

SUNTRON CORP  
Form 10-Q  
May 16, 2007

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**UNITED STATES SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, DC 20549**

**FORM 10-Q**

**Quarterly report pursuant to section 13 or 15 (d) of the Securities Exchange Act of 1934  
For the fiscal quarter ended April 1, 2007, or**

**Transition report pursuant section 13 or 15 (d) of the Securities Exchange Act of 1934  
For the transition period from \_\_\_\_\_ to \_\_\_\_\_**

**Commission file number 0-49651**

**SUNTRON CORPORATION**

(Exact Name of Registrant as Specified in Its Charter)

**Delaware**

**86-1038668**

(State of Incorporation)

(I.R.S. Employer Identification No.)

**2401 West Grandview Road, Phoenix, Arizona**

**85023**

(Address of Principal Executive Offices)

(Zip Code)

**(602) 789-6600**

(Registrant's telephone number, including area code)

Not Applicable

(Former name, former address and former fiscal year, if changed since last report)

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  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer as defined in Exchange Act Rule 12b-2.

Large Accelerated Filer  Accelerated Filer  Non-Accelerated Filer

Indicate by check mark if the Registrant is a shell company (as defined in Exchange Act Rule 12b-2). Yes  No

As of **April 30, 2007**, there were outstanding **27,591,821** shares of the Registrant's Common Stock, \$0.01 par value.

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CONDENSED CONSOLIDATED BALANCE SHEETS****As of December 31, 2006 and April 1, 2007****(In Thousands, Except Per Share Amounts)**

	<b>2006</b>	<b>2007</b>
<b>ASSETS</b>		
Current Assets:		
Cash and equivalents	\$ 46	\$ 48
Trade Receivables, net of allowance for doubtful accounts of \$1,647 and \$1,441, respectively	40,756	46,559
Inventories	56,038	49,854
Prepaid expenses and other	1,186	1,427
Total Current Assets	98,026	97,888
Property and Equipment, net	5,184	4,422
Goodwill	10,918	10,702
Other Assets	2,785	2,650
Total Assets	\$ 116,913	\$ 115,662
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
Current Liabilities:		
Accounts payable	\$ 30,285	\$ 27,711
Outstanding checks in excess of cash balances	804	3,301
Borrowings under revolving credit agreement	19,759	20,523
Accrued compensation and benefits	4,721	5,344
Payable to affiliates	432	365
Other accrued liabilities	4,252	2,859
Total Current Liabilities	60,253	60,103
Long-term subordinated debt payable to affiliate	11,353	11,828
Other long-term liabilities	1,755	1,641
Total Liabilities	73,361	73,572
<b>Commitments (Note 4)</b>		
<b>Stockholders Equity:</b>		
Preferred stock, \$.01 par value. Authorized 10,000 shares, none issued		
Common stock, \$.01 par value. Authorized 50,000 shares; issued and outstanding 27,577 shares and 27,592 shares, respectively	276	276
Additional paid-in capital	381,329	381,537
Accumulated deficit	(338,053)	(339,723)

Total Stockholders' Equity	43,552	42,090
Total Liabilities and Stockholders' Equity	\$ 116,913	\$ 115,662

The Accompanying Notes Are an Integral Part of These Condensed Consolidated Financial Statements.

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**SUNTRON CORPORATION AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**  
**For The Quarters Ended April 2, 2006 and April 1, 2007**  
**(In Thousands, Except Per Share Amounts)**

	<b>2006</b>	<b>2007</b>
<b>Net Sales</b>	\$ 95,795	\$ 65,165
<b>Cost of Goods Sold</b>	87,781	61,697
Gross profit	8,014	3,468
<b>Operating Expenses:</b>		
Selling, general and administrative expenses	6,051	4,405
Severance, retention, and lease exit costs	122	46
Related party management and consulting fees	188	188
Total operating expenses	6,361	4,639
Operating income (loss)	1,653	(1,171)
<b>Other Income (Expense):</b>		
Interest expense	(2,825)	(1,063)
Gain on sale of business unit		448
Gain on sale of assets	20	87
Interest and other income	15	29
Total other income (expense)	(2,790)	(499)
Net loss	\$ (1,137)	\$ (1,670)
<b>Loss Per Share (Basic and Diluted)</b>	\$ (0.04)	\$ (0.06)
<b>Weighed Average Shares Outstanding (Basic and Diluted)</b>	27,456	27,581

The Accompanying Notes Are an Integral Part of These Condensed Consolidated Financial Statements.

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**SUNTRON CORPORATION AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**For The Quarters Ended April 2, 2006 and April 1, 2007**  
**(In Thousands)**

	<b>2006</b>	<b>2007</b>
<b>Cash Flows from Operating Activities:</b>		
Net loss	\$ (1,137)	\$ (1,670)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	1,654	744
Amortization of debt issuance costs	1,711	88
Gain on sale of business unit		(448)
Gain on sale of assets	(20)	(87)
Stock-based compensation expense	207	208
Interest on subordinated debt to affiliate		475
Changes in operating assets and liabilities, net of effects of sale of business unit:		
Decrease (increase) in:		
Trade receivables, net	(2,412)	(7,784)
Inventories	(767)	4,067
Prepaid expenses and other	(150)	(304)
Increase (decrease) in:		
Accounts payable	1,900	(1,589)
Accrued compensation and benefits	1,032	666
Other accrued liabilities	(3,155)	(1,064)
Net cash used in operating activities	(1,137)	(6,698)
<b>Cash Flows from Investing Activities:</b>		
Proceeds from sale of business unit		4,427
Proceeds from sale of property, plant and equipment	16,716	87
Payments for property, plant and equipment	(700)	(339)
Net cash provided by investing activities	16,016	4,175
<b>Cash Flows from Financing Activities:</b>		
Proceeds from borrowings under debt agreements	123,365	67,008
Principal payments under debt agreements	(137,416)	(66,908)
Payments for debt issuance costs	(780)	(72)
Increase (decrease) in outstanding checks in excess of cash balances	(18)	2,497
Proceeds from exercise of stock options	1	
Net cash provided by (used in) financing activities	(14,848)	2,525
Net increase in cash and equivalents	31	2
<b>Cash and Equivalents:</b>		
Beginning of period	59	46
End of period	\$ 90	\$ 48



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CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS  
For The Quarters Ended April 2, 2006 and April 1, 2007  
(In Thousands)**

	<b>2006</b>	<b>2007</b>
<b>Supplemental Disclosure of Cash Flow Information:</b>		
Cash paid for interest	\$ 2,319	\$ 469
 Cash paid for income taxes	 \$	 \$
<b>Supplemental Schedule of Non-cash Investing and Financing Activities:</b>		
Deposit retained by purchaser of real estate to secure obligations related to partial leaseback of building	\$ 1,500	\$

The Accompanying Notes Are an Integral Part of These Condensed Consolidated Financial Statements.

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**SUNTRON CORPORATION AND SUBSIDIARIES**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**(In Thousands, Except Per Share Amounts)**

***1. Basis of Presentation***

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with U. S. generally accepted accounting principles for interim financial information and in conformity with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by U. S. generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the fiscal quarter ended April 1, 2007 are not necessarily indicative of the results that may be expected for the year ending December 31, 2007. The unaudited condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in Suntron's Annual Report on Form 10-K, as amended, for the year ended December 31, 2006.

***2. Loss Per Share***

Basic loss per share excludes dilution for potential common shares and is computed by dividing net loss by the weighted average number of common shares outstanding for the period. Diluted loss per share reflects the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock. Basic and diluted loss per share are the same for the quarters ended April 2, 2006 and April 1, 2007, as all potential common shares were antidilutive. For the quarters ended April 2, 2006 and April 1, 2007, common stock options that were excluded from the calculation of loss per share amounted to an aggregate of 2,600 and 2,308 shares, respectively.

***3. Inventories***

Inventories at December 31, 2006 and April 1, 2007 are summarized as follows:

	<b>2006</b>	<b>2007</b>
Purchased parts and completed sub-assemblies	\$ 40,182	\$ 32,782
Work-in-process	11,699	11,621
Finished goods	4,157	5,451
 Total	 \$ 56,038	 \$ 49,854

For the quarters ended April 2, 2006 and April 1, 2007, the Company recognized write-downs of excess and obsolete inventories resulting in charges to cost of goods sold of \$1,149 and \$674, respectively.

***4. Debt Financing***

At December 31, 2005, the Company had a \$75,000 revolving credit facility with two financial institutions which was scheduled to expire in July 2008. On March 30, 2006, the Company terminated this credit agreement and entered into new debt financing agreements as discussed below. Due to the early termination of this credit agreement, the Company recognized a

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charge to interest expense of \$1,447 to write-off the remaining unamortized debt issuance costs in the first quarter of 2006.

On March 30, 2006, the Company entered into a three-year senior credit agreement with US Bank National Association ( US Bank ). The US Bank credit agreement provides for a \$50,000 commitment under a revolving credit facility that matures in March 2009. The Company has the option to terminate the credit agreement before the maturity date with a prepayment penalty of 1.0% of the commitment amount if the prepayment occurs before November 30, 2008. Under the terms of the US Bank credit agreement, the Company can elect to incur interest at a rate equal to either (a) the Prime Rate plus 0.50%, or (b) the LIBOR Rate plus 3.00%. These rates can be reduced in the future by up to 0.50% for Prime Rate borrowings and 0.75% for LIBOR Rate borrowings depending on the Company's adjusted fixed charge coverage ( FCC ) ratio, as defined in the credit agreement. As of April 1, 2007, the interest rate for Prime Rate borrowings was 8.75% and the effective rate for LIBOR Rate borrowings was 8.36%. In addition, the Company is obligated to pay a commitment fee of 0.25% per annum for the unused portion of the credit agreement.

Substantially all of the Company's assets are pledged as collateral for outstanding borrowings under the US Bank credit agreement. The credit agreement also limits or prohibits the Company from paying dividends, incurring additional debt, selling significant assets, acquiring other businesses, or merging with other entities without the consent of the lenders. The credit agreement requires compliance with certain financial and non-financial covenants, including a rolling four-quarter adjusted FCC ratio.

Similar to the previous credit agreement, the US Bank credit agreement includes a lockbox arrangement that requires the Company to direct its customers to remit payments to restricted bank accounts, whereby all available funds are used to pay down the outstanding principal balance under the credit agreement. Accordingly, the entire outstanding principal balance under the credit agreement is classified as a current liability in our condensed consolidated balance sheets.

Total borrowings under the US Bank credit agreement are subject to limitation based on a percentage of eligible accounts receivable and inventories. Accordingly, the Company's borrowing availability generally decreases as our net receivables and inventories decline. As of April 1, 2007, the borrowing base calculation permitted total borrowings of \$42,364, and the Company was in compliance with all of the covenants under the US Bank credit agreement. After deducting the outstanding principal balance of \$20,523 and outstanding letters of credit of \$2,000, the Company had borrowing availability of \$19,841 as of April 1, 2007.

On March 30, 2006, the Company also entered into a \$10,000 subordinated Note Purchase Agreement (the Second Lien Note ) with an affiliate of the Company's majority stockholder. The Second Lien Note is collateralized by a second priority security interest in substantially all of the collateral under the US Bank credit agreement. The Second Lien Note is subordinated in right of payment to the obligations under the US Bank credit agreement and provides for a maturity date that is 45 days after the maturity date of the US Bank credit agreement. The Second Lien Note provides for an interest rate of 16.0%, payable quarterly in kind (or payable in cash with written approval from US Bank). Upon maturity or termination of the US Bank credit agreement, the Company has the option to prepay the Second Lien Note with a redemption penalty not to exceed 3.0% of the then outstanding principal balance. If the Second Lien Note is pre-paid on the maturity date, a fee equal

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to 2.0% of the then outstanding principal balance is due. Accordingly, the Company is recording interest expense related to this 2.0% fee using the effective interest method.

In connection with the US Bank credit agreement, an affiliate of the Company's majority stockholder also agreed to enter into an FCC maintenance agreement that requires the affiliate to make up to \$5,000 of additional subordinated loans to the Company if the FCC is below a prescribed level. Loans pursuant to the FCC maintenance agreement would have similar terms as the Second Lien Note; however, the interest rate on such additional loans can not exceed 18.0%.

The Company incurred debt issuance costs of \$1,111 in connection with the US Bank credit agreement and the Second Lien Note. These costs are being amortized to interest expense over the term of the financing arrangements.

**5. Restructuring Activities**

The Company periodically takes actions to reduce costs and increase capacity utilization through the closure of facilities and reductions in workforce. The results of operations related to these activities for the quarters ended April 2, 2006 and April 1, 2007, are summarized as follows:

	<b>2006</b>	<b>2007</b>
<b>Amounts related to manufacturing activities and included in cost of goods sold:</b>		
Severance and retention costs	\$ 62	\$ 41
Lease exit costs	7	1,029
Moving and relocation costs	7	(23)
Total included in cost of goods sold	76	1,047
<b>Amounts unrelated to manufacturing activities and excluded from cost of goods sold:</b>		
Severance and retention costs	107	14
Lease exit costs	10	7
Moving, relocation and other costs	5	25
Total severance, retention and lease exit costs	122	46
Total Restructuring Expense	\$ 198	\$ 1,093

Presented below is a description of the principal activities that resulted in the charges shown in the table above:

In March 2007, the Company entered into a lease amendment with the landlord of its Lawrence, Massachusetts facility. The expiration date of the lease remains in March 2011 but the Company agreed to make a cash payment of approximately \$1,080 as consideration for a reduction in the square footage under the lease from 73,000 to approximately 17,000. Accordingly, in the first quarter of 2007, the Company recognized a lease exit charge equal to this cash payment less \$60 for the reversal of non-level rent expensed in prior periods. As a result of this amendment, the Company will be able to avoid future rent payments of approximately \$2,100 that would have otherwise been due through the March 2011 expiration date of the lease.

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For the quarters ended April 2, 2006 and April 1, 2007, the Company incurred severance and retention costs of \$169 and \$55, respectively. These costs primarily related to the termination of executive officers of the Company and other reductions in the manufacturing workforce.

**Summary of Restructuring Liabilities.** Presented below is a summary of changes in liabilities for lease exit costs and severance and retention obligations for the quarter ended April 1, 2007:

	<b>Accrued Lease Exit Costs</b>	<b>Accrued Severance &amp; Retention</b>
Balance, December 31, 2006	\$ 469	\$ 116
Accrued expense for restructuring activities	1,020	55
Cash receipts under subleases	10	
Cash payments	(1,574)	(103)
Accretion of interest	15	
Reclassification of non-level rent liability	60	
Balance, April 1, 2007	\$	\$ 68

The obligation for accrued severance and retention is included in accrued compensation and benefits in the Company's condensed consolidated balance sheet and is expected to be paid over the next three months.

**6. Gain on Sale of Business**

In February 2007, the Company sold its business unit located in Garner, Iowa for net proceeds of \$4,427. The sales agreement provides that the buyer is required to pay additional consideration of up to \$600 depending on the targeted level of net sales generated by this business unit in 2007. As a result of the sale, the Company recognized a gain of approximately \$448 in the first quarter of 2007 and any additional consideration received will be recorded as an additional gain in the period that the targeted sales levels are achieved. The historical results of operations of this business unit were not significant to the Company's financial condition, results of operations or cash flows.

**7. New Accounting Standards**

In July 2006, the Financial Accounting Standards Board issued Interpretation No. 48 ( FIN 48 ), *Accounting for Uncertainty in Income Taxes* . FIN 48 is an interpretation of Statement of Financial Accounting Standards No. 109 , which provides criteria for the recognition, measurement, presentation and disclosures of uncertain tax positions. A tax benefit from an uncertain tax position may be recognized if it is more likely than not that the position is sustainable based solely on its technical merits. The provisions of FIN 48 are effective for fiscal years beginning after December 15, 2006.

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Upon adoption of FIN 48 on January 1, 2007, the Company had no unrecognized tax benefits and management is not aware of any issues that would cause a significant increase to the amount of unrecognized tax benefits within the next year. The Company's policy is to recognize any interest or penalties as a component of income tax expense. The Company's material taxing jurisdictions are comprised of the U.S. federal jurisdiction and the states of Texas, Arizona and Oregon. The tax years 2003 through 2006 remain open to examination by the U.S. federal jurisdiction, and tax years 2002 through 2006 remain open to examination for Texas, Arizona and Oregon.

In September 2006, the Financial Accounting Standards Board ( FASB ) issued Statement No. 157, *Fair Value Measurements* . This new standard establishes a framework for measuring the fair value of assets and liabilities. This framework is intended to provide increased consistency in how fair value determinations are made under various existing accounting standards which permit, or in some cases require, estimates of fair market value. Statement No. 157 also expands financial statement disclosure requirements about a company's use of fair value measurements, including the effect of such measures on earnings. This statement is effective for fiscal years beginning after November 15, 2007. While the Company is currently evaluating the provisions of Statement No. 157, the adoption of this Statement is not expected to have a material impact on its 2008 consolidated financial statements.

In February 2007, the FASB issued Statement No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities Including an amendment of FASB Statement No. 115*". This Statement permits entities to choose to measure many financial instruments at fair value. A business entity shall report unrealized gains and losses on items for which the fair value option has been elected in earnings at each subsequent reporting date. The Company will be required to adopt Statement No. 159 in the first quarter of the year ending December 31, 2008. While management is currently evaluating the provisions of Statement No. 159, the adoption is not expected to have a material impact on the Company's 2008 consolidated financial statements.

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

*The following discussion of our financial condition and results of operations should be read in conjunction with our condensed consolidated financial statements and the related notes, and the other financial information included in this report, as well as the information in our Annual Report on Form 10-K for the year ended December 31, 2006.*

**Statement Regarding Forward-Looking Statements**

*This report on Form 10-Q contains forward-looking statements regarding future events, including our future financial and operational performance. Forward-looking statements include statements regarding markets for our products; trends in net sales, gross profits, and estimated expense levels; liquidity, anticipated cash needs and borrowing availability; and any statement that contains the words anticipate, believe, plan, estimate, expect, seek, and other similar expressions. The forward-looking statements included in this report reflect our current expectations and beliefs, and we do not undertake publicly to update or revise these statements, even if experience or future changes make it clear that any projected results expressed in this report, annual or quarterly reports to stockholders, press releases, or company statements will not be realized. In addition, the inclusion of any statement in this report does not constitute an admission by us that the events or circumstances described in such statement are material. Furthermore, we wish to caution and advise readers that these statements are based on assumptions that may not materialize and may involve risks and uncertainties, many of which are beyond our control, that could cause actual events or performance to differ materially from those contained or implied in these forward-looking statements. These risks and uncertainties include, but are not limited to, risks related to the realization of anticipated revenue and profitability; the ability to meet cost estimates and achieve the expected benefits associated with recent restructuring activities; trends affecting our growth; and the business and economic risks described in Item 1A of Part II herein under the caption Risk Factors.*

**Overview**

Our net sales for the first quarter of 2007 totaled \$65.2 million compared to \$95.8 million for the first quarter of 2006. Despite the \$30.6 million reduction in 2007 net sales, our net loss only increased by \$0.6 million from a net loss of \$1.1 million for the first quarter of 2006 to a net loss of \$1.7 million for the first quarter of 2007. Our net loss for the first quarter of 2007 includes restructuring costs of \$1.1 million compared to \$0.2 million for the first quarter of 2006. By the end of the first quarter of 2007, we had completed all planned restructuring actions to right-size our business to enable us to achieve profitability at lower levels of net sales.

Two key restructuring actions took place in the third and fourth quarters of 2006, when we completed the closures of manufacturing business units in Lawrence, Massachusetts and Olathe, Kansas. In February 2007, we sold our business unit in Garner, Iowa which resulted in net proceeds of \$4.4 million and a gain on sale of \$0.4 million. In March 2007, we amended our lease in Lawrence, Massachusetts whereby future rental payments of approximately \$2.1 million were eliminated in exchange for a cash payment of approximately \$1.1 million. As we begin the second quarter of 2007, the combination of these actions has resulted in a significant reduction in our fixed costs and improved plant capacity utilization at most of our Suntron facilities.



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We believe the restructuring actions taken through the first quarter of 2007 provide us with a more efficient cost structure to carry out our planned activities for the remainder of 2007. In addition, we are continuing to explore opportunities to further improve the utilization of our assets and we are evaluating other actions that will reduce costs and drive sustainable improvement in our future financial performance. Though our primary focus through the first quarter of 2007 was on the right-sizing of our U.S. manufacturing footprint, our sales efforts continue to result in new customer wins. The nature of our low volume/high mix model requires a long ramp-up of production and, therefore, significant sales from new customers added through the first quarter of 2007 may not be recognized until the fourth quarter of 2007. As we continue to execute our business plan for 2007, our focus will be on profitable growth and working capital management, while maintaining quality customer service.

Following is an overview of the information included under each section of Management's Discussion and Analysis of Financial Condition and Results of Operations:

<b>Caption</b>	<b>Overview</b>
<b>Information About Our Business</b>	Under this section we provide information to help understand our industry conditions and information unique to our business and customer relationships.
<b>Critical Accounting Policies and Estimates</b>	This section provides details about some of the critical estimates and accounting policies that must be applied in the preparation of our financial statements. It is important to understand the nature of key uncertainties and estimates that may not be apparent solely from reading our financial statements and the related footnotes.
<b>Overview of Statement of Operations</b>	This section includes a description of the types of transactions that are included in each significant category included in our statement of operations.
<b>Results of Operations</b>	This section includes a discussion and analysis of our operating results for the first quarter of 2006 compared to the first quarter of 2007.
<b>Liquidity and Capital Resources</b>	There are several sub-captions under this section, including a discussion of our cash flows for the first quarter of 2007 and other liquidity measures that we consider important to our business. Under the sub-caption for Contractual Obligations, we discuss on- and off-balance-sheet obligations and the expected impact on our liquidity. Under the sub-caption for Capital Resources, we have included a discussion of our debt agreements, including details about interest rates charged, calculation of the borrowing base and unused availability, compliance with the financial covenant in our debt agreement, and the impact of recent actions to sell assets and enter into new debt agreements.
<b>Information About Our Business</b>	

Suntron delivers complete manufacturing services and solutions to support the entire life cycle of complex products in the industrial, semiconductor capital equipment, aerospace and defense, networking and telecommunications, and medical equipment market sectors of the electronic manufacturing services ( EMS ) industry. We provide design and engineering services, quick-turn prototype, materials management, cable and harness assembly, printed circuit board assembly and testing, electronic interconnect assemblies, subassemblies, and full systems integration (known as box-build), after-market repair and warranty services. We believe our

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competitive niche, low volume, high mix and complex system integration, is a direct result of our ability to provide unique solutions tailored to match each of our customer's specific requirements, while meeting the highest quality standards in the industry.

Our largest single expenditure is for the purchase of electronic components and our expertise in electronics manufacturing techniques is critical to our ability to provide competitive, quality services. However, in order to fully comprehend our business, it is also important to understand that our customers are engaged in industrial, semiconductor capital equipment, aerospace and defense, networking and telecommunications, medical equipment products, and many other industries. While our ability to compete with other companies in the EMS industry is important to our long-term success, short-term fluctuations in the demand for our manufacturing services are primarily affected by the economic conditions in the end-market sectors served by our customers. Since more than half of our customers are currently concentrated in three market sectors (industrial, semiconductor capital equipment, and aerospace and defense), the quarterly fluctuations in our net sales can be extremely volatile when these sectors are experiencing either rapid growth or contraction.

Many of our customers are OEMs that have designed their own products. Our customers request proposals that include key terms such as quality, delivery, and the price to purchase the materials and perform the manufacturing services to make one or more components or assemblies. Generally, the component or assembly that we manufacture is delivered to the customer where it is then integrated into their final product. We determine prices for new business with our customers by obtaining raw material quotes from our suppliers and then estimating the amount of labor and overhead that will be required to make the products.

Before we begin a customer relationship, we typically enter into arrangements that are intended to protect us in case a customer cancels an order after we purchase the raw materials to fill that order. In these circumstances, the customer is generally required to purchase the materials or reimburse us if we incur a loss from liquidating the raw materials.

The EMS industry is extremely dynamic and our customers make frequent changes to their orders. The magnitude and frequency of these changes make it difficult to predict revenues beyond the next quarter, and even relatively short-term forecasts may prove inaccurate depending on changes in economic, political, and military factors, as well as unexpected customer requests to delay shipments near the end of our fiscal quarters. These changes in customer orders also cause substantial difficulties in managing inventories, which often leads to excess inventories and the need to recognize losses on inventories. However, from time to time, we may also have difficulties obtaining certain electronic components that are in short supply. In addition, our inventories consist of over 90,000 different parts and many of these parts have limited alternative uses or markets beyond the products that we manufacture for our customers. When we liquidate excess materials through an inventory broker or auction, we often realize less than the original cost of the materials, and in some cases we determine that there is no market for the excess materials.

The most common reasons we incur losses related to inventories are due to purchasing more materials than are necessary to meet a customer's requirements or failing to act promptly to minimize losses once the customer communicates a cancellation. Occasionally, it is not clear what action caused an inventory loss and there is a shared responsibility whereby our customers agree to negotiate a settlement with us. In some cases, our customers may deny responsibility for excess inventories despite the existence of persuasive evidence that the customer was at fault; in

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these cases we must weigh all alternatives to resolve the dispute, including the possibility of litigation or arbitration. Accordingly, management continually evaluates inventory on-hand, forecasted demand, contractual protections, and net realizable values in order to determine whether an adjustment to the carrying amount of inventory is necessary. When the relationship with a customer terminates, we tend to be more vulnerable to inventory losses because the customer may be reluctant to accept responsibility for the remaining inventory if a product is at the end of its life cycle. We can also incur inventory losses if a customer becomes insolvent and the materials do not have alternative uses or markets into which we can sell them.

**Critical Accounting Policies and Estimates**

The discussion and analysis of our financial condition and results of operations is based upon our condensed consolidated financial statements, which have been prepared in accordance with U.S. generally accepted accounting principles. The preparation of these financial statements requires that we make estimates and judgments that affect the reported amounts of assets, liabilities, revenues, expenses, and the related disclosures. On an on-going basis, we evaluate our estimates, including those related to bad debts, inventories, property, plant and equipment, intangible assets, income taxes, warranty obligations, restructuring-related obligations, and litigation. We base our estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. We cannot assure you that actual results will not differ from those estimates. We believe the following critical accounting policies affect our most significant judgments and estimates used in the preparation of our condensed consolidated financial statements.

**Revenue Recognition.** We recognize revenue from manufacturing services and product sales upon shipment and transfer of title of the manufactured product, whereby our customers assume the risks and rewards of ownership of the product. Occasionally, we enter into arrangements where services are bundled and completed in multiple stages. In these cases, we follow the guidance in Emerging Issues Task Force Issue No. 00-21, *Revenue Arrangements with Multiple Deliverables*, to determine the amount of revenue allocable to each deliverable.

Generally, there are no formal customer acceptance requirements or further obligations related to manufacturing services after shipment; however, if such requirements or obligations exist, then revenue is recognized at the point when the requirements are completed and the obligations fulfilled. If uncertainties exist about whether the customer has assumed the risks and rewards of ownership or if continuing performance obligations exist, we expand our written communications with the customer to ensure that our understanding of the arrangement is consistent with that of the customer before revenue is recognized. Revenue from design, engineering, and other services is recognized as the services are performed.

**Write-Downs for Obsolete and Slow-Moving Inventories.** Our judgments about excess and obsolete inventories are especially difficult because (i) hundreds of different components may be associated with a single product we manufacture for a customer, (ii) we make numerous products for most of our customers, (iii) our customers are engaged in diverse industries, (iv) a significant amount of the parts we purchase are unique to a particular customer's orders and there are limited alternative markets if that customer's order is canceled, and (v) our customers experience dynamic business environments affected by a wide variety of economic, political, and regulatory factors. This complex environment results in positive and negative events that can

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change daily and which affect judgments about future demand for our manufacturing services and the amounts we can realize when it is not possible to liquidate inventories through production of finished products.

We frequently review customer demand to determine if we have excess raw materials that will not be consumed in production. In determining demand we consider firm purchase orders and forecasts of demand submitted by our customers. If we determine that excess inventories exist and that the customer is not contractually obligated for the excess inventories, we make judgments about whether unforecasted demand for those materials is likely to occur or the amount we would likely realize in the sale of this material through a broker or auction. If we determine that future demand from the customer is unlikely, we write down our inventories to the extent that the cost of the inventory exceeds the estimated market value. If we record a write-down to reduce the cost of inventories to market, such write-down is not subsequently reversed.

If actual market conditions are less favorable than those projected by management, additional inventory write-downs may be required in future periods. Likewise, if we underestimate contractual recoveries from customers or future demand, recognition of additional gross profit may be reported as the related goods are sold. Therefore, although we make every effort to ensure the accuracy of our forecasts of future product demand, any significant unanticipated changes in demand or the outcome of customer negotiations with respect to the enforcement of contractual provisions could have a significant impact on the value of our inventory and our reported operating results.

***Allowance for Doubtful Accounts Receivable.*** We maintain an allowance for doubtful accounts for estimated losses resulting from the inability of our customers to make required payments, as well as to provide for adjustments related to pricing and quantity differences. If the financial condition of our customers were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances would be required. When our customers experience difficulty in paying us, we estimate how much of our receivable will not be collected. These judgments are often difficult because the customer may not divulge complete and accurate information. Even if we are fully aware of the customer's financial condition it can be difficult to estimate the expected recovery and there is often a wide range of potential outcomes. Sometimes we collect receivables that we reserved for in prior periods and these recoveries are reflected as a credit to operations in the periods in which the recovery occurs. Over the past few years, we have diversified our concentration of business with our major customers and have added smaller customers that generally have higher credit risk. Accordingly, we may experience higher bad debt losses in the future.

***Restructuring Activities and Asset Impairments.*** When we undertake restructuring activities and decide to close a plant that we occupy under a non-cancelable operating lease, we are required to estimate how long it will take to locate a new tenant to sublease the facility and to estimate the rate that we are likely to receive when a tenant is located. Accordingly, we will incur additional lease exit charges in future periods if our estimates of the rate or timing of sublease payments turns out to be less favorable than our current expectations. We also consider the estimated cost of building improvements, brokerage commissions, and any other costs we believe will be incurred in connection with the subleasing process. The precise outcome of most of these factors is difficult to predict. We review our estimates at least quarterly, including consultation with our commercial real estate advisors to assess changes in market conditions, feedback from parties that have expressed interest, and other information that we believe is relevant to most accurately reflect the expected outcome of obtaining a subtenant to lease the facility.

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When we undergo changes in our business, including the closure or relocation of facilities, we often have equipment and other long-lived assets that are no longer needed in continuing operations. When this occurs, we are required to estimate future cash flows and if such undiscounted cash flows are less than the carrying value of the assets (or asset group, as applicable), we recognize impairment charges to reduce the carrying value to estimated fair value. The determination of future cash flows and fair value tend to be highly subjective estimates. When assets are held for sale and the actual market conditions deteriorate, or are less favorable than those projected by management, additional impairment charges may be required in subsequent periods.

For a detailed discussion on the application of these and other accounting policies, see Note 1 in our audited consolidated financial statements for the year ended December 31, 2006, included in our Annual Report on Form 10-K, as amended.

**Summary of Statement of Operations**

*Net sales* are recognized when title is transferred to our customers, which generally occurs upon shipment from our facilities. Net sales from design, engineering, and other services are less than 10% of our total net sales and are generally recognized as the services are performed. Sales are recorded net of customer discounts and credits taken or expected to be taken.

*Cost of goods sold* includes materials, labor, and overhead expenses incurred in the manufacture of our products. Cost of goods sold also includes charges related to manufacturing operations for lease exit costs, severance and retention costs, impairment of long-lived assets, and obsolete and slow moving inventories. Many factors affect our gross profit, including fixed costs associated with plant and equipment capacity utilization, manufacturing efficiencies, changes in product mix, and production volume.

*Selling, general, and administrative expenses* primarily include the salaries for executive, finance, accounting, and human resources personnel; salaries and commissions paid to our internal sales force and external sales representatives and marketing costs; insurance expense; depreciation expense related to assets not used in manufacturing activities; bad debt charges and recoveries; professional fees for auditing and legal assistance; and general corporate expenses.

*Severance, retention, and lease exit costs* primarily relate to costs associated with the closure of administrative facilities and reductions in our administrative workforce. Severance, retention, and lease exit costs that relate to manufacturing activities are included in cost of goods sold.

*Related party management and consulting fees* consist of fees paid to affiliates of our majority stockholder. The services provided under these arrangements consist of management fees related to corporate development activities and consulting services for strategic and operational matters.

*Interest expense* relates to our senior credit facility, subordinated debt payable to an affiliate of our majority stockholder, and other debt obligations. Interest expense also includes the amortization of debt issuance costs and unused commitment fees that are charged for the portion of our credit facility that is not used from time to time.

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*Gain on sale of business unit* results from the sale of net assets for net proceeds that exceed the net carrying value of the assets sold.

**Results of Operations**

Our results of operations are affected by several factors, primarily the level and timing of customer orders (especially orders from our major customers). The level and timing of orders placed by a customer vary due to the customer's attempts to balance its inventory, changes in the customer's manufacturing strategy, and variations in demand for its products due to, among other things, product life cycles, competitive conditions, and general economic conditions. In the past, changes in orders from customers have had a significant effect on our results of operations. The following table sets forth certain operating data as a percentage of net sales for the quarters ended April 2, 2006 and April 1, 2007:

	<b>2006</b>	<b>2007</b>
Net sales	100.0%	100.0%
Cost of goods sold	91.6%	94.7%
Gross profit	8.4%	5.3%
Operating expenses:		
Selling, general, and administrative expenses	6.3%	6.8%
Severance, retention, and lease exit costs	0.2%	0.0%
Related party management and consulting fees	0.2%	0.3%
Operating income (loss)	1.7%	(1.8)%

**Comparison of Quarters Ended April 2, 2006 and April 1, 2007**

**Net Sales.** Net sales decreased \$30.6 million, or 32.0%, from \$95.8 million for the first quarter of 2006 to \$65.2 million for the first quarter of 2007. The decrease in net sales for the first quarter of 2007 was primarily attributable to decreases of \$16.3 million in our net sales to customers in the industrial sector, \$12.3 million in net sales to customers in the semiconductor capital equipment sector, and \$4.3 million in net sales to customers in the networking and telecommunication sector. The decrease in net sales was partially offset by increases of \$1.9 million in net sales to customers in the aerospace and defense sector and \$0.4 million in net sales to customers in the medical sector.

Net sales for the first quarter of 2006 and 2007 include approximately \$0.7 million and \$2.7 million, respectively, of excess inventories that were sold back to customers pursuant to provisions of our customer agreements.

For the first quarter of 2006, Honeywell accounted for 14% of our net sales, an industrial sector customer accounted for 16% of our net sales, and a customer in our semiconductor capital equipment sector accounted for 12% of our net sales. For the first quarter of 2007, Honeywell accounted for 22% of our net sales, a semiconductor capital equipment sector customer accounted for 15% of our net sales, and a customer in our industrial sector accounted for 10% of our net sales. No other customer accounted for more than 10% of our net sales for the first quarter of 2006 and 2007.

**Gross Profit.** Our gross profit decreased \$4.5 million from a profit of \$8.0 million in the first quarter of 2006 to a profit of \$3.5 million in the first quarter of 2007. Similarly, gross profit

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as a percentage of net sales decreased from a profit of 8.4% of net sales in the first quarter of 2006 to a profit of 5.3% of net sales in the first quarter of 2007. The decrease in gross profit in the first quarter of 2007 is primarily attributable to the reduction in net sales discussed above.

For the first quarter of 2007, we incurred restructuring costs of \$1.0 million, primarily related to the lease amendment for our Lawrence, Massachusetts facility, whereby we reduced our square footage and our future rental obligation by 77% in exchange for a cash payment of \$1.1 million. For the first quarter of 2006, restructuring costs related to our manufacturing activities were insignificant.

Through the first quarter of 2007 a significant amount of equipment became fully depreciated, although many of these assets are still in service. Accordingly, depreciation expense for the first quarter of 2007 declined by approximately \$0.8 million compared to the first quarter of 2006.

Inventory write-downs decreased \$0.4 million from \$1.1 million, or 1.2% of net sales, in the first quarter of 2006 to \$0.7 million, or 1.0% of net sales, in the first quarter of 2007. In both 2006 and 2007, write-downs of excess inventories are related to a variety of customers for which we do not expect to realize the carrying value through production or other means of liquidation.

**Selling, General, and Administrative Expenses.** Selling, general, and administrative expenses ( SG & A ) decreased \$1.7 million from \$6.1 million in the first quarter of 2006 to \$4.4 million in the first quarter of 2007. However, SG&A as a percentage of net sales increased from 6.3% in the first quarter of 2006 to 6.8% in the first quarter of 2007. The decrease in SG&A was attributable to a decrease of \$0.9 million in salaries and benefits due to a reduction in bonuses and in the size of our workforce. The decrease in SG&A was also attributable to a reduction in legal fees of \$0.5 million primarily related to the settlement of the litigation with Applied Materials, Inc. in the fourth quarter of 2006.

**Interest Expense.** Interest expense decreased \$1.7 million, from \$2.8 million in the first quarter of 2006 to \$1.1 million in the first quarter of 2007, primarily due to a charge of approximately \$1.4 million to eliminate the unamortized debt issuance costs associated with the early termination of our previous credit agreement. The decrease in interest expense was also attributable to a decrease in our weighted average borrowings, which was partially offset by higher interest rates. Our weighted average interest rate increased from 9.3% in the first quarter of 2006 to 11.8% in the first quarter of 2007, primarily reflecting increases in short term interest rates and the 16.9% effective interest rate associated with our \$10.0 million subordinated loan from an affiliate of the Company's majority stockholder. Our weighted average borrowings decreased from \$47.5 million for the first quarter of 2006 to \$32.5 million for the first quarter of 2007.

**Gain on Sale of Business Unit.** In February 2007, we sold our business unit located in Garner, Iowa for net proceeds of approximately \$4.4 million. The sales agreement provides that the buyer is required to pay additional consideration of up to \$0.6 million depending on the targeted level of net sales generated by this business unit in 2007. We recognized a gain of approximately \$0.4 million in the first quarter of 2007 and any additional consideration received will be recorded as an additional gain in the period that the targeted sales levels are achieved.

**Liquidity and Capital Resources**



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***Cash Flows from Operating Activities.*** Net cash used in operating activities in the first quarter of 2007 was \$6.7 million, compared with net cash used in operating activities of \$1.1 million in the first quarter of 2006. The difference between our net loss of \$1.7 million in the first quarter of 2007 and \$6.7 million of net cash used in operating activities was primarily attributable to an increase in trade receivables of \$7.8 million, a decrease in accounts payable of \$1.6 million and a decrease of \$1.1 million in other accrued liabilities, offset by \$0.7 million of depreciation and amortization, a decrease in inventories of \$4.1 million, and an increase in accrued compensation and benefits of \$0.7 million. For the first quarter of 2006, our net loss was equal to our negative operating cash flow.

Days sales outstanding (based on annualized net sales for the quarter and net trade receivables outstanding at the end of the quarter) increased to 65 days for the first quarter of 2007, compared to 51 days for the first quarter of 2006. The change in days sales outstanding for the first quarter of 2007 was primarily due to an increase in sales to customers who were not offered discounts for accelerated payment terms.

Inventories decreased 11.0% to \$49.9 million at April 1, 2007, compared to \$56.0 million at December 31, 2006. For the first quarter of 2007, inventory turns (annualized cost of goods sold excluding restructuring charges of \$1.0 million for the first quarter of 2007 and \$0.1 million for the first quarter of 2006, divided by quarter-end inventories) amounted to 4.9 times per year compared to 5.6 times per year for the comparable period in 2006.

***Cash Flows from Investing Activities.*** Net cash provided by investing activities for the first quarter of 2007 was \$4.2 million compared with net cash provided by investing activities of \$16.0 million in the first quarter of 2006. Investing cash flows for the first quarter of 2007 included \$4.4 million of net proceeds received from the sale of our business unit located in Garner, Iowa. Our cash inflows for investing activities were partially offset by capital expenditures of \$0.3 million, primarily for manufacturing equipment and leasehold improvements.

As discussed under Capital Resources below, investing cash flows for the first quarter of 2006 included \$16.7 million of net proceeds received from the sale of our building and land in Sugar Land, Texas. Our cash inflows for investing activities in the first quarter of 2006 were partially offset by payments of \$0.7 million, primarily for manufacturing equipment and leasehold improvements.

***Cash Flows from Financing Activities.*** Net cash provided by financing activities in the first quarter of 2007 was \$2.5 million, compared with net cash used in financing activities of \$14.8 million in the first quarter of 2006. Financing cash flows in the first quarter of 2007 reflect net borrowings of \$0.1 million and an increase in outstanding checks in excess of cash balances of \$2.5 million.

Financing cash flows in the first quarter of 2006 reflect the net repayment of debt of \$14.1 million and payment of \$0.8 million of debt issuance costs.

***Contractual Obligations.*** The following table summarizes our contractual obligations as of April 1, 2007:

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	<b>Debt</b>	<b>Operating</b>	<b>Purchase</b>	<b>Other</b>	<b>Total</b>
	<b>Agreements(1)</b>	<b>Leases</b>	<b>Obligations</b>	<b>(3)</b>	
			<b>(2)</b>		
	<b>(Dollars in Table are in Millions)</b>				
Year ending March 31:					
2008	\$ 22.5	\$ 3.8	\$ 32.9	\$ 0.3	\$ 59.5
2009		3.3		0.2	3.5
2010	11.8	2.8			14.6
2011		2.4			2.4
2012		2.2			2.2
After 2012		1.9			1.9
	\$ 34.3	\$ 16.4	\$ 32.9	\$ 0.5	\$ 84.1

(1) Includes outstanding letters of credit of \$2.0 million and outstanding borrowings under our US Bank revolving credit agreement of \$20.5 million. The US Bank senior credit agreement expires in March 2009 but all borrowings are classified as current liabilities due to the lenders requirement for a lockbox arrangement. Also includes \$11.8 million of principal plus accrued interest that is payable-in-kind under a subordinated

loan from an affiliate of our majority stockholder that is due in May 2009.

- (2) Consists of obligations under outstanding purchase orders. Approximately 84% of the deliveries under outstanding purchase orders are expected to be received in the second quarter of 2007. We often have the ability to cancel these obligations if we provide sufficient notice to our suppliers.

- (3) Consists of \$0.5 million payable under agreements for the acquisition of manufacturing equipment and software licenses.

Effective internal controls are necessary for us to provide reliable financial reports. We have commenced documentation of our internal control procedures in order to satisfy the requirements of Section 404 of the Sarbanes-Oxley Act of 2002, which requires annual management assessments of the effectiveness of our internal control over financial reporting. Effective December 31, 2007, we will be required to provide a report that contains an assessment by management of the effectiveness of our internal control over financial reporting. Effective December 31, 2008, our independent registered public accounting firm will be required to attest to and report on the effectiveness of our internal control over financial reporting. In order to become fully compliant with the requirements of Section 404, we estimate that we will need to incur between \$2.0 million and \$3.0 million for professional and other fees in 2007 compared to a nominal amount of such costs that were incurred in 2005 and 2006.

**Capital Resources.** Our working capital totaled \$37.8 million at December 31, 2006 and April 1, 2007. As discussed in detail below, during 2006 through the first quarter of 2007, we completed several major transactions to reduce our indebtedness, improve borrowing availability, reduce fixed overhead costs and improve plant capacity

utilization.

***Sale of Business Unit.*** In February 2007, we sold our business unit located in Garner Iowa which resulted in net proceeds of approximately \$4.4 million. This transaction resulted in a gain of approximately \$0.4 million.

***Sale of Sugar Land Real Estate.*** In January 2006, we obtained approval from our board of directors and lenders to enter into two separate agreements to sell our building and adjoining land in Sugar Land, Texas. We were able to structure the sale of the building with a concurrent agreement to leaseback approximately 50% of the building, which permitted our current business operations in Sugar Land to continue without interruption. The sale of the building was completed on March 30, 2006 and resulted in a net selling price of \$18.2 million.

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Concurrent with the building sale, we leased back approximately 50% of the building for a period of seven years. The annual rental payments under this lease are approximately \$1.5 million. The gain on the sale of \$0.8 million was deferred and is being accounted for as a reduction of rent expense over the seven-year term of the lease agreement. A cash deposit of \$1.5 million was withheld from the building sale proceeds to secure our obligations under the lease. The lease also required the issuance of letters of credit for \$1.5 million and \$0.5 million. The \$1.5 million cash deposit is required to be refunded and the letters of credit are required to be canceled upon expiration of the primary lease term. However, if we achieve any one of three quarterly financial tests beginning in the second quarter of 2007, the cash deposit is refundable at the rate of \$0.2 million each quarter that one of the tests is achieved until the cash deposit (plus interest) is fully refunded. At such time that the cash deposit is fully refunded, the \$1.5 million letter of credit shall be reduced by \$0.2 million for each succeeding quarter that one of the financial tests is achieved.

***Revolving Credit Agreement.*** At December 31, 2005, we had a \$75.0 million revolving credit facility that was scheduled to expire in July 2008. On March 30, 2006, we entered into a three-year senior credit agreement with US Bank. The US Bank credit agreement provides for a \$50.0 million commitment under a revolving credit facility that matures in March 2009. We have the option to terminate the credit agreement before the maturity date with a prepayment penalty of 1.0% of the commitment amount if the prepayment occurs before November 30, 2008. Under the terms of the US Bank credit agreement, we can initially elect to incur interest at a rate equal to either (a) the Prime Rate plus 0.50% or (b) the LIBOR Rate plus 3.00%. These rates can be reduced in the future by up to 0.50% for Prime Rate borrowings and 0.75% for LIBOR Rate borrowings depending on our adjusted fixed charge coverage ( FCC ) ratio, as defined in the credit agreement. As of April 1, 2007, the interest rate for Prime Rate borrowings was 8.75% and the effective rate for LIBOR Rate borrowings was 8.36%. In addition, we are obligated to pay a commitment fee of 0.25% per annum for the unused portion of the credit agreement. Due to the early termination of the previous credit agreement, we recognized a charge to interest expense of approximately \$1.4 million to write-off the remaining unamortized debt issuance costs in the first quarter of 2006.

Substantially all of our assets are pledged as collateral for outstanding borrowings under the US Bank senior credit agreement. The credit agreement also limits or prohibits us from paying dividends, incurring additional debt, selling significant assets, acquiring other businesses, or merging with other entities without the consent of the lenders. The credit agreement requires compliance with certain financial and non-financial covenants, including a rolling four-quarter adjusted FCC ratio.

Similar to our previous credit agreement, the US Bank credit agreement includes a lockbox arrangement that requires us to direct our customers to remit payments to restricted bank accounts, whereby all available funds are used to pay down the outstanding principal balance under the amended credit agreement. Accordingly, the entire outstanding principal balance under our credit agreement is classified as a current liability in our condensed consolidated balance sheets.

Total borrowings under the US Bank credit agreement are subject to limitation based on a percentage of eligible accounts receivable and inventories. Accordingly, our borrowing

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availability generally decreases as our net receivables and inventories decline. As of April 1, 2007, the borrowing base calculation permitted total borrowings of \$42.3 million. After deducting the outstanding principal balance of \$20.5 million and outstanding letters of credit of \$2.0 million, we had borrowing availability of \$19.8 million as of April 1, 2007.

**Second Lien Financing.** On March 30, 2006, we also entered into a \$10.0 million subordinated Note Purchase Agreement (the Second Lien Note ) with an affiliate of our majority stockholder. The Second Lien Note is collateralized by a second priority security interest in substantially all of the collateral under the US Bank credit agreement. The Second Lien Note is subordinated in right of payment to the obligations under the US Bank credit agreement and provides for a maturity date that is 45 days after the maturity date of the US Bank credit agreement. The Second Lien Note provides for an interest rate of 16.0%, payable quarterly in kind (or payable in cash with written approval from US Bank). We have the option to prepay the Second Lien Note with a prepayment penalty up to 3.0% of the then outstanding principal balance. If the Second Lien Note is paid on the maturity date, a fee equal to 2.0% of the then outstanding principal balance is due. Accordingly, we are recording interest expense related to this 2.0% fee using the effective interest method. Since interest is payable in kind, accrued interest is added to the principal balance each quarter which has resulted in an outstanding principal balance of \$11.8 million as of April 1, 2007.

In connection with the US Bank credit agreement, an affiliate of our majority stockholder also agreed to enter into an FCC maintenance agreement that requires the affiliate to make up to an additional \$5.0 million of subordinated loans to us if the FCC ratio is below a prescribed level. Loans pursuant to the FCC maintenance agreement would have similar terms as the Second Lien Note; however, the interest rate on such additional loans can be up to 18.0%. Prior to the end of the first quarter of 2007, our internal forecast indicated that the affiliate could be required to loan us between \$1.2 and \$2.0 to achieve compliance with the FCC covenant for the first quarter of 2007. However, our net sales for the quarter exceeded expectations which drove improved profitability and enabled us to avoid the need for an additional loan from the affiliate. We currently do not expect that additional loans will be required to achieve compliance with the FCC covenant for the remainder of 2007.

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**EBITDA Financial Covenant.** The primary measure of our operating performance is net income (loss). However, our lenders and many investment analysts believe that other measures of operating performance are relevant. One of these alternative measures is Earnings Before Interest, Taxes, Depreciation and Amortization ( EBITDA ). Management emphasizes that EBITDA is a non-GAAP measurement that excludes many significant items that are also important to understanding and assessing Suntron's financial performance. Additionally, in evaluating alternative measures of operating performance, it is important to understand that there are no standards for these calculations. Accordingly, the lack of standards can result in subjective determinations by management about which items may be excluded from the calculations, as well as the potential for inconsistencies between different companies that have similarly titled alternative measures. In order to illustrate our EBITDA calculations, we have provided the details below of the calculations for the quarters ended April 2, 2006 and April 1, 2007 using a traditional definition, as well as the calculation pursuant to the definition in our revolving credit agreement. For calculations related to compliance with financial covenants, our lenders have agreed to modify the traditional definition of EBITDA to exclude certain operating charges that may be considered unlikely to recur in the future or that may be excluded due to a variety of other reasons. As shown below, the measure of EBITDA under a traditional definition differs materially from the calculation of EBITDA for purposes of determining compliance with our financial covenants:

	<b>For the Quarter Ended:</b>	
	<b>April 2, 2006</b>	<b>April 1, 2007</b>
	<b>(Dollars in Millions)</b>	
Net loss	\$ (1.1)	\$ (1.7)
Income tax expense		
Interest expense	2.8	1.1
Depreciation and amortization	1.6	0.7
EBITDA per traditional definition	3.3	0.1
Restructuring costs <b>(A)</b>	0.2	1.1
Other charges <b>(B)</b>	0.8	(0.3)
EBITDA per credit agreement definition	\$ 4.3	\$ 0.9

**(A)** Restructuring costs include lease exit costs, and severance, retention, and moving costs related to facility closures and other reductions in workforce.

**(B)** Includes stock-based compensation expense, and net

gains from  
disposition of  
capital assets.  
For the first  
quarter of 2006,  
charges also  
include  
litigation costs  
related to the  
termination of  
our business  
relationship  
with Applied  
Materials.

**Impact of Recently Issued Accounting Standards**

In July 2006, the Financial Accounting Standards Board issued Interpretation No. 48 ( FIN 48 ), *Accounting for Uncertainty in Income Taxes* . FIN 48 is an interpretation of Statement of Financial Accounting Standards No. 109 , which provides criteria for the recognition, measurement, presentation and disclosures of uncertain tax positions. A tax benefit from an



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uncertain tax position may be recognized if it is more likely than not that the position is sustainable based solely on its technical merits. The provisions of FIN 48 are effective for fiscal years beginning after December 15, 2006.

Upon adoption of FIN 48 on January 1, 2007, we had no unrecognized tax benefits and we are not aware of any issues that would cause a significant increase to the amount of unrecognized tax benefits within the next year. Our policy is to recognize any interest or penalties as a component of income tax expense. Our material taxing jurisdictions are comprised of the U.S. federal jurisdiction and the states of Texas, Arizona, and Oregon. The tax years 2003 through 2006 remain open to examination by the U.S. federal jurisdiction, and tax years 2002 through 2006 remain open to examination for Texas, Arizona and Oregon.

In September 2006, the Financial Accounting Standards Board issued Statement No. 157, *Fair Value Measurements*. This new standard establishes a framework for measuring the fair value of assets and liabilities. This framework is intended to provide increased consistency in how fair value determinations are made under various existing accounting standards which permit, or in some cases require, estimates of fair market value. Statement No. 157 also expands financial statement disclosure requirements about a company's use of fair value measurements, including the effect of such measures on earnings. This statement is effective for fiscal years beginning after November 15, 2007. While we are currently evaluating the provisions of Statement No. 157, the adoption of which is not expected to have a material impact on our 2008 consolidated financial statements.

In February 2007, the FASB issued Statement No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities Including an amendment of FASB Statement No. 115*. This Statement permits entities to choose to measure many financial instruments at fair value. A business entity shall report unrealized gains and losses on items for which the fair value option has been elected in earnings at each subsequent reporting date. We will be required to adopt Statement No. 159 in the first quarter of the year ending December 31, 2008. While we are currently evaluating the provisions of Statement No. 159, the adoption is not expected to have a material impact on our 2008 consolidated financial statements.

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**Item 3. Quantitative and Qualitative Disclosures about Market Risk**

As of April 1, 2007, we had a revolving line of credit that provides for total borrowings of up to \$50.0 million. The interest rate under this credit agreement is based on the prime rate and LIBOR rates, plus applicable margins. Therefore, as interest rates fluctuate, we may experience changes in interest expense that will impact financial results. We have not entered into any interest rate swap agreements, or similar instruments, to protect against the risk of interest rate fluctuations. Assuming outstanding borrowings of \$50.0 million, if interest rates were to increase or decrease by one percentage point, the result would be an increase or decrease in annual interest expense of \$0.5 million. Accordingly, significant increases in interest rates could have a material adverse effect on our future results of operations.

**Item 4. Controls and Procedures**

Under the supervision and with the participation of our management, including our Chief Executive Officer and our Chief Financial Officer, we have evaluated the effectiveness of the design and operation of the Company's disclosure controls and procedures pursuant to Exchange Act Rule 13a-15 as of the end of the period covered by this report. Based upon that evaluation, our Chief Executive Officer and our Chief Financial Officer concluded that our disclosure controls and procedures are effective. There were no changes in our internal control over financial reporting during the quarter ended April 1, 2007, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Disclosure controls and procedures are designed to ensure that information required to be disclosed in our reports filed or submitted under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms. Disclosure controls and procedures include controls and procedures designed to ensure that information required to be disclosed in our reports filed under the Exchange Act is accumulated and communicated to management, including the Company's Chief Executive Officer and Chief Financial Officer as appropriate, to allow timely decisions regarding required disclosure.

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**PART II. OTHER INFORMATION**

**Item 1. Legal Proceedings**

Not Applicable

**Item 1A. Risk Factors**

*An investment in our common stock involves a high degree of risk. You should carefully consider the factors described below, in addition to those discussed elsewhere in this report, in analyzing an investment in our common stock. If any of the events described below occur, our business, financial condition, and results of operations could likely deteriorate, the trading price of our common stock could fall, and you could lose all or part of the money you paid for our common stock. In addition, the following factors could cause our actual results to differ materially from those projected in our forward-looking statements, whether made in this Form 10-Q, our annual or quarterly reports to stockholders, future press releases, other SEC filings, or orally, whether in presentations, responses to questions, or otherwise. See Statement Regarding Forward-Looking Statements.*

**Our level of indebtedness could adversely affect our financial viability, and the restrictions imposed by the terms of our debt instruments may severely limit our ability to plan for or respond to changes in our business.**

As of April 1, 2007, we had outstanding bank debt of approximately \$20.5 million, outstanding letters of credit of \$2.0 million, and subordinated debt payable to an affiliate of our majority stockholder of \$11.8 million. In addition, subject to the restrictions under our debt agreements, we may incur significant additional indebtedness from time to time to finance working capital requirements, capital expenditures, business acquisitions, or for other purposes. In connection with our bank debt, we have entered into a Fixed Charge Coverage Maintenance Agreement that would require us to borrow additional amounts from an affiliate of our majority stockholder if necessary to maintain compliance with the financial covenants in our credit agreement. We would be required to accept these loans which bear interest at an annual rate as high as 18.0%; even if we did not believe the funding was necessary to finance our business activities.

Significant levels of debt could have negative consequences. For example, it could:

require us to dedicate a substantial portion of our cash flow from operations to service interest and principal repayment requirements, limiting the availability of cash for other purposes;

increase our vulnerability to adverse general economic conditions by making it more difficult to borrow additional funds to maintain our operations if our revenues decrease;

limit our ability to attract new customers if we do not have sufficient liquidity to meet working capital needs; and

hinder our flexibility in planning for, or reacting to, changes in our business and industry if we are unable to borrow additional funds to upgrade our equipment or facilities.

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**We may need additional capital in the future and it may not be available on acceptable terms, or at all.**

We may need to raise additional funds for the following purposes:

to fund working capital requirements for future growth that we may experience;

to fund severance, lease exit, and other costs associated with restructuring efforts;

to enhance or expand the range of services we offer, including required capital equipment needs;

to increase our promotional and marketing activities; or

to respond to competitive pressures or perceived opportunities, such as investment, acquisition, and international expansion activities.

If such funds are not available when required or on acceptable terms, our business and financial results could deteriorate.

**We experience significant volatility in our net sales, which leads to significant operating inefficiencies and the potential for significant charges.**

Over the past five fiscal years, our quarterly net sales have fluctuated from a low of \$65.2 million in the first quarter of 2007 to a high of \$130.4 million in the second quarter of 2004. During periods of rapidly declining net sales, we generally take actions to eliminate variable and fixed costs, which often results in significant restructuring charges. When our net sales decline significantly, it is difficult to operate our plants profitably because it is not possible to eliminate most of our fixed costs. If we believe that the decline in sales is unlikely to be followed by a rapid recovery, we may determine that there are significant benefits to reducing our cost structure by closing plants and transferring existing business to other plants that are also operating below optimal capacity levels. However, there can be no assurance that customers impacted by a restructuring will agree to transition their business to another Suntron location. In order to realize the long-term benefits of these actions, we usually incur substantial charges for impairment of assets, lease exit costs, and the payment of severance and retention benefits to affected employees. In addition to the up-front costs associated with these actions, the transition of inventory and manufacturing services to a different facility can result in: (1) quality and delivery issues that may have an adverse impact in retaining customers that are affected by the plant closure and (2) ramp-up costs and manufacturing inefficiencies that could impact our gross profit levels. Our results of operations could also be materially and adversely affected by our inability to timely sell or sublet closed facilities on expected terms, or otherwise achieve the expected benefits of our restructuring activities.

During periods of rapidly increasing net sales, we often experience inefficiencies related to hiring and training workers, as well as incremental costs incurred to expedite the purchase and delivery of raw materials and overtime costs related to our workforce. Periods of rapid growth tend to stress our resources and we may not have sufficient capacity to meet our customers' delivery requirements. Significant increases in net sales are typically accompanied by corresponding increases in inventories and receivables that may be financed with borrowings under our revolving credit agreement.

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**We are dependent upon the highly competitive electronics industry, and excess capacity or decreased demand for products produced by this industry could result in increased price competition as well as a decrease in our gross margins and unit volume sales.**

Our business is heavily dependent on the EMS industry, which is extremely competitive and includes hundreds of companies. The contract manufacturing services we provide are available from many independent sources, and we compete with numerous domestic and foreign EMS firms, including Benchmark Electronics, Inc.; Celestica Inc; Flextronics International Ltd.; Jabil Circuit, Inc.; Plexus Corp.; Sanmina-SCI Corporation; SMTC Corporation; Solectron Corporation; Sypris Electronics, LLC; and others. Many of such competitors are more established in the industry and have greater financial, manufacturing, or marketing resources than we do. We may be operating at a cost disadvantage as compared to our competitors that have greater direct buying power from component suppliers, distributors, and raw material suppliers and have lower cost structures. In addition, many of our competitors have a broader geographic presence, including manufacturing facilities in Asia, Europe, and South America.

We believe that the principal competitive factors in our targeted market are quality, reliability, the ability to meet delivery schedules, price, technological sophistication, and geographic location. We also face competition from our current and potential customers, who are continually evaluating the relative merits of internal manufacturing versus contract manufacturing for various products. As stated above, the price of our services is often one of many factors that may be considered by prospective customers in awarding new business. We believe existing and prospective customers are placing greater emphasis on contract manufacturers that can offer manufacturing services in low cost regions of the world, such as certain countries in Asia. Accordingly, in situations where the price of our services is a primary driver in prospective customers' decision to award new business, we currently believe we may have a competitive disadvantage in these circumstances.

Our net sales are generated from the industrial, semiconductor capital equipment, aerospace and defense, networking and telecommunications, and medical sectors of the EMS industry, which is characterized by intense competition and significant fluctuations in product demand. Furthermore, these sectors are subject to economic cycles and have experienced in the past, and are likely to experience in the future, recessionary economic cycles. A recession or any other event leading to excess capacity or a downturn in these sectors of the EMS industry typically results in intensified price competition as well as a decrease in our unit volume sales and our gross margins.

**We are dependent upon a small number of customers for a large portion of our net sales, and a decline in sales to major customers could harm our results of operations.**

A small number of customers are responsible for a significant portion of our net sales. For the year ended December 31, 2006, Honeywell accounted for 16% of our net sales and a semiconductor capital equipment sector customer accounted for 11% of our net sales. For the first quarter of 2007, Honeywell accounted for 22% of our net sales, a semiconductor capital equipment sector customer accounted for 15% of our net sales, and a customer in our industrial sector accounted for 10% of our net sales.

Our customer concentration could increase or decrease depending on future customer requirements, which will depend in large part on business conditions in the market sectors in which our customers participate. The loss of one or more major customers or a decline in

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sales to our major customers could significantly harm our business and results of operations. If we are not able to expand our customer base, we will continue to depend upon a small number of customers for a significant percentage of our sales. There can be no assurance that current customers will not terminate their manufacturing arrangements with us or significantly change, reduce, or delay the amount of manufacturing services ordered from us.

In addition, we generate significant accounts receivable in connection with providing manufacturing services to our customers. From time to time we agree to accept orders from smaller, less creditworthy customers. While losses due to credit risk have not been a significant factor in the past, this trend may not continue in the future as we continue to diversify our major customer concentration with orders from smaller customers. If delinquencies related to our receivables increase in the future, this could adversely affect our borrowing capacity because accounts that are aged more than 90 days from the invoice date are ineligible for the borrowing base calculation under our revolving credit agreement. Finally, if one or more of our significant customers were to become insolvent or were otherwise unable to pay for our services, our results of operations could deteriorate substantially.

**Our customers may cancel their orders, change production quantities, or delay production.**

EMS providers must provide increasingly rapid product turnaround for their customers. We generally do not obtain firm, long-term purchase commitments from our customers, and we expect to continue to experience reduced lead-times for customer orders. Customers may cancel their orders, change production quantities, or delay production for a number of reasons. Cancellations, reductions, or delays by a significant customer or by a group of customers could seriously harm our results of operations. When customer orders are changed or cancelled, we may be forced to hold excess inventories and incur carrying costs as a result of delays, cancellations, or reductions in orders or poor forecasting by our key customers.

In addition, we make significant decisions, including determining the levels of business that we seek and accept, production schedules, component procurement commitments, personnel needs, and other resource requirements based on estimates of customer production requirements. The short-term nature of our customers' commitments to us, combined with the possibility of rapid changes in demand for their products, reduces our ability to accurately estimate future customer orders. In addition, because many of our costs and operating expenses are relatively fixed, a reduction in customer demand generally harms our operating results.

**If we are unable to respond to rapid technological change and process development, we may not be able to compete effectively.**

The market for our products and services is characterized by rapidly changing technology and continual implementation of new production processes. The future success of our business will depend in large part upon our ability to maintain and enhance our technological capabilities, to develop and market products that meet changing customer needs, and to successfully anticipate or respond to technological changes on a cost-effective and timely basis. We expect that the investment necessary to maintain our technological position will increase as customers make demands for products and services requiring more advanced technology on a quicker turnaround basis.

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In addition, the EMS industry could encounter competition from new or revised manufacturing and production technologies that render existing manufacturing and production technology less competitive or obsolete. We may not be able to respond effectively to the technological requirements of the changing market. Recent new environmental requirements implemented by the European Community ( EC ) and China require the use of lead-free chemicals to manufacture electronic sub-assemblies. New production technology and equipment is required to manufacture products that conform to these new specifications. While we have implemented a dual process capability (leaded and lead-free) at all sites, additional changes in the environmental laws may impact our future production capabilities. If we need new technologies and equipment to remain competitive, the development, acquisition and implementation of those technologies may require us to make significant capital investments.

**Operating in foreign countries exposes us to increased risks that could adversely affect our results of operations.**

We have had operations in Mexico since 1999 and we intend to expand in the future into other foreign countries. Because of the scope of our international operations, we are subject to the following risks, which could adversely impact our results of operations:

economic or political instability;

transportation delays and interruptions;

increased employee turnover and labor unrest;

incompatibility of systems and equipment used in foreign operations;

foreign currency exposure;

difficulties in staffing and managing foreign personnel and diverse cultures; and

less developed infrastructures.

In addition, changes in policies by the United States or foreign governments could negatively affect our operating results due to increased duties, increased regulatory requirements, higher taxation, currency conversion limitations, restrictions on the transfer of funds, the imposition of or increase in tariffs, and limitations on imports or exports. Also, we could be adversely affected if our host countries revise their policies away from encouraging foreign investment or foreign trade, including tax holidays.

**If we are unsuccessful in managing future opportunities for growth, our results of operations could be harmed.**

Our future results of operations will be affected by our ability to successfully manage opportunities for growth. Rapid growth is likely to place a significant strain on our managerial, operational, financial, and other resources. If we experience extended periods of rapid growth, it may require us to implement additional management information systems, to further develop our operating, administrative, financial, and accounting systems and controls and to maintain close coordination among our accounting, finance, sales and marketing, and customer service and support departments. In addition, we may be required to retain additional personnel to adequately support our growth. If we cannot effectively manage periods of rapid growth in our operations, we may not be able to continue to grow, or we may grow at a slower pace. Any failure to successfully manage growth and to develop financial controls and accounting and operating systems or to add and retain personnel that adequately support growth could harm our business and financial results.

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**Our results of operations are affected by a variety of factors, which could cause our results of operations to fail to meet expectations.**

We have experienced large variations in our quarterly results of operations, and we may continue to experience significant fluctuations from quarter to quarter. Our results of operations are affected by a number of factors, including:

- timing of orders from and shipments to major customers;
- mix of products ordered by major customers;
- volume of orders as related to our capacity at individual locations;
- pricing and other competitive pressures;
- component shortages, which could cause us to be unable to meet customer delivery schedules;
- our ability to minimize excess and obsolete inventory exposure;
- our ability to manage the risks associated with uncollectible accounts receivable;
- our ability to manage effectively inventory and fixed asset levels;
- changing environmental laws affecting component chemistry and process changes needed to meet these new requirements; and
- timing and level of goodwill and other long-lived asset impairments.

**We are dependent on limited and sole source suppliers for electronic components and may experience component shortages, which could cause us to delay shipments to customers.**

We are dependent on certain suppliers, including limited and sole source suppliers, to provide critical electronic components and other materials for our operations. At various times, there have been shortages of some of the electronic components we use, and suppliers of some components have lacked sufficient capacity to meet the demand for these components. For example, from time to time, some components we use, including semiconductors, capacitors, and resistors, have been subject to shortages, and suppliers have been forced to allocate available quantities among their customers. Such shortages have disrupted our operations in the past, which resulted in late shipments of products to our customers. Our inability to obtain any needed components during future periods of allocations could cause delays in shipments to our customers. The inability to make scheduled shipments could in turn cause us to experience a shortfall in revenue. Component shortages may also increase our cost of goods sold due to premium charges we may pay to purchase components in short supply. Accordingly, even though component shortages have not had a lasting negative impact on our business, component shortages could harm our results of operations for a particular fiscal period due to the resulting revenue shortfall or cost increases and could also damage customer relationships over a longer-term period.



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**We depend on our key personnel and may have difficulty attracting and retaining skilled employees.**

Our future success will depend to a significant degree upon the continued contributions of our key management, marketing, technical, financial, accounting, and operational personnel. The loss of the services of one or more key employees could have a material adverse effect on our results of operations. We also believe that our future success will depend in large part upon our ability to attract and retain additional highly skilled managerial and technical resources. Competition for such personnel is intense. There can be no assurance that we will be successful in attracting and retaining such personnel. In addition, recent and potential future facility shutdowns and workforce reductions may have a negative impact on employee recruiting and retention.

**Our manufacturing processes depend on the collective EMS industry experience of our employees. If these employees were to leave and take this knowledge with them, our manufacturing processes may suffer and we may not be able to compete effectively.**

We do not have any patent or trade secret protection for our manufacturing processes and generally we do not enter into non-compete agreements with our employees. We rely on the collective experience of our employees to ensure that we continuously evaluate and adopt new technologies in our industry. Although we are not dependent on any one employee or a small number of employees, if a significant number of employees involved in our business were to leave our employment and we are not able to replace these people with new employees with comparable experience, our results of operations may deteriorate. As a result, we may not be able to continue to compete effectively.

**Our failure to comply with the requirements of environmental laws could result in fines and revocation of permits necessary to our manufacturing processes.**

Our operations are regulated under a number of federal, state, and foreign environmental and safety laws and regulations that govern, among other things, the discharge of hazardous materials into the air and water, as well as the handling, storage, and disposal of such materials. These laws and regulations include the Clean Air Act; the Clean Water Act; the Resource Conservation and Recovery Act; and the Comprehensive Environmental Response, Compensation, and Liability Act; as well as analogous state and foreign laws. Compliance with these environmental laws is a major consideration for us because our manufacturing processes use and generate materials classified as hazardous, such as ammoniacal etching solutions, copper, and nickel. In addition, because we use hazardous materials and generate hazardous wastes in our manufacturing processes, we may be subject to potential financial liability for costs associated with the investigation and remediation of our own sites or sites at which we have arranged for the disposal of hazardous wastes, if such sites become contaminated. Even if we fully comply with applicable environmental laws and are not directly at fault for the contamination, we may still be liable. The wastes we generate include spent ammoniacal etching solutions, solder stripping solutions, and hydrochloric acid solutions containing palladium; waste water that contains heavy metals, acids, cleaners, and conditioners; and filter cake from equipment used for on-site waste treatment. We have not incurred significant costs related to compliance with environmental laws and regulations, and we believe that our operations comply with all applicable environmental laws. However, any material violations of environmental laws could subject us to revocation of our effluent discharge and other environmental permits. Any such revocations could require us to cease or

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limit production at one or more of our facilities. Even if we ultimately prevail, environmental lawsuits against us could be time consuming and costly to defend.

Environmental laws could also become more stringent over time, imposing greater compliance costs and increasing risks and penalties associated with violation. We operate in environmentally sensitive locations and are subject to potentially conflicting and changing regulatory agendas of political, business, and environmental groups. Changes or restrictions on discharge limits; emissions levels; or material storage, handling, or disposal might require a high level of unplanned capital investment or relocation. It is possible that environmental compliance costs and penalties from new or existing regulations may harm our business, financial condition, and results of operations.

**We may be subject to risks associated with acquisitions, and these risks could harm our results of operations.**

We completed two business combinations in 2002 and one each in 2003 and 2004, and we anticipate that we will seek to identify and acquire additional suitable businesses in the EMS industry. The long-term success of business combinations depends upon our ability to unite the business strategies, human resources, and information technology systems of previously separate companies. The difficulties of combining operations include the necessity of coordinating geographically separated organizations and integrating personnel with diverse business backgrounds. Combining management resources could result in changes affecting all employees and operations. Differences in management approach and corporate culture may strain employee relations.

Future business combinations could cause certain customers to either seek alternative sources of product supply or service, or delay or change orders for products due to uncertainty over the integration of the two companies or the strategic position of the combined company. As a result, we may experience some customer attrition.

Acquisitions of companies and businesses and expansion of operations involve certain risks, including the following:

- the business fails to achieve anticipated revenue and profit expectations;

- the potential inability to successfully integrate acquired operations and businesses or to realize anticipated synergies, economies of scale, or other value;

- diversion of management's attention;

- difficulties in scaling up production and coordinating management of operations at new sites;

- the possible need to restructure, modify, or terminate customer relationships of the acquired business;

- loss of key employees of acquired operations;

- the potential liabilities of the acquired businesses; and

- the possibility of impairment charges for goodwill related to acquisitions.

Accordingly, we may experience problems in integrating the operations associated with any future acquisition. We therefore cannot provide assurance that any future acquisition will result in a positive contribution to our results of operations. In particular, the successful combination with any businesses we acquire will require substantial effort from each

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company, including the integration and coordination of sales and marketing efforts. The diversion of the attention of management and any difficulties encountered in the transition process, including the interruption of, or a loss of momentum in, the activities of any business acquired, problems associated with integration of management information and reporting systems, and delays in implementation of consolidation plans, could harm our ability to realize the anticipated benefits of any future acquisition. In addition, future acquisitions may result in dilutive issuances of equity securities, the incurrence of additional debt, significant inventory write-offs, and the creation of goodwill or other intangible assets that could ultimately result in increased impairment or amortization expense.

**Failure to maintain an effective system of internal controls in accordance with Section 404 of the Sarbanes-Oxley Act could inhibit our ability to accurately report our financial results and have a material adverse impact on our business and stock price.**

Effective internal controls are necessary for us to provide reliable financial reports. We have in the past discovered, and may in the future discover, areas of our internal controls that need improvement. We have commenced documentation of our internal control procedures in order to satisfy the requirements of Section 404 of the Sarbanes-Oxley Act of 2002, which requires annual management assessments of the effectiveness of our internal control over financial reporting. Effective December 31, 2007, we will be required to provide a report that contains an assessment by management of the effectiveness of our internal control over financial reporting. Effective December 31, 2008, our independent registered public accounting firm must attest to and report on the effectiveness of our internal control over financial reporting. During the course of our testing we may identify deficiencies which we may not be able to remediate in time to meet the upcoming deadlines imposed by the Sarbanes-Oxley Act of 2002 for compliance with the requirements of Section 404. Failure to achieve and maintain effective internal control over financial reporting could have a material adverse effect on our stock price.

**Our stock is traded on the Nasdaq SmallCap Market and if we are unable to sustain compliance with their listing requirements this could adversely impact our ability to use the capital markets to raise additional capital and our stockholders may be unable to efficiently sell their shares of our common stock.**

Our stock is currently being traded on the Nasdaq SmallCap Market. There can be no assurance that we will continue to meet the listing requirements of the Nasdaq SmallCap market, including the requirement to maintain a minimum bid price of \$1.00 per share. If we are unable to sustain compliance with their listing requirements, this could adversely impact our ability to use the capital markets to raise additional capital and our stockholders may be unable to efficiently sell their shares of our common stock.

**Our stock price may be volatile, and our stock is thinly traded, which could cause investors to lose all or part of their investments in our common stock.**

The stock market may experience volatility that has often been unrelated to the operating performance of any particular company or companies. If market sector or industry-based fluctuations continue, our stock price could decline regardless of our actual operating performance, and investors could lose a substantial part of their investments. Moreover, if an active public market for our stock is not sustained in the future, it may be difficult to resell our stock.

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Since March 2002 when Suntron shares began trading, the average number of shares of our common stock that traded on the Nasdaq National and SmallCap markets has been approximately 8,000 shares per day compared to approximately 27,592,000 issued and outstanding shares as of April 1, 2007. When trading volumes are this low, a relatively small buy or sell order can result in a large percentage change in the trading price of our common stock, which may be unrelated to changes in our stock price that are associated with our operating performance.

The market price of our common stock will likely fluctuate in response to a number of factors, including the following:

announcements about the financial performance and prospects of the industries and customers we serve;

announcements about the financial performance of our competitors in the EMS industry;

the timing of announcements by us or our competitors of significant contracts or acquisitions;

failure to meet the performance estimates of securities analysts;

changes in estimates of our results of operations by securities analysts; and

general stock market conditions.

**Our major stockholder controls us and our stock price could be influenced by actions taken by this stockholder. Additionally, this stockholder could prevent a change of control or other business combination, or could effect a short form merger without the approval of other stockholders.**

Thayer-Blum owns approximately 90% of our common stock, and five of our ten directors are representatives of Thayer-Blum. In addition, during the first quarter of 2006, we borrowed \$10.0 million from an affiliate of Thayer-Blum. The interests of Thayer-Blum may not always coincide with those of our other stockholders, particularly if Thayer-Blum decides to sell its controlling interest. In addition, Thayer-Blum will have sufficient voting power (without the approval of Suntron's other stockholders) to elect the entire Board of Directors of Suntron and, in general, to determine the outcome of various matters submitted to stockholders for approval, including fundamental corporate transactions. Thayer-Blum could cause us to take actions that we would not consider absent Thayer-Blum's influence, or could delay, deter, or prevent a change of control or other business combination that might otherwise be beneficial to our other stockholders.

In addition, Thayer-Blum could contribute its Suntron stock to a subsidiary corporation that, as a 90% stockholder, then would have the ability under Delaware law to merge with or into Suntron without the approval of the other Suntron stockholders. In the event of such a short-form merger, Suntron stockholders would have the right to assert appraisal/dissenters' rights to receive cash in the amount of the fair market value of their shares in lieu of the consideration they would have otherwise received from the transaction.

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**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

Not Applicable.

**Item 3. Defaults Upon Senior Securities**

Not Applicable.

**Item 4. Submission Of Matters To A Vote Of Security Holders**

Not Applicable

**Item 5. Other Information**

Not Applicable

**Item 6. Exhibits**

The following exhibits are filed with this report:

- Exhibit 10.19 Lease Modification Agreement, effective as of March 1, 2007, between EFTC Operating Corp. and H.J. Brooks, L.L.C.
- Exhibit 31.1 Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes- Oxley Act of 2002
- Exhibit 31.2 Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- Exhibit 32.1 Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
- Exhibit 32.2 Certification of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

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**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this Report to be signed on its behalf by the undersigned, thereunto duly authorized.

**SUNTRON CORPORATION**

(Registrant)

Date: May 16, 2007

/s/ Hargopal Singh

Hargopal Singh  
*Chief Executive Officer*

Date: May 16, 2007

/s/ Thomas B. Sabol

Thomas B. Sabol  
*Chief Financial Officer*

Date: May 16, 2007

/s/ James A. Doran

James A. Doran  
*Chief Accounting Officer*

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