SI TECHNOLOGIES INC
Form 10-K
November 05, 2004

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

Commission file number 0-12370

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(D) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended

July 31, 2004

SI TECHNOLOGIES, INC.

(Exact name of registrant as specified in its charter)

Delaware	**95-3381440**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification Number)**

14192 Franklin Avenue, Tustin, CA 92780

(Address of principal executive offices) (Zip Code)

714-505-6483

Registrant s telephone number, including area code

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

None

Securities registered pursuant to Section 12 (g):

Common Stock, par value $.01 per share

(Title of Class)

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

Indicate by checkmark if no 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 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. ¨

Indicate by checkmark whether the registrant is an accelerated filer (as defined in Exchange A Rule 12b-2)

Yes ¨ No x

The aggregate market value of the voting stock held by non-affiliates of the registrant (based upon the closing price of such stock, as reported by the Nasdaq stock market on January 31, 2004 was $6,915,361.

The number of shares outstanding of each of the registrant s common stock as of July 31, 2004 was 4,126,996.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant s definitive Proxy Statement for the 2004 Annual Meeting of Stockholders are incorporated by reference into Part III of this report.

PART I

ITEM 1. BUSINESS

General

SI Technologies, Inc. and subsidiaries (SI , SI Technologies or the Company) designs, manufactures and markets high-performance industrial sensors, weighing and factory automation systems, and related products. Five acquisitions in the late 1990s have enabled SI to expand to a global supplier of devices, equipment and systems that move, measure and inspect goods and materials. SI products are used around the world in a wide variety of industries, including aerospace, agriculture, aviation, food processing and packaging, forestry, manufacturing, mining, transportation/distribution and waste management.

The Company was incorporated in California in 1979 as Invention, Design, Engineering Associates, Inc. and was reincorporated in Delaware in 1983. In February 1996, the Company changed its name to SI Technologies, Inc. The Company s principal executive offices and headquarters are located at 14192 Franklin Avenue, Tustin, California. Headquarters communication information is as follows: telephone, 714-505-6483, fax, 714-573-2034, e-mail address, sitech@sitechnologies.com, Web site, www.sitechnologies.com.

The Company s strategy is to generate profitable growth while becoming a leading supplier of weighing devices, equipment, engineered systems and services used in the niche industrial markets in which it operates and to expand its markets through new product development, strategic alliances and acquisition of complementary products in the $70 billion industrial measurement and automation industry.

Letter of Intent to be Acquired by Vishay Intertechnology, Inc.

SI has signed a non-binding letter of intent which contemplates the acquisition of SI by Vishay Intertechnology, Inc. (Vishay). As described in the letter of intent, Vishay would acquire all of the equity of SI in exchange for approximately $17.65 million in cash subject to reduction on a dollar for dollar basis if SI s outstanding bank indebtedness exceeds $12 million at the closing.

The transaction is subject to satisfactory completion of due diligence by Vishay, the execution of a definitive purchase agreement approved by the Boards of Directors of SI and Vishay, approval of the SI shareholders, and other material conditions. SI has agreed not to solicit or engage in negotiations for an acquisition by any other person/company. Either SI or Vishay may terminate the letter of intent on or after November 20, 2004.

No assurance can be given that SI will complete a transaction with Vishay.

On-going Acquisition/Merger Activities

In pursuit of the Company s growth strategy, management is continuously evaluating acquisition/merger opportunities with numerous companies. Companies of interest are leading manufacturers, distributors and service providers who compete with technology advantage, are generating internal growth and profit, and show potential for strong synergy with the Company s technology, manufacturing operations and marketing and sales organization.

Products and Services

Industrial Measurement

The Company s industrial sensor and control products consist of a wide range of National Type Evaluation (NTEP) and International Organization of Legal Metrology (OIML) approved, EX, Factory Mutual and IP rated load cells, transducers, force translators and custom designed sensors. These devices represent the

core technology of SI and allow us to design high accuracy electromechanical components that convert a physical force to an electrical signal. When combined with microprocessor-controlled digital electronics, they measure forces such as pressure, weight, mass and torque. Commercially, the products are used for measurement, inspection and control. SI sensor and control products are principally used in electronic weighing equipment; batching, blending, mixing, fill-by-weight applications and, machinery operation and control systems. SI electronic controls are normally designed as an integral part of a complete weighing system. In recent years, SI instrumentation has expanded into more complex electronics to provide users with the ability to acquire, record in memory and download to mainframe management information systems that provide operational information other than weight information. In this expanded capacity, SI instrumentation becomes a critical link between operations and management information systems.

SI designs and manufactures dynamic and static electronic weighing equipment and systems for use in a wide range of industrial applications. As a result of the uniqueness of the Company s combined sensor, weighing and automation system technologies, SI is one of few manufacturers in the industry who design and manufacture all three of the primary components of an electronic scale. These components are the load-handling structure, sensors and instrumentation. Many manufacturers of conventional scale systems manufacture only load-handling structures, outsourcing to industry suppliers their sensor and instrumentation requirements. The Company utilizes its technical expertise and manufacturing know-how in each of these critical components to provide a competitive advantage and believes our expertise can be exploited through our acquisition/integration growth strategy.

Dynamic weighing systems are installed on transportation vehicles, material-handling equipment and in manufacturing process systems for weight measurement of goods and materials. Weight information generated by these systems has broad application including loading, transporting and delivery payload management; manufacturing process, inventory and quality control; and operations automation. Key products marketed under the *AirScale, Allegany*, *Checkmate, Evergreen Weigh, Structural Instrumentation, RouteMan, SmartPin, The Logger, Trojan,* and *Tuffer* trade names are dynamic weigh-in-motion and mobile on-board vehicle and material-handling equipment scales, pallet weighers, crane scales and engineered system scales. SI systems are available as standard products for use with most major original equipment manufacturer (OEM) trucks, trailers, forklifts, loaders, cranes and lifting devices. Products are marketed predominately to the agriculture, construction, forestry, foundry, freight, manufacturing, mining, steel, transportation and waste management industries.

Depending on application, specific economic benefits are derived by eliminating overweight vehicle fines and delays; reduced time loading, checkweighing and adjusting loads to maximum legal limits; reduced mileage and driving time to checkweighing locations such as commercial in-ground truck scales; immediate measurement and recording of pick-up and delivery weights; reduced equipment abuse, maintenance downtime and expense; and higher capital equipment capacity utilization. Additionally, the weight information produced by these systems is often the critical measurement in controlling, batching, blending and mixing operations in the manufacture of materials.

All systems combine force measurement sensors and microprocessor-based electronic instrumentation to meet customer applications. The instrumentation supplies power to the sensors, provides operator interface and controls, processes sensor signals that determine weights, displays weight readings and records in memory weight information and other inputs from the system and/or the operator. Force measurement sensors employing electronic strain gage technology to measure forces applied. The electrical resistance of force measurement sensors changes proportionally to the force applied; thus the return signal to the meter varies by load or force.

The Company s static weighing system product line consists of scales designed for numerous industrial and aviation weighing applications. Key products marketed under the trade names *Air Guardian, Jet Weigh, Lodec, EvergreenWeigh, Road Guardian*, *and Road Runner* are permanent and portable axle scales, wheel-load weighers, canister load cell systems and heavy-capacity platform scales. Much like dynamic weighing systems, the static weighing systems have broad industrial application. Key markets in which these products enjoy

significant market share include aggregate, aviation, construction, freight terminals, land remediation, mining and weight enforcement. Static weighing systems utilize the same technology as dynamic weighing systems; however, they are designed to weigh loads in a static or stationary mode.

Industrial Automation

SI s industrial automation products consist of load handling, moving and positioning equipment and systems. These products often utilize highly specialized air-bearing movement systems to move loads of any weight efficiently and with extreme precision. Air bearings are air-cushion devices that are used to float heavy loads on a thin film of air. Additionally, the Company manufactures systems utilizing water bearings for use in large outdoor applications where water is used as the flotation medium rather than air. These products, marketed under the trade names *AeroCaster, AeroGo, AeroPallets, AeroPlanks* and *AirShuttle,* are the world leaders in practical and efficient methods of movement, transfer, location, rotation and alignment of materials and products weighing from several hundred pounds to more than 6,000 tons.

The Company s industrial automation product line comprises two distinct categories. The first is a standard product line of rugged, industrial, off-the-shelf air-cushion devices that allow a single person to easily and safely move loads weighing from a few hundred pounds to many tons. Standard products routinely move manufacturing fixtures, printing press bulky paper rolls, jet engines, and other heavy loads.

The other category of the product line consists of engineered products. Engineered products and specialized systems designed and manufactured by the Company in recent years are currently moving 100,000-pound dies, launching ships, moving 4,500-ton stadium sections, transporting aerospace booster rockets and moving large assemblies in and out of assembly line operations in numerous heavy equipment manufacturing facilities. Additional examples of engineered products include: automated guided vehicle systems, transporters, assembly line turntable systems, precision handling and positioning fixtures, quick die/mold changing carts, caisson manufacturing and moving systems, and aircraft inspection turntables.

SI industrial automation products commonly represent significant economic benefit in comparison to conventional material handling equipment through lower capital investment in manufacturing site construction, preparation and system installation, and greater operating efficiencies based on system versatility (not limited to following rails or tracks, as typically required with cranes and conveyors). These systems often represent the most viable means for handling extreme material handling applications involving very heavy loads, precision movement and positioning, and high efficiency assembly line automation.

Marketing and Sales

The Company s products are marketed and serviced worldwide primarily through 300 distributors and independent manufacturer representatives, each operating in a specific trade area and serving industrial customers, engineering firms and various government agencies. In addition to headquarters marketing and sales personnel, and subsidiary business unit marketing and sales operations, the Company maintains North American regional sales offices in California, Maryland, Oregon, Washington and British Columbia, Canada; and our European Headquarters in Breda, the Netherlands with regional sales offices in France, Germany, the United Kingdom and the Netherlands. Company sales personnel assist distributors, representatives and customers by making direct sales calls on potential customers in areas not covered by distribution, and support the Company s direct major accounts.

The Company generates leads through a full complement of marketing programs, including advertisement in industry publications, direct-mail advertising, trade show participation and telemarketing. Headquarters and subsidiary personnel initiate the Company s sales process on all

inquiries by providing the potential user with information on Company products and services and qualifying the product lead. After qualification, inquiries are either maintained in sales for follow-up by Company sales personnel and distribution, or dispatched to engineering for design, cost estimating and preparation of price quotations or bid packages.

Due to the Company s mix of standard off-the-shelf products and custom-engineered products, the time period between initial inquiry, purchase order receipt and shipment varies widely. Standard product orders are normally shipped within one to three days of purchase order receipt at published prices and with trade terms of FOB factory and 30 days net. Engineered products and projects are subject to specific contract terms negotiated between the Company and customer. Typically, contract terms provide for progress payments, provision for change orders and, on longer-term projects, provision for inflation-based price adjustment. On certain projects, the Company provides complete site preparation, system installation, start-up and customer training services. In this capacity, from time to time, the Company serves as a contractor on a time and material basis.

The Company s business is not seasonal in nature.

Market Conditions and Competition

Market Conditions

Overall industry growth normally approximates inflation. The Company believes its unique products, diversity of markets and worldwide geographic presence present significant opportunities for internal growth within the industry.

Product uniqueness (niche products) is a competitive advantage for SI. Manufacturers of conventional mature products competing for market share with non-differentiated products normally compete primarily on product price and availability. SI s unique products such as dynamic weighing and air-bearing load-handling and factory automation systems frequently compete within the industry as substitute products or as an alternative means for meeting the customers needs. As a result of this high level of product differentiation and the application versatility of SI s unique products, the Company believes demand for SI products is more elastic than demand for conventional products within the industry.

Market diversity is a growing competitive advantage for SI. Over the past few years, SI has been redirecting its focus to new markets in an effort to mitigate a sharp capital spending downturn in the Company s traditionally strong forestry and waste management markets. Since the 1996 acquisition of Evergreen Weigh cross-selling of products and integration of Company sales organizations have steadily increased market share in several markets including, aggregate, aviation, and construction industries. With the acquisition of AeroGo in fiscal 1997, and the acquisitions of NV Technology, Allegany Technology and Revere Transducers in fiscal 1998, the Company has further expanded its market diversity and potential for revenue synergies and increases. The Company intends to capitalize on its growing market diversity, worldwide presence and cross-selling opportunities with an expanding product line to create internal growth.

SI maintains inventories of raw materials, work-in-process and finished goods. To supply products with competitive availability, the Company carries approximately 50% of inventory in finished goods. While the Company manufactures the majority of its value-added components, certain components, manufacturing processes and sub-assemblies are outsourced. Outsourced items are normally purchased on fixed price contracts on a just-in-time basis. Should the need arise, the Company believes that any supplier and/or subcontractor could be replaced without significant disruption to its business.

Competition

Competition in the industrial measurement and automation equipment and system industry is extremely fragmented with approximately 6,000 manufacturers and a greater number of distributors and service companies. To the Company s knowledge, there are no competitors with the same product mix as SI. Direct competitors (competing head-to-head with similar products) normally compete on a single product line and are smaller and may have less financial resources than SI. General industry-wide competitors (competing with

alternative conventional products) range from very small, local companies to large, international companies with greater financial resources than SI.

In the dynamic and static weighing systems product line, direct competitors are all smaller, privately held companies. Occasionally and on specific applications, the weighing systems product line competes as an alternative product with larger companies that manufacture conventional, industrial weighing systems. These companies include Cardinal Scale Manufacturing Company, Fairbanks Scale Company, Mettler-Toledo Holding, Inc. and Weigh-Tronix, Inc. Competition among larger manufacturers of conventional weighing systems, due to lack of product differentiation, is principally based on price, local dealer trade-area presence and relationships, and product availability.

Competition in the industrial sensor and control product line varies widely depending on customer type and application. Industry standard sensors sold directly to large industrial scale manufacturers compete primarily on price, quality and service. Standard and custom sensors sold to OEMs of other types of products and equipment, and to user customers in process industries, primarily compete on the supplier s ability to provide engineering expertise and assistance, quality, and on-going customer support and service. Competitors range from small, local companies to large, international companies.

Competition in load handling and factory automation products is similar to weighing system products. In the air and water bearing product line, all competitors are smaller, privately held companies that may have less financial resources than the Company. Direct competitors include Airfloat, Hovair, and Aircaster. In custom-engineered products and projects, the Company normally competes as a substitute or alternative product versus conventional material-handling equipment manufactured by companies ranging in size from much smaller to significantly larger than the Company.

International markets vary widely in competitive issues. In some countries, price competition is more intense than in North America, while in other markets the relationships and product quality receive more customer emphasis than do marginal pricing differentials, thus price competition is less intensive. As a result of product uniqueness, innovative design solutions, quality of product and dependability, SI products and services are frequently sold in situations where the Company is not the low bidder.

Significant Customers

Historically the Company s primary customers have been transportation, agriculture, forestry, manufacturing, waste management and general industrial companies. Over the past few years, as a result of the Company s growth strategy, the customer base has expanded to include the aviation/aerospace, automotive, food processing, construction and maritime industries. Significant customers in recent years include Boeing, Caterpillar, Carrier, Chrysler, Ford, Hyundai, Mettler-Toledo, Lockheed, Michelin, Mitsubishi, NASA, Siemens, and Thiokol just to name a few. SI believes it will continue to expand its product and customer base in developing countries.

While a significant portion of the Company s annual revenues represent repeat business from its existing customers, no individual customer represents 10% or more of the Company s revenues.

Acquisition History

Since 1996, SI Technologies has completed five acquisitions.

Acquired Company	Date Acquired	Primary Products	Industries Served
Evergreen Weigh, Inc.	1996	Dynamic & Static Weighing Systems	Aviation, mining, Transportation
AeroGo, Inc.	1997	Factory Automation Equipment & Systems	Aviation/aerospace, automotive, manufacturing, general industry
NV Technology, Inc.	1998	Sensors	General industry, food, Transportation
Allegany Technology, Inc.	1998	Sensors & Dynamic Weighing Systems	Aerospace, transportation, general industry
Revere Transducers, Inc.	1998	Sensors & Static Weighing Equipment	Aviation/aerospace, food, general industry

Backlog

At July 31, 2004, the Company s backlog was $6,128,000, compared with $3,093,000 on July 31, 2003. The Company s backlog consists of written orders and commitments believed to be firm, approximately 95% of which is shippable in fiscal 2005. Purchase orders and contracts for products and services are from time to time modified and/or canceled by mutual consent between the Company and the customer. Therefore, the backlog on any specific date may not be indicative of the Company s future performance.

Employees

At July 31, 2004, the Company employed 213 full time employees. We have employees located in Tustin, California; Cumberland Maryland; Seattle, Washington; Kelowna, British Columbia and Breda, the Netherlands. The Company believes its relationships with its employees are satisfactory.

Sources of Supply

The materials and components used by the Company to manufacture its products are available from a variety of sources. The Company believes that it is not dependent at this time on any particular supplier for either its materials or components and has experienced no difficulty in obtaining supplies. Outsourcing the production of certain high-volume, low-margin component products to manufacturing partners in low labor cost countries has reduced the Company s cost of sales. Should the flow of goods from these partners be disrupted, the Company may incur substantial additional costs to procure those goods.

Patents and Trademarks

The Company holds numerous patents on various force measurement devices and weighing system design applications. The patents have expiration dates ranging from 2004 to 2016. The Company also has patent license agreements to build force measurement devices under patents held by others. The license agreements are fully paid up and irrevocable for the lifetime of these patents. The Company has no reason to believe its patents are not valid. However, if the patents were successfully contested, management does not believe it would have a material adverse impact on the Company.

Research, Development And Engineering Expenses

Research, development and engineering expenses are application engineering costs are for the enhancement of ongoing product lines. The Company has the ability to determine the timing and amount of research, development and engineering expenditures as opportunity arises.

Financial Information about Foreign Operations

Foreign Operations

Included in the consolidated balance sheet at July 31, 2004 are the identifiable assets of the Company s subsidiary, Revere Transducers Europe B.V., which total approximately $4,450,000.

The Company derives approximately 52% of its revenues from customers within the United States. Approximately 30% come from sales to customers in 16 different countries in Europe. The balance of sales are to Canada, Mexico and Latin America. Sales outside the United States are primarily to developed countries.

For additional information regarding foreign assets and operations, see Note K to the Consolidated Financial Statements included herein.

ITEM 2. PROPERTIES

Location	Segment	Utilization	Square Footage	Leased or Owned	Lease Termination
UNITED STATES					
Tustin, CA	Industrial Measurement	Corporate offices, headquarters and U.S. operations for Revere Transducers and SI/Allegany	93,000	Leased	Month-to-month
Seattle, WA	Industrial Automation	Offices and operations for AeroGo, Inc.	55,326	Leased	April 2011
Cumberland, MD	Industrial Measurement	Discontinued use as operations for SI/Allegany. Partial use as East Coast Sales and Service Center	33,000	Leased	May 2006
Cumberland, MD	Industrial	Aircraft hanger	4,200	Owned	

	Measurement				
INTERNATIONAL					
Breda, the Netherlands	Industrial	European operations for Revere	22,000	Leased	June 2007
	Measurement	Transducers			
Kelowna, B.C., Canada	Industrial	Canadian Sales & Service Center	3,000	Leased	May 2006
	Measurement				

The Company believes that its properties have been adequately maintained, are in generally good condition and are suitable for the Company s business as presently conducted. The Company also believes that upon the expiration of its current leases, it either will be able to secure renewal terms or enter into leases for alternative locations at market terms. The Company plans to relocate its Tustin facility to a permanent location in the event that the Vishay acquisition does not materialize

ITEM 3. LEGAL PROCEEDINGS

From time to time, the Company is involved in various legal matters in the normal course of business. Management does not believe any matter exists at July 31, 2004 that would result in any significant adverse effect to the financial statements.

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

No matters were submitted to a vote of stockholders during the quarter ended July 31, 2004.

PART II

ITEM 5. MARKET FOR REGISTRANT S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

SI s Common Stock is traded on the Nasdaq SmallCap Stock Market under the symbol SISI. The following table sets forth the high and low closing sales prices of the Common Stock, as reported by Nasdaq, by quarter, for fiscal years 2004 and 2003.

Price Range of Common Shares

	2004		2003	
	HIGH	LOW	HIGH	LOW
1st Quarter	$ 3.39	$ 2.04	$ 1.55	$ .50
2nd Quarter	3.44	2.75	2.28	1.05
3rd Quarter	4.88	2.50	2.07	1.45
4th Quarter	3.12	2.35	3.79	1.62

As of October 18, 2004, there were approximately 200 holders of record of the Company s Common Stock. Management believes that as of that date there were approximately 600 beneficial owners of the Company s Common Stock

Dividend Policy

The Company has never paid cash dividends on its Common Stock. The Company intends to retain all future earnings for reinvestment in its business and does not plan to pay dividends in the foreseeable future. Furthermore, the Company is prohibited from declaring and/or paying cash dividends on its capital stock under the terms of certain indebtedness.

Equity Compensation Plan Information

The following tables summarize information concerning currently outstanding and exercisable stock options:

Plan Category	Number of securities to be issued upon exercise of outstanding options, warrants and rights	Weighted-average exercise price of outstanding options,	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))

		warrants and rights	
Equity compensation plans approved by security holders	783,824	$ 2.52	160,000
Equity compensation plans not approved by security holders	0	0	0
TOTAL	783,824	$ 2.52	160,000

ITEM 6. SELECTED FINANCIAL DATA

At or for the year ended July 31:

	2004	2003	2002	2001	2000
Net sales	$ 36,196,000	$ 33,047,000	$ 32,613,000	$ 36,291,000	$ 41,329,000
Net income (loss)	351,000	1,197,000	1,673,000	(7,128,000)	351,000
Net income (loss) per share basic	.09	.33	.47	(2.00)	.10
Net income (loss) per share assuming dilution	.08	.32	.47	(2.00)	.09
Total assets	24,986,000	26,943,000	25,782,000	25,910,000	33,018,000
Long-term debt, less current portion	2,733,000	3,366,000	4,039,000		10,809,000
Other long-term obligations	50,000	408,000	360,000	569,000	976,000

ITEM 7. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATION

Overview

SI develops, designs, manufactures and markets high-performance industrial sensors, weighing, and factory automation systems. It products are used in a wide variety of industries including aerospace, aviation, food processing and packaging, forestry manufacturing, mining, transportation, warehousing, distribution, and waste management.

SI categorizes it products into two market applications: industrial measurement, and industrial automation. Its industrial measurement products measure forces such as pressure weight, mass and torque when matched with microprocessor controlled digital electronics. Its industrial automation products are load handling, moving/positioning, and systems for applications in manufacturing, construction and other environments in which heavy bulky materials are being transported and positioned.

Net sales increased 9.8% to $36.3 million in fiscal year 2004 compared to $33.0 million in fiscal year 2003. Net sales increased in both of the Company s business segments. Net income for fiscal year 2004 was $504,000 compared to $1,197,000 in fiscal year 2003. Net income in fiscal year 2004 was less principally because of a tax benefit of $1,078,000 recorded in fiscal year 2003 due to the elimination of the deferred tax valuation allowance in fiscal year 2003.

The Company has entered into a nonbinding letter of intent with Vishay Intertechnology Company, Inc. (Vishay), which contemplates the acquisition of the Company by Vishay. The transaction is subject to satisfactory completion of due diligence by Vishay, the execution of a definitive Purchase Agreement approved by the Board of Directors of SI and Vishay, approval of the SI shareholders and other material conditions. Accordingly, no assurance can be given that the Company will enter into a definitive agreement with Vishay or complete a transaction with Vishay.

During the past several years, the Company has reduced its manufacturing activities and outsourced certain high volume, low margin component products to suppliers in countries with lower labor costs. This has had the effect of improving gross margin while creating excess capacity at its Tustin location. The Company currently leases its corporate headquarters in Tustin, California on a month-to-month basis. If the Company or Vishay determine not to proceed with a transaction, the Company anticipates relocating its corporate headquarters to smaller facility in Southern California, as the Company needs less space due to outsourcing .

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While management expects demand for the Company s products to continue, the near-term outlook for the Company s markets remains clouded by uncertain economic conditions and competition. Management believes a recovery in global capital spending would allow the Company to leverage its more efficient operating structure to improve sales and profitability.

RESULTS OF OPERATION

As an aid to understanding the Company s operating results, the following table indicates the percentage of revenues that each income statement item represents and the percentage increase or decrease in such items for the years indicated.

Total SI Technologies	**Year ended July 31,**			**Percent Increase/(Decrease)**	
	2004	**2003**	**2002**	**2004 vs. 2003**	**2003 vs. 2002**
Net sales	100.0%	100.0%	100.0%	9.5%	1.3%
Cost of sales	65.0	65.1	64.1	9.5	2.9
Gross profit	35.0	34.9	35.9	9.6	(1.5)
Selling, general and administrative	26.7	25.8	24.6	13.3	6.4
Research, development and engineering	4.7	4.7	4.3	8.0	12.8
Amortization of intangibles	-0-	-0-	1.1	(11.1)	(100.0)
Restructuring charges	(0.6)	1.6	-0-	(148.8)	100.0
Operating expenses	30.8	32.1	30.0	5.1	8.4
Income from operations	4.2	2.8	5.9	60.9	(51.5)
Interest expense	(2.3)	(2.9)	(2.8)	(16.3)	8.0
Other income (expense), net	(0.1)	0.5	0.3	(122.2)	62.8
Income (loss) before income tax expense	1.8	0.4	3.4	458.8	(89.5)
Income tax (expense) benefit	(0.8)	3.2	1.7	(129.1	