margins to approximate 30.0% to 31.0% of sales in fiscal 2001.

Selling, General and Administrative Expense

With additional sales volume, selling expense increased during the period. Selling expense amounted to \$12.4 million, or 9.4% of sales in 2000, compared to \$9.7 million, or 10.0% of sales in 1999. The decrease in selling expense as a percentage of sales principally reflects economies of scale realized with additional sales volume. General and administrative expense was \$9.1 million in 2000, compared to \$8.0 million in 1999. Of the \$1.1 million increase, approximately \$200,000 arises from the amortization of goodwill recognized in connection with our acquisition of SCPD and \$241,000 arises from the write-off of debt issuance costs upon the early payoff of certain indebtedness. The remaining increase in general and administrative expense primarily reflects additional personnel costs and professional fees incurred to support business growth.

Other Income and Expense

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Interest expense increased by \$368,000 during the period, from \$1.4 million in 1999 to \$1.8 million in 2000. Of this increase, \$277,000 reflects greater short-term bank borrowings and higher average interest rates in 2000. Weighted average short-term borrowings under our domestic line of credit were \$4.3 million in 2000, compared to \$1.5 million in 1999. Weighted average interest rates for borrowings under our domestic line of credit were approximately 8.6% in 2000 and 7.4% in 1999. The remaining increase of \$91,000 principally reflects additional interest under the term loan incurred to substantially finance the acquisition of SCPD. As more fully discussed below, all borrowings under the term loan and our domestic line of credit were repaid in August 2000.

We hold numerous United States and foreign patents relating to polymer multilayer ("PML") technology. In 2000, we realized \$452,000 of license fee income upon the granting of PML technology licenses. Although these licenses, as well as other PML licenses that we have previously granted, require certain royalties to be paid to us upon the sale of products utilizing PML technology, it is not known what future commercial value, if any, these patents and related licenses may have.

Our wholly-owned foreign subsidiaries transact business with certain customers and vendors in currencies other than their local currency. As a result, we recognize gains and losses on foreign currency transactions. We incurred net gains of \$7,000 in 2000 and \$4,000 in 1999 on these foreign currency transactions.

We realized interest income of \$198,000 in 2000 and \$72,000 in 1999 from temporary cash investments.

Income Taxes

Our effective income tax rate was 38.0% in 2000 and 38.1% in 1999, compared to an applicable federal and state statutory income tax rate of approximately 40.0%. Differences between the effective tax rate and statutory tax rate primarily arise from state tax provisions and foreign income tax rates.

At November 30, 2000, we had recorded certain deferred tax assets. We have assessed our past earnings history and trends, and expiration dates of tax attribute carryforwards, and have determined that it is more likely than not that these deferred tax assets will be realized to offset future taxable income from ordinary and recurring operations.

Management's Discussion and Analysis of Financial Condition and Results of Operations (Continued)

1999 Compared to 1998

Net Sales

Consolidated 1999 net sales increased by \$37.9 million, or 63.2%, from 1998. Of this increase, \$21.3 million was generated from the sale of SCPD and other signal products, with the remaining \$16.6 million primarily generated from the sale of power products. These power products are principally used in telecommunications equipment, including wireless base stations, telephone switching networks, and Internet servers. Overall market demand in the telecommunications industry was strong throughout the year. In 1999, we received total customer orders of \$119.8 million, an increase of 93.5% from 1998. In addition to these customer orders, we assumed approximately \$5.1 million of

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customer order backlog in connection with the acquisition of SCPD. Average selling prices declined slightly during the year as a result of market pressures.

Gross Margin

Gross margin was \$27.9 million, or 28.6% of sales in 1999, compared to \$18.3 million, or 30.5% of sales in 1998. The decrease in gross margin percentage reflects several factors of relative equal significance, including: additional production costs and inefficiencies incurred during the integration of SCPD into our Signal Products Group; changes in sales mix from our signal products to our power product offerings; yield losses and resultant higher labor costs incurred at our ceramic components division in New Orleans, Louisiana; and lower average selling prices as indicated above.

Selling, General and Administrative Expense

As a result of greater sales volume, selling expense increased during the period. Selling expense amounted to \$9.7 million, or 10.0% of sales in 1999, compared to \$6.8 million, or 11.4% in 1998. The decrease in selling expense as a percentage of sales principally reflects economies of scale realized with the additional sales volume. General and administrative expense was approximately \$8.0 million in 1999, compared to \$5.0 million in 1998. Of this increase, approximately \$400,000 consisted of the amortization of goodwill recognized in connection with our acquisition of SCPD in March 1999. The remaining increase in general and administrative expense reflects additional personnel costs, professional fees and other operating expenses associated with our increased business activity.

Other Income and Expense

As a result of additional bank indebtedness, interest expense increased by \$1.2 million in 1999, from \$228,000 to \$1.4 million. In March 1999, we secured a \$20.0 million term loan to substantially finance the acquisition of SCPD. Interest on the term loan was \$990,000 in 1999, with an average interest rate of approximately 7.3%. In addition, weighted average short-term bank borrowings were \$1.6 million in 1999, compared to \$28,000 in 1998.

In 1999 and 1998, our wholly-owned German subsidiary transacted business with certain customers and vendors in currencies other than the Deutsche Mark. As a result, we realized net gains of \$4,000 in 1999 and incurred net losses of \$40,000 in 1998 on these foreign currency transactions.

We recognized other income of \$79,000 in 1999 and \$125,000 in 1998 from certain short-term investments and patent licensing fees.

Management's Discussion and Analysis of Financial Condition and Results of Operations (Continued)

Income Taxes

Our effective income tax rate was 38.1% in 1999 and 37.7% in 1998, compared to an applicable federal and state statutory income tax rate of approximately 40.0%. Differences between the effective tax rate and statutory tax rate primarily arise from state tax provisions and foreign income tax rates. In 1998, the effective tax rate also reflects the elimination of a deferred tax asset valuation allowance previously recorded for certain foreign net operating loss carryforwards.

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Risk Factors That May Affect Future Results

Our results of operations may be affected in the future by a variety of factors including: competitive pricing pressures, new product offerings by us and our competitors, new technologies, product cost changes, changes in the overall economic climate, availability of raw materials, changes in product mix, and unexpected costs and delays in adding manufacturing capacity. In 2000, approximately 64% of our sales were to customers in the telecommunications industry. Our largest single customer, an original equipment manufacturer of telecommunication equipment, represented 20% of our total consolidated net sales in 2000. Any significant change in the activity level of this major customer, or the overall telecommunications industry, would have a direct impact on our performance.

Liquidity, Capital Resources and Financial Condition

On August 16, 2000, we sold 2.3 million shares of our Common Stock in a public offering which resulted in net proceeds of \$27.8 million, after deducting issuance costs. The net proceeds of the offering were used to repay \$7.4 million of revolving line of credit indebtedness and \$17.3 million of term loan debt, with the remaining proceeds added to cash and cash equivalents available for general corporate purposes.

We maintain a \$12.0 million line of credit with our principal lending institution, PNC Bank, N.A. of Erie, Pennsylvania. This revolving credit line is unsecured, with interest rates on borrowings at or below the prevailing prime rate. At November 30, 2000, no borrowings were outstanding under the line of credit. The line of credit agreement contains certain covenants, the most restrictive of which require us to maintain designated minimum levels of net worth and profitability and impose certain restrictions on us regarding additional indebtedness. At November 30, 2000, we were in compliance with all debt covenants. The current line of credit agreement expires April 30, 2003.

Our wholly-owned German subsidiary maintains unsecured Deutsche Mark lines of credit with several German financial institutions aggregating \$1.5 million (DM 3.5 million). At November 30, 2000, no borrowings were outstanding under these lines of credit. Future borrowings, if any, will bear interest at rates below the prevailing prime rate and will be payable upon demand.

With the proceeds from our public stock offering and the related retirement of debt, our working capital and current ratio improved significantly in 2000. At November 30, 2000, we had net working capital of \$43.0 million, compared to \$24.0 million at November 30, 1999 and \$18.6 million at November 30, 1998. At November 30, 2000, current assets were 4.27 times current liabilities, compared to 2.10 at November 30, 1999 and 4.23 at November 30, 1998.

Management's Discussion and Analysis of Financial Condition and Results of

Operations (Continued)

Our cash expenditures for property, plant and equipment amounted to \$6.9 million in 2000, compared to \$5.0 million in 1999 and \$3.3 million in 1998. Capital expenditures in fiscal year 2000 primarily related to manufacturing equipment for our new Mexican facility and other capacity expansion within our Signal Products Group. The 1999 capital expenditures principally related to metal fabrication machinery and other manufacturing equipment for capacity expansion in our Power Technologies Group, domestic facility expansion within our Signal Products Group, and construction of our new corporate administrative

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office facility in Fairview, Pennsylvania. In order to meet expected customer demand and production requirements for our power product offerings, we have expanded our Wesson, Mississippi facility. A 26,000 square foot addition to our existing facility was completed in November 2000. Financing for this \$1.1 million project will be substantially provided by the State of Mississippi through general obligation bonds in fiscal 2001. With the exception of this project, we had not entered into any material commitments for capital expenditures or debt financing at November 30, 2000.

Income taxes paid during the fiscal years ended November 30, 2000, 1999, and 1998 amounted to \$3.8 million, \$3.0 million, and \$1.5 million, respectively. We expect cash outlays for income taxes to be less than income tax expense for the next three fiscal years.

In September 1998, we initiated a stock repurchase program. Under the program, we may repurchase up to \$4.0 million of our Common Stock. Acquired shares are to be purchased in the open market, with the cost of the program financed out of available cash reserves and borrowings under our revolving line of credit facility. The amount and timing of the shares repurchased are based on the ongoing assessment of our capital structure, liquidity, and the market price of our Common Stock. In 2000 and 1999, no shares were repurchased. During 1998, 70,000 shares were repurchased at an aggregate cost of \$294,000. The repurchased shares are held as treasury stock.

Research and development expenditures, which encompass the personnel and related expenses devoted to developing new products and processes, amounted to \$1.5 million in 2000, \$1.2 million in 1999, and \$961,000 in 1998. We expect research and development expenses to increase in fiscal 2001, as we continue to enhance existing product lines, design new signal and power products, and develop our new advanced systems product offerings. We believe research and development expenses will approximate 1.5% of sales in 2001.

Current financial resources, including working capital and existing lines of credit, and anticipated funds from operations are expected to be sufficient to meet cash requirements throughout fiscal 2001. These cash requirements include scheduled long-term debt repayment, planned capital expenditures, research and development expenses, and possible stock repurchases. There can be no assurance, however, that unplanned capital replacement or other future events will not require us to seek additional debt or equity financing and, if so required, that it will be available on terms acceptable to us.

With additional profitability and reduced working capital requirements, our operating cash flow increased significantly in 2000. For the year ended November 30, 2000, net cash generated from operations amounted to \$11.1 million, an increase of \$9.1 million from the comparable period of 1999. In 1999, operating cash flow was negatively impacted by increased working capital requirements. Net cash generated from operations amounted to \$2.0 million in 1999, a decrease of \$6.3 million from 1998. During the year ended November 30, 1999, inventories increased by approximately \$6.4 million from operations. The increase in inventories primarily reflects additional customer consigned inventory requirements, as well as additional raw material and work-in-process inventories to support increased production and shipment requirements.

Management's Discussion and Analysis of Financial Condition and Results of

Operations (Continued)

In 1998, we had strong operating cash flow. During the year ended November 30, 1998, net cash generated from operations amounted to \$8.3 million

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and proceeds realized upon the exercise of employee stock options amounted to \$414,000. This cash flow was used to fund capital additions of \$3.3 million, debt repayment of \$743,000, stock repurchases of \$294,000, and the aggregate purchase price of two acquired businesses. In 1998, we acquired substantially all of the assets of Republic Electronics Corporation, a manufacturer of subminiature ceramic capacitors, and Potter Production Corporation, a manufacturer of electronic filters and power products. The total cash purchase price of the acquired assets amounted to \$4.1 million.

At November 30, 2000, goodwill represented 15.6% of total assets and 19.5% of stockholders' equity. A majority of this goodwill was recognized in 1999 in connection with our acquisition of SCPD. We amortize goodwill on a straight-line basis over a period of 20 years and periodically review its carrying value for possible impairment. Based upon a review of expected future operating cash flows derived from the acquisition of SCPD, we have determined that no impairment losses need be recognized in the accompanying financial statements.

Quantitative and Qualitative Disclosures About Market Risk

Foreign Currency

Certain of our European sales and related selling expenses are denominated in German Deutsche Marks, British Pounds, and other local currencies. In addition, certain of our operating expenses are denominated in Mexican Pesos. As a result, fluctuations in currency exchange rates may affect our operating results and cash flows. To manage our exposure to the Deutsche Mark, we occasionally enter into forward currency exchange contracts. At November 30, 2000, we had forward currency exchange contracts (to receive U.S. Dollars and pay German Deutsche Marks) with aggregate notional amounts of \$850,000 and average contractual exchange rates of 2.06. For each of the three years ended November 30, 2000, currency exchange rate gains and losses were not material. In addition, an assumed 10.0% adverse change in all foreign currencies in which we currently transact business would not have a material impact on our operating results, financial position, or cash flows.

Euro

Certain member countries of the European Union have established fixed conversion rates between their existing currencies and the European Union's common currency, the Euro. We have implemented all the necessary enhancements to our sales order, banking arrangements and operational procedures to ensure Euro compliance. We are able to process orders, invoice customers and accept payment in Euros throughout Europe. The introduction of the Euro has not had any material adverse impact upon us. We continue to monitor the risk of price erosion which could result from increased price transparency among countries using the Euro.

Interest Rate Exposure

We have market risk exposure relating to possible fluctuations in interest rates. From time to time, we utilize interest rate swap agreements to minimize the risks and costs associated with variable rate debt. We do not enter into derivative financial instruments for trading or speculative purposes. The interest rate swap agreements are entered into with major financial institutions thereby minimizing the risk of credit loss. At November 30, 2000, no interest rate swap agreements were outstanding.

Management's Discussion and Analysis of Financial Condition and Results of

Operations (Continued)

Environmental Matters

We are subject to various laws and governmental regulations concerning environmental matters and employee safety and health in the United States and other countries. U.S. federal environmental legislation having particular impact on us includes the Toxic Substances Control Act; the Resource Conservation and Recovery Act; the Clean Air Act; the Clean Water Act; and the Safe Drinking Water Act. We also are subject to regulation by the Occupational Safety and Health Administration ("OSHA") concerning employee safety and health matters. The United States Environmental Protection Agency ("EPA"), OSHA, and other federal agencies have the authority to promulgate regulations that have an impact on our operations.

In addition to these federal agencies, various states have been delegated certain authority under the aforementioned federal statutes. Many state and local governments have adopted environmental and employee safety and health laws and regulations, some of which are similar to federal requirements. State and federal authorities may seek fines and penalties for violation of these laws and regulations. As part of our continuing environmental program, we have been able to comply with such proceedings and orders without any materially adverse effect on our business. We are not currently involved in any legal proceedings involving environmental matters.

Impact of Inflation

In recent years, inflation has not had a significant impact on our operations. However, we continuously monitor operating price increases, particularly in connection with the supply of precious metals used in our manufacturing of certain ceramic capacitors. To the extent permitted by competition, we pass increased costs on to our customers by increasing sales price over time. Sales increases reported in the accompanying financial statements, however, have substantially arisen from increased sales volume, not increases in selling prices.

New Accounting Pronouncements

In June 1998, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 133, "Accounting for Derivative Instruments and for Hedging Activities" ("SFAS No. 133"). SFAS No. 133 provides a comprehensive and consistent standard for the recognition and measurement of derivatives and hedging activities. It requires that an entity recognize all derivatives as either assets or liabilities in the statement of financial position and measure those instruments at fair value. For a derivative not designated as a hedging instrument, changes in the fair value of the derivative are recognized in earnings in the period of change. SFAS No. 133 is effective for fiscal years beginning after June 15, 2000. In December 1999, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 101, "Revenue Recognition in Financial Statements" ("SAB No. 101"), which clarifies the accounting rules for revenue recognition in financial statements. We must implement SAB No. 101 by the fourth quarter of fiscal year 2001. We do not expect the adoption of SFAS No. 133 or SAB No. 101 to have a material impact on our financial position or results of operations.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

The following consolidated financial statements of Spectrum Control, Inc. and subsidiaries are included herein:

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| | Page Number ----- |
|---|-------------------------|
| Report of Independent Auditors | 25 |
| Consolidated Balance Sheets as of November 30, 2000 and 1999 | 26 |
| Consolidated Statements of Income for the years ended November 30, 2000, 1999, and 1998 | 27 |
| Consolidated Statements of Stockholders' Equity for the years ended November 30, 2000, 1999, and 1998 | 28 |
| Consolidated Statements of Cash Flows for the years ended November 30, 2000, 1999, and 1998 | 29 |
| Notes to Consolidated Financial Statements | 30-47 |

REPORT OF INDEPENDENT AUDITORS

To the Board of Directors and Shareholders of Spectrum Control, Inc.

We have audited the accompanying consolidated balance sheets of Spectrum Control, Inc. and subsidiaries as of November 30, 2000 and 1999, and the related consolidated statements of income, stockholders' equity, and cash flows for each of the three years in the period ended November 30, 2000. Our audits also included the financial statement schedule listed in the Index at Item 14 (a). These financial statements and schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and schedule based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Spectrum Control, Inc. and subsidiaries at November 30, 2000 and 1999, and the consolidated results of their operations and their cash flows for each of the three years in the period ended November 30, 2000, in conformity with accounting

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principles generally accepted in the United States. Also, in our opinion, the related financial statement schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

/s/ Ernst & Young LLP

Pittsburgh, Pennsylvania
January 3, 2001

ERNST & YOUNG LLP

SPECTRUM CONTROL, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
NOVEMBER 30, 2000 AND 1999
(Dollar Amounts in Thousands)

| | 2000 | 1999 |
|--|-----------------------------|--------------------------|
| | ---- | ---- |
| ASSETS | | |
| Current assets | | |
| Cash and cash equivalents | \$ 5,977 | \$ |
| Accounts receivable, less allowances of \$766 in 2000 and \$673 in 1999 | 23,831 | 19, |
| Inventories (Note 3) | 25,239 | 24, |
| Deferred income taxes (Note 12) | 779 | |
| Prepaid expenses and other current assets | 293 | |
| Total current assets | ----- 56,119 | ----- 45, |
| Property, plant and equipment, net (Note 4) | 23,490 | 21, |
| Other assets (Note 5) | | |
| Goodwill, net | 14,893 | 14, |
| Other noncurrent assets | 721 | 1, |
| Total other assets | ----- 15,614 | ----- 15, |
| Total assets | ----- \$ 95,223 ===== | ----- \$ 82, ===== |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Current liabilities | | |
| Short-term debt (Note 6) | \$ - | \$ |
| Accounts payable | 8,714 | 8, |
| Accrued salaries and wages | 3,002 | 2, |
| Accrued interest | 75 | |
| Accrued federal and state income taxes | 645 | |
| Accrued other expenses | 181 | |
| Current portion of long-term debt (Note 7) | 540 | 4, |
| Total current liabilities | ----- 13,157 | ----- 21, |
| Long-term debt (Note 7) | 2,107 | 19, |

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| | | |
|---|-----------|--------|
| Deferred income taxes (Note 12) | 3,413 | 2, |
| Stockholders' equity | | |
| Common stock, no par value, authorized 25,000,000 shares, issued 13,448,052 shares in 2000 and 11,018,703 in 1999 | 43,175 | 14, |
| Retained earnings | 34,771 | 25, |
| Treasury stock, 70,000 shares in 2000 and 1999, at cost (Note 10) | (294) | (|
| Accumulated other comprehensive income | | |
| Foreign currency translation adjustment | (1,106) | (|
| | ----- | ----- |
| Total stockholders' equity | 76,546 | 39, |
| | ----- | ----- |
| Total liabilities and stockholders' equity | \$ 95,223 | \$ 82, |
| | ===== | ===== |

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

SPECTRUM CONTROL, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME
FOR THE YEARS ENDED NOVEMBER 30, 2000, 1999 AND 1998
(Dollar Amounts in Thousands, Except Per Share Data)

| | 2000 | 1999 |
|---|------------|-----------|
| | ---- | ---- |
| Net sales | \$ 132,639 | \$ 97,729 |
| Cost of products sold | 94,707 | 69,817 |
| | ----- | ----- |
| Gross margin | 37,932 | 27,912 |
| Selling, general and administrative expense | 21,482 | 17,748 |
| | ----- | ----- |
| Income from operations | 16,450 | 10,164 |
| Other income (expense) | | |
| Interest expense | (1,788) | (1,420) |
| Other income and expense, net (Note 11) | 657 | 96 |
| | ----- | ----- |
| | (1,131) | (1,324) |
| | ----- | ----- |
| Income before provision for income taxes | 15,319 | 8,840 |
| Provision for income taxes (Note 12) | 5,816 | 3,370 |
| | ----- | ----- |
| Net income | \$ 9,503 | \$ 5,470 |
| | ===== | ===== |
| Earnings per common share (Note 13): | | |
| Basic | \$ 0.81 | \$ 0.50 |
| | ===== | ===== |

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Diluted

\$ 0.79

\$ 0.49

=====

=====

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

SPECTRUM CONTROL, INC. AND SUBSIDIARIES
 CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
 FOR THE YEARS ENDED NOVEMBER 30, 2000, 1999 AND 1998
 (Dollar Amounts in Thousands)

| | Common Stock | | Retained Earnings | Treasury Stock |
|---|--------------|----------|----------------------|-------------------|
| | Shares | Amount | | |
| | ----- | ----- | ----- | ----- |
| Balance - November 30, 1997 | 10,838,345 | \$13,977 | \$15,864 | \$ - |
| Net income | - | - | 3,934 | - |
| Foreign currency translation adjustment | - | - | - | - |
| Comprehensive income | - | - | - | - |
| Issuance of common stock upon exercise of employee stock options | 118,663 | 414 | - | - |
| Purchase of treasury stock | - | - | - | (294) |
| Tax benefits from exercise of stock options | - | 79 | - | - |
| | ----- | ----- | ----- | ----- |
| Balance - November 30, 1998 | 10,957,008 | 14,470 | 19,798 | (294) |
| Net income | - | - | 5,470 | - |
| Foreign currency translation adjustment | - | - | - | - |
| Comprehensive income | - | - | - | - |
| Issuance of common stock upon exercise of employee stock options | 68,663 | 182 | - | - |
| Purchase and retirement of common stock | (6,968) | (56) | - | - |
| Tax benefits from exercise of stock options | - | 37 | - | - |
| | ----- | ----- | ----- | ----- |
| Balance - November 30, 1999 | 11,018,703 | 14,633 | 25,268 | (294) |
| Net income | - | - | 9,503 | - |
| Foreign currency translation adjustment | - | - | - | - |
| Comprehensive income | - | - | - | - |
| Issuance of common stock upon : | | | | |
| Exercise of employee stock options | 64,801 | 197 | - | - |
| Exercise of stock warrants | 65,584 | 410 | - | - |
| Public stock offering | 2,300,000 | 27,836 | - | - |

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| | | | | |
|---|------------|----------|----------|----------|
| Purchase and retirement of common stock | (1,036) | (18) | - | - |
| Tax benefits from exercise of stock options | - | 117 | - | - |
| | ----- | ----- | ----- | ----- |
| Balance - November 30, 2000 | 13,448,052 | \$43,175 | \$34,771 | \$ (294) |
| | ===== | ===== | ===== | ===== |

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

SPECTRUM CONTROL, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED NOVEMBER 30, 2000, 1999, AND 1998
(Dollar Amounts in Thousands)

| | 2000 | 1999 |
|---|----------|----------|
| | ---- | ---- |
| CASH FLOWS FROM OPERATING ACTIVITIES: | | |
| Net income | \$ 9,503 | \$ 5,470 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation | 4,757 | 3,919 |
| Amortization | 1,124 | 624 |
| Deferred income taxes | 687 | 634 |
| Tax benefits from exercise of stock options | 117 | 37 |
| Gain on sale of property, plant and equipment | - | (13) |
| Changes in assets and liabilities, excluding effects of business acquisitions: | | |
| Accounts receivable | (4,803) | (8,734) |
| Inventories | (886) | (6,380) |
| Prepaid expenses and other assets | 355 | (742) |
| Accounts payable and accrued expenses | 296 | 7,194 |
| | ----- | ----- |
| Net cash provided by operating activities | 11,150 | 2,009 |
| | ----- | ----- |
| CASH FLOWS FROM INVESTING ACTIVITIES: | | |
| Proceeds from sale of property, plant and equipment | - | 13 |
| Purchase of property, plant and equipment | (6,905) | (4,972) |
| Payment for acquired businesses | (1,450) | (21,846) |
| | ----- | ----- |
| Net cash used in investing activities | (8,355) | (26,805) |
| | ----- | ----- |
| CASH FLOWS FROM FINANCING ACTIVITIES: | | |
| Net borrowings (repayment) of short-term debt | (5,089) | 4,532 |
| Borrowings of long-term debt | - | 20,800 |
| Repayment of long-term debt | (20,640) | (843) |
| Purchase of common stock | - | - |
| Net proceeds from issuance of common stock: | | |
| Exercise of employee stock options | 179 | 126 |
| Exercise of stock warrants | 410 | - |
| Public stock offering | 27,836 | - |
| | ----- | ----- |
| Net cash provided by (used in) | | |

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| | | |
|--|----------|--------|
| | 2,696 | 24,615 |
| financing activities | ----- | ----- |
| Effect of exchange rate changes on cash | (52) | (20) |
| Net increase (decrease) in cash and cash equivalents | 5,439 | (201) |
| Cash and cash equivalents, beginning of year | 538 | 739 |
| Cash and cash equivalents, end of year | \$ 5,977 | \$ 538 |
| | ===== | ===== |

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

SPECTRUM CONTROL, INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Summary of Significant Accounting Policies

Principles of Consolidation

The consolidated financial statements include the accounts of Spectrum Control, Inc. and its subsidiaries (the "Company"). The fiscal year of the Company's German subsidiary, Spectrum Control GmbH, ends October 31 to facilitate timely reporting. All significant intercompany accounts are eliminated upon consolidation.

Cash Equivalents

The Company considers all highly liquid money market instruments with original maturities of three months or less to be cash equivalents.

Financial Instruments

From time to time, the Company utilizes interest rate swap agreements to minimize the risks and costs associated with variable rate debt. The swap agreements are contracts to exchange floating rate for fixed interest payments periodically over the life of the agreements without the exchange of the underlying notional amounts. The notional amounts of interest rate agreements are used to measure interest to be paid or received and do not represent the amount of exposure to credit loss. Net cash amounts paid or received on the agreements are accrued and recognized as an adjustment to interest expense. The Company does not utilize interest rate agreements for trading or other speculative purposes.

The Company enters into forward currency exchange contracts in the regular course of business to manage its exposure against foreign currency fluctuations on sales denominated in foreign currencies. The terms of these contracts are generally six months or less. Gains and losses related to these agreements are recorded when the related transaction occurs.

Inventories

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Inventories are valued at the lower of cost or market, with cost for raw materials, work-in-process and finished goods at standard cost, which approximates the first-in, first-out basis.

Property, Plant and Equipment

Property, plant and equipment are stated at cost. Depreciation is computed over the estimated useful lives of the assets using the straight-line method. Expenditures for maintenance and repairs are charged against earnings in the year incurred; major replacements, renewals and betterments are capitalized and depreciated over their estimated useful lives. The cost and accumulated depreciation of assets sold or retired are removed from the respective accounts and any gain or loss is reflected in earnings.

Intangibles and Other Assets

Goodwill, representing the excess of cost over the fair value of net tangible and identifiable intangible assets of acquired businesses, is stated at cost and amortized to expense on a straight-line basis over a period of 20 years. Patents and patent rights are amortized to expense on a straight-line basis over periods not exceeding 17 years. The carrying value of intangible assets is periodically reviewed by the Company and impairments are recognized when the expected future operating cash flows derived from such intangible assets is less than their carrying value. No impairment losses have been recognized in any of the periods presented herein.

Debt issuance costs are amortized to expense on a straight-line basis over the term of the related indebtedness.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Income Taxes

The Company uses the liability method in accounting for income taxes. Deferred tax assets and liabilities are recorded for temporary differences between the tax basis of assets and liabilities and their reported amounts in the financial statements, using statutory tax rates in effect for the year in which the differences are expected to reverse.

Foreign Currency Translation

The assets and liabilities of the Company's foreign operations are translated into U.S. dollars at current exchange rates. Revenue and expense accounts of these operations are translated at average exchange rates prevailing during the year. These translation adjustments are accumulated in a separate component of stockholders' equity.

Foreign currency transaction gains and losses are included in determining net income for the year in which the exchange rate changes.

Revenue Recognition

Product sales are generally recorded at the time of shipment. Sales of consigned inventories are recorded when the customer has taken title

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and assumed the risks and rewards of ownership as specified in the customer's purchase order or sales agreement. Service revenues are recorded when the related services are performed.

Advertising and Promotion

Advertising and promotion costs are expensed as incurred. Advertising and promotion expense amounted to \$1,060,000 in 2000, \$726,000 in 1999, and \$633,000 in 1998.

Research and Development

Research and development costs are expensed as incurred. Research and development expense amounted to \$1,535,000 in 2000, \$1,184,000 in 1999, and \$961,000 in 1998.

Stock-Based Compensation

Stock options granted by the Company are accounted for in accordance with Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" ("APB 25"). The exercise price of employee stock options equals the market price of the underlying stock on the date of option grant. Once granted, an option's exercise price and number of shares to be issued remain fixed throughout the option term. Accordingly, in accordance with APB 25, no stock-based compensation expense has been recognized in the accompanying financial statements.

Earnings Per Common Share

Basic earnings per common share is computed by dividing net income by the weighted average number of common shares outstanding during the period. Diluted earnings per common share is computed by dividing net income by the weighted average number of common shares outstanding during the period and the effect of all dilutive common stock equivalents, such as stock options and warrants.

Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements, the disclosure of contingent assets and liabilities, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

New Accounting Pronouncements

In June 1998, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 133, "Accounting for Derivative Instruments and for Hedging Activities" ("SFAS No. 133"). SFAS No. 133 provides a comprehensive and consistent standard for the recognition and measurement of derivatives and hedging activities. It requires that an entity recognize all

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derivatives as either assets or liabilities in the statement of financial position and measure those instruments at fair value. For a derivative not designated as a hedging instrument, changes in the fair value of the derivative are recognized in earnings in the period of change. SFAS No. 133 is effective for fiscal years beginning after June 15, 2000. In December 1999, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 101, "Revenue Recognition in Financial Statements" ("SAB No. 101"), which clarifies the accounting rules for revenue recognition in financial statements. The Company must implement SAB No. 101 by the fourth quarter of fiscal year 2001. Management does not expect the adoption of SFAS No. 133 or SAB No. 101 to have a material impact on the Company's financial position or results of operations.

Reclassifications

Certain prior year amounts have been reclassified to conform with the current year presentation.

2. Acquisitions

On March 26, 1999, the Company acquired substantially all of the assets of the Signal Conditioning Products Division ("SCPD") of AMP Incorporated ("AMP"). Through SCPD, AMP manufactured and sold a broad line of electromagnetic interference ("EMI") filters, filtered arrays, filtered connectors, and related products. The aggregate cash purchase price of the acquired assets, including related acquisition costs, was \$20,745,000. The Company also assumed obligations in the aggregate amount of \$1,866,000. The aggregate purchase price of the acquisition was allocated to the acquired assets based upon their respective fair market values. The excess of the aggregate purchase price over the fair value of the net assets acquired (goodwill) amounted to \$11,937,000 and is being amortized ratably over a period of 20 years.

On September 21, 1998, the Company acquired substantially all of the assets of Potter Production Corporation, a manufacturer of electronic filters and power products used in various communication, industrial control, and medical equipment. The aggregate price of the acquired assets amounted to \$2,918,000, excluding future contingent payments. The amount of the contingent payments are being determined based upon the Company's sales of power products during the three years subsequent to the acquisition date. Contingent payments under this arrangement amounted to \$1,207,000 in 2000 and \$514,000 in 1999. The amount of the contingent payments are being allocated to goodwill and amortized ratably over the asset's remaining life. Also, in connection with this acquisition, the Company issued warrants to purchase 100,000 shares of the Company's Common Stock at an exercise price of \$6.25 per share. The warrants are immediately exercisable and expire on September 21, 2002. In 2000, warrants to purchase 65,584 shares were exercised. At November 30, 2000, warrants to purchase 34,416 shares remained outstanding.

These acquisitions were accounted for using the purchase method of accounting and, accordingly, the results of operations of the acquired businesses have been included in the accompanying consolidated financial statements from their respective dates of acquisition.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

3. Inventories

Inventories by major classification are as follows:

| | Nov 2000 |
|-----------------|----------------|
| | ----- |
| | 2000 |
| | ---- |
| | (in thousands) |
| Finished goods | \$ 4,111 |
| Work-in-process | 10,357 |
| Raw materials | 10,771 |
| | ----- |
| | \$ 25,239 |
| | ===== |

4. Property, Plant and Equipment

Property, plant and equipment consist of the following:

| | Nov 2000 |
|-------------------------------|----------------|
| | ----- |
| | 2000 |
| | ---- |
| | (in thousands) |
| Land and improvements | \$ 1,544 |
| Buildings and improvements | 12,660 |
| Machinery and equipment | 29,940 |
| Construction in progress | 254 |
| | ----- |
| | 44,398 |
| Less accumulated depreciation | 20,908 |
| | ----- |
| | \$ 23,490 |
| | ===== |

5. Other Assets

Other assets consist of the following:

| | Nov 2000 |
|-------------------------------|----------------|
| | ----- |
| | 2000 |
| | ---- |
| | (in thousands) |
| Goodwill | \$ 16,236 |
| Less accumulated amortization | 1,343 |
| | ----- |
| Goodwill, net | \$ 14,893 |
| | ===== |

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| | |
|-------------------------------|--------|
| Patents and patent rights | \$ 571 |
| Debt issuance costs | 375 |
| | ----- |
| | 946 |
| Less accumulated amortization | 549 |
| | ----- |
| | 397 |
| Deferred income taxes | - |
| Deferred charges | 324 |
| | ----- |
| Other noncurrent assets | \$ 721 |
| | ===== |

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

6. Short-Term Debt

Short-term debt consists of the following:

| | November 30 | |
|--|----------------|----------|
| | 2000 | 1999 |
| | ----- | ----- |
| | (in thousands) | |
| Notes payable - domestic line of credit (1) | \$ - | \$ 4,400 |
| Notes payable - foreign lines of credit (2) | - | 689 |
| | ----- | ----- |
| Total | \$ - | \$ 5,089 |
| | ===== | ===== |

- (1) The Company has a \$12,000,000 unsecured line of credit with its principal lending institution, with interest rates on borrowings at or below the prevailing prime rate. During 2000, weighted average borrowings under the revolving credit line amounted to \$4,275,000, with an average interest rate of 8.63%, and maximum month-end borrowings of \$7,400,000. During 1999, weighted average borrowings amounted to \$1,489,000, with an average interest rate of 7.35%, and maximum month-end borrowings of \$4,400,000. The line of credit agreement contains certain covenants, the most restrictive of which require the Company to maintain designated minimum levels of net worth and profitability and impose certain restrictions on the Company regarding additional indebtedness. At November 30, 2000, the Company was in compliance with all debt covenants. The current line of credit agreement expires April 30, 2003.
- (2) The Company's wholly-owned German subsidiary maintains unsecured Deutsche Mark lines of credit with financial institutions aggregating \$1,502,000 (DM 3,500,000) at November 30, 2000 and \$1,330,000 (DM 2,500,000) at November 30, 1999. Weighted average borrowings under the lines of credit amounted to \$389,000 (DM 907,000) in 2000 and \$95,000 (DM 179,000) in 1999, with average

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interest rates of 7.50% in 2000 and 6.50% in 1999. The maximum amount of borrowings under the lines of credit at the end of any month was \$961,000 (DM 2,238,000) in 2000 and \$689,000 (DM 1,296,000) in 1999. Borrowings bear interest at rates below the prevailing prime rate and are payable upon demand.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

7. Long-Term Debt

Long-term debt consists of the following:

| | November 30 | |
|--|----------------|-----------|
| | 2000 | 1999 |
| | (in thousands) | |
| Industrial development authority notes at variable interest rate (4.25% at November 30, 2000 and 4.00% at November 30, 1999) (1) | \$ 1,600 | \$ 1,800 |
| Industrial development authority notes at variable interest rate (4.87% at November 30, 2000 and 4.35% at November 30, 1999) (2) | 300 | 700 |
| Mortgage note payable to bank at an interest rate of 8.50% (3) | 747 | 787 |
| Term loan payable to bank at variable interest rate (7.59% at November 30, 1999) | - | 20,000 |
| Total | 2,647 | 23,287 |
| Less current portion | 540 | 4,276 |
| Long-term debt | \$ 2,107 | \$ 19,011 |

(1) The industrial development authority notes are collateralized by certain land, building and equipment and an irrevocable letter of credit issued by the Company, through its principal lending institution. The notes bear interest at approximately 50% of the prevailing prime rate and require annual principal payments ranging from \$200,000 to \$300,000 through the year 2007.

(2) The industrial development authority notes are collateralized by an irrevocable letter of credit issued by the Company, through its principal lending institution. The notes bear interest at approximately 50% of the prevailing prime rate and require annual principal payments of \$400,000 through the year 2000, with a final principal payment of \$300,000 due in the year 2001.

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- (3) The mortgage note payable is collateralized by certain land and building and requires monthly principal payments of approximately \$3,000 through July 2009, with a final principal payment of \$400,000 due in August 2009.

The aggregate maturities of all long-term debt during each of the five years ending November 30, 2005, are \$540,000, \$340,000, \$240,000, \$240,000, and \$340,000, respectively.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

8. Fair Value of Financial Instruments

The carrying amounts of cash, cash equivalents, accounts receivable, accounts payable, and accrued liabilities approximate fair value due to the short-term maturities of these assets and liabilities. The interest rates on substantially all of the Company's bank borrowings are adjusted regularly to reflect current market rates. Accordingly, the carrying amounts of the Company'