NORTECH SYSTEMS INC
Form 10-Q
May 04, 2016
Table of Contents

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D. C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2016

OR

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

For the transition period from to

NORTECH SYSTEMS INCORPORATED

Commission file number **0-13257**

State of Incorporation: **Minnesota**

IRS Employer Identification No. **41-1681094**

Executive Offices: **7550 Meridian Circle N, Suite # 150, Maple Grove, MN 55369**

Telephone number: **(952) 345-2244**

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

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

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

Large Accelerated Filer o	Accelerated Filer o
Non-accelerated Filer o	Smaller Reporting Company x

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

Number of shares of $.01 par value common stock outstanding at April 28, 2016 - 2,747,831

(The remainder of this page was intentionally left blank.)

Table of Contents

TABLE OF CONTENTS

Table of Contents

PART 1

ITEM 1. FINANCIAL STATEMENTS

NORTECH SYSTEMS INCORPORATED AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

	MARCH 31 2016 (Unaudited)	DECEMBER 31 2015
ASSETS		
Current Assets		
Cash	$ 740,884	$ 887
Accounts Receivable, Less Allowance for Uncollectible Accounts	16,192,500	18,431,746
Inventories, Less Reserve for Excess and Obsolete	21,246,345	20,185,445
Prepaid Expenses	1,276,416	1,452,656
Income Taxes Receivable	288,254	302,005
Total Current Assets	39,744,399	40,372,739
Property and Equipment, Net	10,770,830	10,507,748
Other Intangible Assets, Net	2,004,756	2,052,420
Goodwill	3,283,454	3,283,454
Deferred Tax Assets	341,501	341,000
Other Assets	7,726	7,726
Total Assets	$ 56,152,666	$ 56,565,087
LIABILITIES AND SHAREHOLDERS EQUITY		
Current Liabilities		
Current Maturities of Long-Term Debt	$ 1,454,407	$ 1,495,513
Accounts Payable	12,197,858	13,041,377
Accrued Payroll and Commissions	3,709,601	3,139,698
Other Accrued Liabilities	1,662,739	1,987,740
Income Taxes Payable	(20,700)	7,382
Total Current Liabilities	19,003,905	19,671,710
Long-Term Liabilities		
Line of Credit	$ 8,223,127	$ 7,691,237
Long-Term Debt, Net of Current Maturities	5,673,259	5,954,669
Other Long-Term Liabilities	916,599	975,615
Total Long-Term Liabilities	14,812,985	14,621,521
Total Liabilities	33,816,890	34,293,231
Shareholders Equity		
Preferred Stock, $1 par value; 1,000,000 Shares Authorized: 250,000 Shares Issued and Outstanding	250,000	250,000
Common Stock - $0.01 par value; 9,000,000 Shares Authorized: 2,746,325 Shares Issued and Outstanding	27,463	27,463
Additional Paid-In Capital	15,767,007	15,766,013

Accumulated Other Comprehensive Loss		(62,936)		(62,936)
Retained Earnings		6,354,242		6,291,316
Total Shareholders Equity		22,335,776		22,271,856
Total Liabilities and Shareholders Equity	$	56,152,666	$	56,565,087

See Accompanying Condensed Notes to Consolidated Financial Statements

Table of Contents

NORTECH SYSTEMS INCORPORATED AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

(UNAUDITED)

	THREE MONTHS ENDED MARCH 31	
	2016	**2015**
Net Sales	$ 28,950,042	$ 26,539,622
Cost of Goods Sold	25,571,481	23,673,467
Gross Profit	3,378,561	2,866,155
Operating Expenses		
Selling Expenses	1,303,490	1,363,442
General and Administrative Expenses	1,854,123	1,704,314
Total Operating Expenses	3,157,613	3,067,756
Income (Loss) From Operations	220,948	(201,601)
Other Expense		
Interest Expense	(132,022)	(95,186)
Income (Loss) Before Income Taxes	88,926	(296,787)
Income Tax Expense (Benefit)	26,000	(104,000)
Net Income (Loss)	$ 62,926	$ (192,787)
Earnings (Loss) Per Common Share:		
Basic	$ 0.02	$ (0.07)
Weighted Average Number of Common Shares Outstanding - Basic	2,746,325	2,742,992
Diluted	$ 0.02	$ (0.07)
Weighted Average Number of Common Shares Outstanding - Diluted	2,748,771	2,742,992

See Accompanying Condensed Notes to Consolidated Financial Statements

Table of Contents

NORTECH SYSTEMS INCORPORATED AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(UNAUDITED)

	THREE MONTHS ENDED MARCH 31	
	2016	**2015**
Cash Flows From Operating Activities		
Net Income (Loss)	$ 62,926	$ (192,787)
Adjustments to Reconcile Net Income (Loss) to Net Cash		
Provided by (Used in) Operating Activities		
Depreciation	517,103	516,666
Amortization	47,663	1,323
Compensation on Stock-Based Awards	994	3,669
Compensation on Equity Appreciation Rights	(9,666)	(11,683)
Loss on Disposal of Property and Equipment		1,129
Changes in Current Operating Items, Net of Acquisition		
Accounts Receivable	2,239,246	957,527
Inventories	(1,060,900)	(988,799)
Prepaid Expenses	176,240	(151,898)
Income Taxes Receivable	13,250	(138,740)
Income Taxes Payable	(28,082)	
Accounts Payable	(839,055)	(168,158)
Accrued Payroll and Commissions	569,903	(15,088)
Other Accrued Liabilities	(373,780)	(52,762)
Net Cash Provided by (Used in) Operating Activities	1,315,842	(239,601)
Cash Flows from Investing Activities		
Purchases of Property and Equipment	(785,219)	(907,260)
Cash Flows from Financing Activities		
Net Change in Line of Credit	531,890	944,161
Proceeds from Long-Term Debt		347,000
Principal Payments on Long-Term Debt	(322,516)	(163,209)
Net Cash Provided by Financing Activities	209,374	1,127,952
Net Increase (Decrease) in Cash	739,997	(18,909)
Cash - Beginning	887	66,371
Cash - Ending	$ 740,884	$ 47,462
Supplemental Disclosure of Cash Flow Information		
Cash Paid During the Period for Interest	$ 127,711	$ 92,265
Cash Paid During the Period for Income Taxes		
Supplemental Noncash Investing and Financing Activities		
Capital Expenditures in Accounts Payable	49,603	2,440

See Accompanying Condensed Notes to Consolidated Financial Statements

5

Table of Contents

CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The accompanying unaudited consolidated financial statements for the interim periods have been prepared in accordance with Generally Accepted Accounting Principles in the United States of America (GAAP) for interim financial information and pursuant to the rules and regulations of the Securities and Exchange Commission. Accordingly, they do not include all of the financial information and footnotes required by GAAP for complete financial statements, although we believe the disclosures are adequate to make the information presented not misleading. It is suggested that these consolidated financial statements be read in conjunction with the consolidated financial statements and the notes thereto included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2015. The operating results for the interim periods presented are not necessarily indicative of the results expected for the full year or for any other interim period. In our opinion, all adjustments (consisting of normal recurring adjustments) considered necessary for a fair presentation have been included.

The preparation of financial statements in conformity with GAAP requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. In preparing these consolidated financial statements, we have made our best estimates and judgments of certain amounts included in the consolidated financial statements, giving due consideration to materiality. Changes in the estimates and assumptions used by us could have a significant impact on our financial results, since actual results could differ from those estimates.

Principles of Consolidation

The consolidated financial statements include the accounts of Nortech Systems Incorporated and its wholly owned subsidiaries, Manufacturing Assembly Solutions of Monterrey, Inc. and Nortech Systems Hong Kong Company, Limited. All significant intercompany accounts and transactions have been eliminated.

Revenue Recognition

We recognize manufacturing revenue when we ship goods or the goods are received by our customer, when title has passed, all contractual obligations have been satisfied, the price is fixed or determinable and collection of the resulting receivable is reasonably assured. Generally, there are no formal substantive customer acceptance requirements or further obligations related to manufacturing services. If such requirements or obligations exist, then we recognize the related revenues at the time when such requirements are completed and the obligations are fulfilled. We also provide engineering services separate from the manufacture of a product. Revenue for engineering services is generally recognized on a time and material basis or upon completion of the engineering process. In addition, we have another separate source of revenue that comes from short-term repair services, which are recognized when the repairs are completed and the repaired products are shipped back to the customer. Our net sales for services were less than 10% of our total sales for all periods presented, and accordingly, are included in net sales in the consolidated statement of operations. Shipping and handling costs charged to our customers are included in net sales, while the corresponding shipping expenses are included in cost of goods sold.

Table of Contents

Stock Options

Following is the status of all stock options outstanding as of March 31, 2016:

	Shares		Weighted-Average Exercise Price Per Share	Weighted-Average Remaining Contractual Term (in years)		Aggregate Intrinsic Value
Outstanding - January 1, 2016	139,750	$	6.66			
Granted						
Cancelled	(49,500)		7.44			
Outstanding - March 31, 2016	90,250	$	6.23	2.73	$	10,400
Exercisable - March 31, 2016	90,250	$	6.23	2.73	$	10,400

There were no options exercised during the three months ended March 31, 2016 and 2015. There were no stock options granted during the three months ended March 31, 2016 and 2015.

Total compensation expense related to stock options for the three months ended March 31, 2016 and 2015 was $994 and $3,669, respectively. As of March 31, 2016, there was no remaining unrecognized compensation.

Equity Appreciation Rights Plan

In November 2010, the Board of Directors adopted the Nortech Systems Incorporated Equity Appreciation Rights Plan (the 2010 Plan). The total number of Equity Appreciation Right Units (Units) that can be issued under the 2010 Plan shall not exceed an aggregate of 1,000,000 Units (as amended and restated on March 11, 2015). The 2010 Plan provides that Units issued shall fully vest three years from the base date as defined in the agreement unless terminated earlier. Units give the holder a right to receive a cash payment equal to the appreciation in book value per share of common stock from the base date, as defined, to the redemption date. Unit redemption payments under the 2010 Plan shall be paid in cash within 90 days after we determine the book value of the Units as of the calendar year immediately preceding the redemption date.

During the three months ended March 31, 2016, no additional Units were granted.

Total compensation income related to the vested outstanding Units based on the estimated appreciation over their remaining terms was approximately $9,700 and $11,700 for the three months ended March 31, 2016 and 2015, respectively. The income for the three months ended March 31, 2016 and 2015 was the result of a change in the estimate of the appreciation of book value per share of common stock.

Table of Contents

As of March 31, 2016 and December 31, 2015, approximately $72,000 and $143,000 is accrued under this plan, respectively. As of March 31, 2016, approximately $49,000 of this balance is included in Other Accrued Liabilities and the remaining $23,000 balance was included in Other Long-term Liabilities. As of December 31, 2015, approximately $61,000 of this balance is included in Other Accrued Liabilities and the remaining $82,000 balance was included in Other Long-term Liabilities.

Earnings per Common Share

For the three months ended March 31, 2016, 16,000 stock options were included in the computation of diluted per share amounts as their impact is dilutive. For the three months ended March 31, 2016, stock options of 74,250 were excluded because their inclusion would be antidilutive. For the three months ended March 31, 2015, the company reported a net loss and all diluted options were excluded.

Segment Reporting Information

All of our operations fall under the Contract Manufacturing segment within the Electronic Manufacturing Services industry. We strategically direct production between our various manufacturing facilities based on a number of considerations to best meet our customers   requirements. We share resources for sales, marketing, engineering, supply chain, information services, human resources, payroll, and all corporate accounting functions. Consolidated financial information is available that is evaluated regularly by the chief operating decision maker in assessing performance and allocating resources.

Accounts Receivable and Allowance for Doubtful Accounts

We grant credit to customers in the normal course of business. Accounts receivable are unsecured and are presented net of an allowance for doubtful accounts. The allowance for doubtful accounts was approximately $355,000 and $320,000 at March 31, 2016 and December 31, 2015, respectively. We determine our allowance by considering a number of factors, including the length of time accounts receivable are past due, our previous loss history, the customers   current ability to pay their obligations to us, and the condition of the general economy and the industry as a whole. We write-off accounts receivable when they become uncollectible, and payments subsequently received on such receivables are credited to the allowance for uncollectible accounts.

Inventories

Inventories are stated at the lower of cost (first-in, first-out method) or market (based on the lower of replacement cost or net realizable value). Costs include material, labor, and overhead required in the warehousing and production of our products. Inventory reserves are maintained for the estimated value of the inventories that may have a lower value than stated or quantities in excess of future production needs.

Inventories are as follows:

Table of Contents

		March 31 2016		December 31 2015
Raw Materials	$	14,148,371	$	13,782,411
Work in Process		4,753,230		4,674,223
Finished Goods		3,024,494		2,478,423
Reserve		(679,750)		(749,612)
Total	$	21,246,345	$	20,185,445

Other Intangible Assets

Other intangible assets at March 31, 2016 and December 31, 2015 are as follows:

	March 31, 2016						
	Remaining Lives (Years)		Gross Carrying Amount		Accumulated Amortization		Net Book Value
Customer Relationships	8	$	1,302,000	$	108,499	$	1,193,501
Trade Names	19	$	814,000	$	30,524	$	783,476
Bond Issue Costs	5	$	79,373	$	51,594	$	27,779
Totals		$	2,195,373	$	190,617	$	2,004,756

	December 31, 2015						
	Remaining Lives (Years)		Gross Carrying Amount		Accumulated Amortization		Net Book Value
Customer Relationships	9	$	1,302,000	$	72,333	$	1,229,667
Trade Names	20	$	814,000	$	20,350	$	793,650
Bond Issue Costs	6	$	79,373	$	50,271	$	29,102
Totals		$	2,195,373	$	142,954	$	2,052,419

Amortization expense for the three months ended March 31, 2016 and 2015 was $47,663 and $1,323, respectively.

Estimated future amortization expense related to these assets is as follows:

Remainder of 2016	$	143,000
2017		191,000
2018		191,000
2019		191,000
2020		191,000
Thereafter		1,097,756
Total	$	2,004,756

Table of Contents

Impairment of Goodwill and Other Intangible Assets

In accordance with ASC 350, *Goodwill and Other Intangible Assets*, goodwill is not amortized but is required to be reviewed for impairment at least annually or when events or circumstances indicate that carrying value may exceed fair value. We test impairment annually as of October 1st. No events were identified during the three months ended March 31, 2016 that would require us to test for impairment.

Impairment Analysis

We evaluate long-lived assets, primarily property and equipment, as well as the related depreciation periods, whenever current events or changes in circumstances indicate that the carrying amount of an asset or asset group may not be recoverable. Recoverability for assets to be held and used is based on our projection of the undiscounted future operating cash flows of the underlying assets. To the extent such projections indicate that future undiscounted cash flows are not sufficient to recover the carrying amounts of related assets, a charge might be required to reduce the carrying amount to equal estimated fair value.

Recent Accounting Pronouncements

In March 2016, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2016-09, *Compensation - Stock Compensation: Improvements to Employee Share-Based Payment Accounting*, which changes how companies account for certain aspects of share-based payments to employees. The new guidance requires all income tax effects of awards to be recognized in the income statement when the awards vest or are settled, allows an employer to repurchase more of an employee s shares than previously allowed for tax withholding purposes without triggering liability accounting, allows a company to make a policy election to account for forfeitures as they occur, and eliminates the requirement that excess tax benefits be realized before companies can recognize them. The new guidance also requires excess tax benefits and tax shortfalls to be presented on the cash flow statement as an operating activity rather than as a financing activity, and clarifies that cash paid to a tax authority when shares are withheld to satisfy its statutory income tax withholding obligation are to be presented as a financing activity. The standard is effective for our financial statements issued for fiscal years beginning after December 15, 2016, and interim periods within those fiscal years. Early adoption is permitted. We are currently evaluating the impact of adoption of this ASU on our consolidated financial statements.

During February 2016, the FASB issued ASU No. 2016-02, Leases. ASU No. 2016-02 was issued to increase transparency and comparability among organizations by recognizing all lease transactions (with terms in excess of 12 months) on the balance sheet as a lease liability and a right-of-use asset (as defined). ASU No. 2016-02 is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years, with earlier application permitted. Upon adoption, the lessee will apply the new standard retrospectively to all periods presented or retrospectively using a cumulative effect adjustment in the year of adoption. We are currently assessing the effect that ASU No. 2016-02 will have on its results of operations, financial position and cash flows.

Table of Contents

In November 2015, the FASB issued ASU 2015-17, Income Taxes (Topic 740) Balance Sheet Classification of Deferred Taxes which requires that deferred tax assets and liabilities be classified as noncurrent in a classified balance sheet. The amendment takes effect for public entities for fiscal years beginning after December 15, 2016, with early adoption available. We have adopted the standard in this report and reclassified comparative periods for consistency.

In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers (Topic 606) . This standard outlines a single comprehensive model for companies to use in accounting for revenue arising from contracts with customers and supersedes most current revenue recognition guidance, including industry-specific guidance. The core principle of the revenue model is that revenue is recognized when a customer obtains control of a good or service. A customer obtains control when it has the ability to direct the use of and obtain the benefits from the good or service. Transfer of control is not the same as transfer of risks and rewards, as it is considered in current guidance. We will also need to apply new guidance to determine whether revenue should be recognized over time or at a point in time. This standard will be effective for the first interim period within annual reporting periods beginning after December 15, 2017, with no early adoption permitted, using either of two methods: *(a)* retrospective to each prior reporting period presented with the option to elect certain practical expedients as defined within ASU 2014-09; or *(b)* retrospective with the cumulative effect of initially applying ASU 2014-09 recognized at the date of initial application and providing certain additional disclosures as defined in ASU 2014-09. We have not yet selected a transition method and are currently evaluating the impact of the pending adoption of ASU 2014-09 on the consolidated financial statements.

NOTE 2. CONCENTRATION OF CREDIT RISK AND MAJOR CUSTOMERS

Financial instruments that potentially subject us to concentrations of credit risk consist principally of cash and accounts receivable. With regard to cash, we maintain our excess cash balances in checking accounts at two high-credit quality financial institutions. These accounts may at times exceed federally insured limits. We grant credit to customers in the normal course of business and do not require collateral on our accounts receivable.

Our largest customer has two divisions that together accounted for approximately 10% or more of our net sales during the three months ended March 31, 2016 and 2015. One division accounted for approximately 17% of net sales for the three months ended March 31, 2016 and 2015, respectively. The other division accounted for approximately 7% and 9% of net sales for the three months ended March 31, 2016 and 2015, respectively. Together, they accounted for approximately 24% and 26% of net sales for the three months ended March 31, 2016 and 2015, respectively. Accounts receivable from the customer at March 31, 2016 and December 31, 2015 represented approximately 17% of our total accounts receivable, respectively.

Export sales represented approximately 11% and 7% of net sales for the three months ended March 31, 2016 and 2015, respectively.

Table of Contents

NOTE 3. FINANCING ARRANGEMENTS

We have a credit agreement with Wells Fargo Bank (WFB) which was most recently amended on February 22, 2016 and provides for a line of credit arrangement of $15.0 million that expires, if not renewed, on May 31, 2018. The credit arrangement also has a $1.8 million real estate term note outstanding with a maturity date of March 31, 2027, an additional $1.7 million real estate term note outstanding that is due, if not renewed, on December 31, 2027, an equipment loan for $2.7 million and a term loan facility of up to $1.0 million for capital expenditures, both with maturity dates of May 31, 2018.

Under the credit agreement, both the line of credit and real estate term notes are subject to variations in the LIBOR rate. Our line of credit bears interest at three-month LIBOR + 2.25% (approximately 2.9% at March 31, 2016) while our real estate term notes bear interest at three-month LIBOR + 2.75% (approximately 3.4% at March 31, 2016). The weighted-average interest rate on our line of credit was 2.9% for the three months ended March 31, 2016. We had borrowing on our line of credit of $8,223,127 and $7,691,237 outstanding as of March 31, 2016 and December 31, 2015, respectively. The line of credit requires a lock box arrangement; however there are no acceleration clauses that would accelerate the maturity of our outstanding borrowings.

As part of the July 1, 2015 Devicix acquisition we entered into two unsecured subordinated promissory notes payable to the seller in the principal amounts of $1.0 million and $1.3 million. The $1.0 million promissory note has a four-year term, bearing interest at 4% per annum, requiring monthly principal and interest payments of $22,579 and is subject to offsets if certain revenue levels are not met. The $1.3 million promissory note has a four year term and bears interest at 4% per annum, requiring monthly principal and interest payments of $29,353 and is not subject to offset.

The credit agreement contains certain covenants which, among other things, require us to adhere to regular reporting requirements, abide by annual shareholder dividend limitations, maintain certain financial performance, and limit the amount of annual capital expenditures.

The availability under the line is subject to borrowing base requirements, and advances are at the discretion of the lender. At March 31, 2016, we have net unused availability under our line of credit of approximately $5.4 million. The line is secured by substantially all of our assets.

Long-term debt at March 31, 2016 and December 31, 2015 consisted of the following:

Table of Contents

		March 31 2016		December 31 2015
Term notes payable - Wells Fargo Bank, N.A.				
Real estate term notes bearing interest at three month LIBOR + 2.75% maturing March 31, 2027, and December 31, 2027 with combined monthly payments of approximately $19,000 plus interest, secured by substantially all assets.	$	2,587,978	$	2,645,495
Equipment notes bearing interest at three month LIBOR + 2.75% maturing May 2018 with a combined monthly payments of approximately $46,000 plus interest, secured by substantially all assets		2,489,733		2,633,740
Industrial revenue bond payable to the City of Blue Earth, Minnesota which bears a variable interest rate (approx. 0.25% at March 31, 2016), and has a maturity date of June 1, 2021, with principal of $80,000 payable annually on June 1		280,000		280,000
Devicix Acquistion Note 1 payable to DeLange Holdings bears interest rate of 4.0% per annum, maturing July 1, 2019		844,226		903,128
Devicix Acquistion Note 2 payable to DeLange Holdings bears interest rate of 4.0% per annum, maturing July 1, 2019		1,097,494		1,174,066
		7,299,431		7,636,429
Discount on Devicix Notes Payable		(132,160)		(142,072)
Debt issuance Costs		(39,605)		(44,175)
Total long-term debt		7,127,666		7,450,182
Current maturities of long-term debt		(1,454,407)		(1,495,513)
Long-term debt - net of current maturities	$	5,673,259	$	5,954,669

NOTE 4. INCOME TAXES

On a quarterly basis, we estimate what our effective tax rate will be for the full fiscal year and record a quarterly income tax provision based on the anticipated rate. As the year progresses, we refine our estimate based on the facts and circumstances, including discrete events, by each tax jurisdiction. Our effective tax rate for the three months ended March 31, 2016 and 2015 was 29% and 35%, respectively. The effective tax rate for the year ended December 31, 2016 is expected to be 30% compared to 36% for the year ended December 31, 2015. The decrease is due mainly to the impact of the federal research and development credit.

The differences between federal income taxes computed at the federal statutory rate and reported income taxes for the three months ended March 31, 2016 and 2015 are as follows:

Table of Contents

	Three Months Ended March 31	
	2016	2015
Statutory federal tax provision (benefit)	$ 34,000	$ (82,000)
State income taxes (benefits)	3,000	(10,000)
Income tax credits	(23,000)	(13,000)
Other	12,000	1,000
Income tax expense (benefit)	$ 26,000	$ (104,000