

INNOVEX INC
Form 10-K
December 10, 2002

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

Washington, DC 20549

FORM 10-K

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

For the fiscal year ended September 30, 2002

or

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

Commission File No. 0-13143

INNOVEX, INC.

(Exact name of registrant as specified in its charter)

Minnesota
(state or other jurisdiction of
incorporation or organization)

41-1223933
(IRS Employer
Identification No.)

5540 Pioneer Creek Drive
Maple Plain, Minnesota
(Address of principal executive offices)

55359-9003
(Zip Code)

Registrant's telephone number, including area code: (763) 479-5300

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

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

(Title of Class)
Common Stock (\$.04 par value)

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

(Title of Class)Common Stock (\$.04 par value)

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Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (S229.405 of this chapter) is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

The aggregate market value of the voting stock held by non-affiliates of the Registrant was approximately \$49,937,000 at November 15, 2002 when the closing sale price of such stock, as reported in the Nasdaq National Market System, was \$3.50.

The number of shares outstanding of the Registrant's Common Stock, \$.04 par value, as of November 15, 2002 was 15,151,975 shares.

Documents Incorporated by Reference:

1. Portions of the Registrant's Proxy Statement to be filed with the Commission within 120 days after the end of the Registrant's fiscal year are incorporated by reference into Part III of the Form 10-K.

INNOVEX, INC. 2002 Form 10-K

PART I

ITEM 1. BUSINESS

(a) GENERAL DEVELOPMENT OF BUSINESS

Prior to fiscal 1999, Innovex, Inc. and its subsidiaries (the Company) primarily operated through two divisions, Precision Products (Precision) and Litchfield Precision Components (LPC). Each division had its own administrative, engineering, manufacturing and marketing organizations. During the quarter ending September 30, 1998, the Company combined the operations of its two core operating divisions, Precision and LPC into one operating division, Innovex Precision Components. The combination merged the rapidly growing LPC flexible circuit fabrication and chemical etching operations with Precision's high volume fine wire manufacturing expertise. The combination also allowed Innovex to leverage Precision's disk drive industry market and trade knowledge to disk drive industry flexible circuit applications as the industry transitioned from wire interconnects.

Prior to the divisional combination, the largest division, Precision, developed, engineered and manufactured specialty precision electromagnetic products for original equipment manufacturers (OEMs). Lead wire assemblies for the thin film disk drive market were the division's primary product. Lead wire assemblies are fine twisted magnet wires that connect the back end electronics of a disk drive with the inductive or magneto resistive thin film heads that read and write information on the disk. After the divisional combination, the lead wire assembly revenue declined as anticipated. As a result, during the fiscal 1999 fourth quarter, charges of \$2.8 million were recorded to account for the discontinuance of this product line.

LPC, prior to the fiscal 1998 divisional combination, designed and manufactured highly complex flexible circuitry and chemically machined components for computer, computer peripheral, medical and other applications. The Company purchased Litchfield Precision Components, Inc. on May 16, 1996. This acquisition reduced the Company's reliance on the disk drive industry while providing an entry into the large and rapidly growing flexible circuit market.

The Company purchased all of the outstanding shares of ADFlex Solutions, Inc. (ADFlex) in two parts on August 9, 1999 and September 14, 1999. The total ADFlex purchase price, including transaction costs, change in control payments and all of the issued and outstanding common stock was approximately \$37 million. At that time, the Company also obtained credit facilities totaling in principal amount \$40 million, which were utilized to refinance ADFlex's outstanding debt, pay down current liabilities and pay related transaction costs. Prior to the acquisition, ADFlex was a leading supplier of flexible circuit based solutions to the computer, computer peripheral, communications and consumer electronics industries. Applications for these flex-based interconnects include cellular phones, hard disk drives, other storage systems, high-end consumer products, notebook computers, pagers and personal communication systems. ADFlex's diverse customer and industry base has reduced

(a) GENERAL DEVELOPMENT OF BUSINESS

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Innovex's reliance on the disk drive industry. Prior to the ADFlex acquisition, the Company had one primary operating group, Innovex Precision Components. The Company combined its operations into one group that designs and manufactures flexible circuits.

On November 27, 2002, the Company entered into an Option Agreement with Concorde PAPE II (Concorde), pursuant to which Concorde granted to the Company an option to acquire shares of KRP Precision Public Company Limited (KRP) representing 24.9% of the issued and outstanding shares of KRP. Currently, Concorde owns approximately 55.7% of the shares of KRP. The option is exercisable in the discretion of the Company at any time on or prior to December 31, 2003. Payment of the exercise price is due in shares of Company common stock. If exercised, the Company will deliver shares of its common stock in exchange for the KRP shares. In addition, if the Company exercises this option, Concorde will grant the Company a second option to purchase the remaining shares of KRP owned by Concorde. In the event the second option is not exercised, Concorde may require the Company to purchase its KRP shares under certain circumstances. Further, in the event the Company exercises its second option, the Company may be required to make a general offer to purchase KRP shares from KRP shareholders.

Innovex, Inc. was incorporated under the laws of the State of Minnesota in 1972. Its principal executive offices are located at 5540 Pioneer Creek Drive, Maple Plain, Minnesota 55359-9003 and its telephone number is (763) 479-5300. Products are developed and manufactured through the Company's wholly owned subsidiaries, Innovex Precision Components, Inc. and Innovex (Thailand) Ltd. Innovex Precision Components, Inc. is a Minnesota corporation and Innovex (Thailand) Ltd. is a Thailand corporation.

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(b) FINANCIAL INFORMATION ABOUT INDUSTRY SEGMENTS

Prior to the ADFlex acquisition, the Company had one major operating unit during fiscal 1999. The Company currently consists of one segment that manufactures and markets flexible circuits to various industries and financial results will be presented as a single segment. Topics covered throughout this document may be discussed referencing former separate operations where helpful to the reader's understanding.

(c) NARRATIVE DESCRIPTION OF BUSINESS

Company Overview

Innovex is a leading worldwide provider of flexible circuit interconnect solutions to OEMs in the electronics industry. The Company offers a full range of customized flexible circuit applications and services from initial design, development and prototype to fabrication, assembly and test on a global basis. The Company targets high-volume markets where miniaturization, form and weight are driving factors and flexible circuits are an enabling technology. Applications for flexible circuits currently addressed by the Company include notebook computers, LCD displays for portable communication devices, data storage devices such as hard disk drives (HDDs), tape drives and arrays, high-end consumer electronics products such as digital video disk(DVD) and compact disk(CD) players and printers. The Company's principal customers include 3M, Alps, Compaq, Dell, Hewlett Packard, IBM, Iomega, Littelfuse, Maxtor, Medtronic, Motorola, Nokia, Philips, Qualcomm, Quantum, ReadRite, SAE Magnetics, Samsung, Seagate, Staktek, StorageTek, Xerox and other leading electronic OEMs.

Flexible circuits consist of copper conductive patterns on flexible substrate materials, such as polyimide, and provide electrical connection between components in electronic systems. Flexible circuit interconnects frequently incorporate components such as integrated circuits (ICs), connectors, stiffeners, resistors and capacitors mounted directly on a flexible circuit. With proliferation of electronic applications, electronic products have become smaller, lighter and more portable. To meet the challenges represented by the increased complexity of miniaturization, form and weight requirements, OEMs have increasingly turned to flexible circuit interconnect solutions because they decrease the weight and expense of connectors and

other packaging components, conform to contoured, ergonomic shapes or small spaces and provide mechanical flexure. The Company's products consist of flexible circuits with high to mid-range tolerances and may include other secondary finishing or assembly operations. The high-end flexible circuits generate the highest gross margin percentages. The mid-range or standard flexible circuits with components added through the performance of additional assembly steps garner lower gross margin percentages due to higher material costs and the increased number of competitors.

Prior to 1999, the Company's primary products were small lead wire assemblies for computer disk drives. The disk drive industry has transitioned away from lead wire assembly interconnects to integrated interconnects such as the Company's Head Interconnect Flex (HIF) and Flex suspension assembly (FSA) products. This transition has had a significant impact on the Company's operations since 1998 as it has had to manage the rapid increase in its flexible circuit business while controlling the rapid drop in its lead wire assembly operations. Lead wire assembly sales constituted none of fiscal 2002 and 2001 consolidated revenues and less than 1% of fiscal 2000 revenues after comprising over 72% of fiscal 1998 revenues.

While the trend toward miniaturization and portability increases product complexity, electronic OEMs face escalating time to market, cost and global sourcing requirements. In response, the Company has established manufacturing facilities in Thailand that have lower cost structures and closer proximity to the Company's OEM customer base. The Company believes it is a preferred supplier for the majority of its customers' high-end, high-volume flexible circuit interconnect requirements.

Industry Overview and Trends

Flexible circuit interconnects provide electrical connection between components in electronic systems and are increasingly used as a platform to support the attachment of electronic devices. Flexible circuits offer several advantages over rigid printed circuit boards (PCBs) and ceramic hybrid circuits, particularly for small, complex electronic systems. Flexible circuits, due to their mechanical flexure and three-dimensional shape, accommodate packaging contours and motion in a manner that traditional two-dimensional rigid PCBs cannot. Flexible circuits also provide improved thermal dissipation and signal propagation as compared to PCBs. In addition, flexible circuits can reduce the size, weight and expense of: (i) the primary substrate for component attachment when flexible circuits are used in place of a PCB; (ii) connectors, cables and other interconnection schemes when flexible circuits provide the connection to other substrates or subsystems within the system; and (iii) individual IC die packages by bonding an IC directly to a flexible chip carrier rather than a ceramic or plastic package.

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These capabilities enable circuits to solve many of the challenges faced by electronic OEMs who currently use traditional interconnection devices. Products which currently use polyimide flexible circuit interconnect assemblies include notebook computers, portable communication devices, printers, scanners and data storage devices such as HDDs, tape drives and arrays, and high-end consumer electronic products such as DVD and CD disk players, cameras and camcorders.

The Company considers the following trends important in understanding the electronic flexible circuit interconnect industry:

Miniaturization, Portability and Complexity of Electronic Products. Electronics OEMs continue to design and introduce more compact and portable high-performance products with greater functionality. The complexity of these new products requires smaller size, lighter weight, greater circuit and component density, better thermal dissipation properties, higher frequencies and increased reliability as compared to conventional rigid board assemblies. These requirements necessitate greater sophistication in flexible circuit interconnect manufacturing and process technologies. The trend toward increasingly sophisticated products also requires greater engineering expertise and investment in manufacturing and process technology for suppliers to produce high-quality electronic interconnect products on time, in volume and at acceptable cost.

Shorter Product Life Cycles and Time to Market. Rapid advances in technology have significantly shortened the life cycle of complex electronic products and placed increased pressure on OEMs to quickly develop and introduce new products. These time-to-market challenges have in turn increased OEMs' emphasis on the development, design engineering, prototype development and ramp-to-volume capabilities of their suppliers. In addition, the importance of being first to market with new

products has heightened the emphasis on shortening supply channels, reducing the number of suppliers and finding turnkey sourcing capabilities that are supported by technologically advanced manufacturing infrastructure.

Globalization and Reduction of Manufacturing Costs. At the same time that shorter product life cycles increase time-to-market pressures, users continue to demand increased electronic performance at lower prices. Notable product examples of this trend are notebook computers, desktop computers, peripherals, portable communications and consumer electronics. Leading OEMs who often manufacture products in multiple geographic regions are relying more on suppliers with global sourcing capabilities which can help to shorten the OEMs' supply chain and provide regionally competitive pricing. As part of global sourcing, OEMs increasingly require their suppliers to establish local infrastructure to provide proximity to engineering, manufacturing and sales support.

Outsourcing. To avoid delays in new product introductions, reduce manufacturing costs and avoid logistical complexities, OEMs are increasingly turning to fewer suppliers which are capable of producing electronic interconnect products from development, design, quick-turn prototype and pre-production through volume production and assembly. Many OEMs have accelerated this process by outsourcing their captive component, subsystem and even system manufacturing to focus on their core competencies. The accelerated time-to-market and time-to-volume needs of OEMs have resulted in increased collaboration with qualified suppliers capable of providing a broad and integrated offering. To meet their rapidly changing electronic interconnect requirements, many OEMs have moved to limit their vendor base to a smaller number of technically qualified, strategically located suppliers capable of providing both quick-turn prototype and pre-production quantities as well as cost-competitive volume production quantities.

Current Product Applications

The Company provides flexible circuit interconnect products to a diverse group of markets. Historically, the HDD market has represented the largest component of the Company's sales at 74%, 68%, and 59% of total sales for 2002, 2001 and 2000. Through the ADFlex acquisition and new market expansion efforts, the Company is continuing its efforts to reduce the impact of cyclical nature of the HDD industry on its business. However, net sales attributable to this market are expected to continue to represent a large component of total sales for the foreseeable future. Accordingly, the occurrence of significant slowdowns or changes in this industry has had and may continue to have a material adverse effect on the Company's operating results.

Current applications addressed by the Company include:

Flex Suspension Assembly. The disk drive market uses flexible circuits as the interconnect between the read/write head and disk drive electronics. In these applications, circuits need to mechanically flex hundreds of millions of times through the life of the drive. These applications include the Company's head interconnect flex (HIF) and Flex Suspension Assembly (FSA) which provide the electrical interconnect from the disk drive head to the back end electronics (actuator flex) of the disk drive. The HIF is bonded to a disk drive suspension by the Company's customers. The FSA is a HIF that is bonded to a suspension for customers desiring a more complete solution. During fiscal 2001, the Company introduced the Flex Gimbal Suspension Assembly (FgSA). The FgSA is the next generation FSA that provides improved technical performance at a lower cost than competing products by increasing the utilization of the flexible circuit characteristics and simplifying the suspension used in the assembly. These interconnects were provided by lead wire assemblies produced by the Company prior to the use of flexible circuits.

Data Storage. The data storage market includes interconnects used for tape drives, disk arrays, CD and DVD applications and other interconnects in hard disk drives. Large individual drive storage systems are being replaced by arrays of less expensive disk drives or tape drives. The growth of personal computer networks has generated a growth in small arrays for local area network storage. In addition to the flexible circuit interconnects inside each of the individual drives, controlled impedance flex interconnects are used to connect the back of the drives to standard interface boards. The Company also produces the actuator flex which provides the back end electronic interconnect for hard disk drives. Mounting an unpackaged die directly onto the flexible circuit substrate, or flip chip, is becoming the predominant interconnect technology for these applications. CD and DVD consumer applications are growing rapidly. These devices use flexible circuits as the interconnect

between the read/write head and CD/DVD drive electronics.

New Ventures. The new venture markets include flexible circuits for integrated circuit substrates, optoelectronic interconnects for broadband applications, hand held color liquid crystal displays, plasma displays, laptop computers, various solid ink and ink jet printer applications, etched metal fuses and other high-end flexible circuits markets. These markets are projected to have rapid growth in the future and the Company is producing increasing levels of flexible circuits for these markets.

Sales and Support

The Company markets its products directly to a number of industries requiring electronic interconnects through the use of an internal sales staff. In addition, the Company utilizes sales representatives on a limited basis in several Asian countries where it is advantageous to be represented locally. Historically, the Company has sold a substantial portion of its flexible circuit interconnects to a limited number of customers. Innovex has benefited from early entry as a supplier to the disk drive industry and has been able to leverage relationships to the next generation integrated flexible circuit interconnects. This, coupled with the Company's reputation for high standards of quality and innovative manufacturing processes, has established Innovex as a predominant supplier of interconnects for the industry. The Company's principal customers, each accounting for over 10 percent of the Company's consolidated net sales in at least one of the last three years are Maxtor and Seagate. See Note H of Notes to Consolidated Financial Statements for additional information.

Because of the Company's focus on leading edge imaging technology, its customers include a number of the leading technology companies in the world including 3M, Alps, Compaq, Dell, Hewlett Packard, IBM, Iomega, Littelfuse, Maxtor, Medtronic, Motorola, Nokia, Philips, Qualcomm, Quantum, ReadRite, SAE Magnetics, Samsung, Seagate, Staktek, StorageTek, Xerox and other leading electronic OEMs.

Even though the Company's customer mix will change from period to period in the future, the Company expects that sales to relatively few customers will continue to account for a high percentage of its net sales in the foreseeable future. The loss of a significant customer or a substantial reduction in orders by any significant customer, including reductions due to market, economic or competitive conditions in the computer, computer peripheral, communications and high-end consumer markets has had and may continue to have a material adverse effect on the Company's business, financial condition, results of operations and cash flows.

Research and Development

The Company continually engages in research, development and engineering activities. The Company's goals are to utilize these activities to improve and enhance existing products and to develop new products in order to expand its market share. During fiscal years 2002, 2001 and 2000, the Company spent approximately \$4,786,000, \$4,518,000 and \$3,472,000 on research and development. The Company's research and development effort is concentrated on improving and increasing long run flexible circuit manufacturing capabilities for both adhesiveless and adhesive based flexible circuits, developing processes for manufacturing new products including flexible circuits for display, integrated circuit substrate and printer applications, developing new FSA and FgSA generations and improving the FSA attachment process.

The Company expects to continue its past practice of acquiring new technology from outside sources through the payment of cash, Company stock and royalties in addition to developing technology internally.

Environmental Controls

Flexible circuit interconnect manufacturing requires the use of chemicals. As a result, the Company is subject to a variety of environmental laws relating to the storage, discharge, handling, emission, generation, manufacture, use and disposal of chemicals, solid and hazardous waste and other toxic and hazardous materials used to manufacture the Company's products. The Company has discontinued operations in its Chandler Arizona location and has decommissioned the facility. A preliminary review of the facility indicates that no material remediation costs will be required. However, given the uncertainties associated with environmental contamination, there can be no assurance that such costs will not have a material adverse impact on the Company. Pursuant to the agreements governing the 1993 ADFlex purchase of certain assets from Rogers Corporation (Rogers), Rogers has retained all environmental liabilities relating to the purchased assets prior to the closing date of the acquisition. While Rogers currently has sufficient assets to fulfill its obligations under the acquisition agreements, if environmental liabilities requiring remediation are discovered and the Company was unable to enforce the acquisition agreement against Rogers, the Company could become subject to costs and damages relating to such environmental liabilities. Any such costs and damages imposed on the Company could materially adversely affect the Company.

The Company believes it has been operating its facilities in substantial compliance in all material respects with existing environmental laws and regulations. However, the Company cannot predict the nature, scope or effect of legislation or regulatory requirements that could be imposed or how existing or future laws or regulations will be administered or interpreted with respect to products or activities to which they have not previously been applied. For this reason, the Company implemented procedures geared toward minimizing the negative impacts and reducing potential financial risks arising from environmental issues. Compliance with more stringent laws or regulations, or more vigorous enforcement policies of regulatory agencies could require substantial expenditures by the Company and could adversely affect the results of operations of the Company. The Company does not anticipate any material amount of environmental-related capital expenditures in fiscal 2003.

Backlog

The backlog for the Company's continuing operations was \$23.9 million, \$20.1 million and \$19.1 million at September 30, 2002, 2001 and 2000, respectively. The Company's backlog fluctuates based on the timing of the receipt of orders from customers. Backlog is defined by the Company as firm orders that are scheduled to be delivered within 12 months from the date of the order. While the Company currently believes substantially all of its September 30, 2002 backlog will be delivered within 12 months, customers may determine not to release orders into production, may extend requested delivery dates or cancel orders. In such cases, the Company may not realize the revenue indicated by the backlog.

Competition

The flexible circuit interconnect market is differentiated by customers, markets and geography with each niche having its own combination of complex packaging and interconnection requirements. The Company believes it competes principally on the basis of design capability, price, quality, flexibility and technological advancements in underlying applications. During periods of economic slowdown in the electronics industry and other periods when excess capacity exists, electronic OEMs become more price sensitive. The Company believes that once a customer has selected a particular vendor to design and manufacture a flexible circuit interconnect, the customer generally relies upon that vendor's design for the life of that specific application and, to the extent possible, subsequent generations of similar applications. Accordingly, it is difficult to achieve significant sales to a particular customer with respect to any application once another vendor has been selected to design and manufacture the flexible circuit interconnect used in that application. While this market paradigm may provide a barrier to the Company's competitors in the markets served by the Company, it also may present an obstacle to the Company's entry into other markets.

The flexible circuit interconnect market is highly competitive. The Company experiences competition world-wide from a number of leading foreign and domestic providers such as 3M Company (3M) and Sumitomo for high-end applications, and

Nippon Mektron (NOK), Fujikura Ltd. (Fujikura) and Multi-Fineline Electronix, Inc. (M-Flex) for standard flex and assembly applications. 3M, Sumitomo, NOK and Fujikura are substantially larger than the Company with greater financial and other resources. There are a number of other flexible circuit manufacturers that target other flexible circuit markets and rarely compete directly with the Company. Expansion of the Company's existing products or services could expose the Company to new competition. Moreover, new developments in the electronics industry could render existing technology obsolete or less competitive and could potentially introduce new competition into the market. There can be no assurance that the Company's competitors will not develop enhancements to, or future generations of, competitive products or services that will offer superior price or performance features to those of the Company or that new competitors will not enter the Company's markets. Finally, as many of the Company's competitors are based in foreign countries, they have cost structures and prices based on foreign currencies. Accordingly, currency fluctuations could cause the Company's dollar-priced products to be less competitive than its competitors' products priced in other currencies.

The Company's competitors can be expected to continue to improve the design and performance of their products and to introduce new products with competitive price/performance characteristics. Competitive pressures often necessitate price reductions that adversely affect operating results. The Company will be required to make a continued high level of investment in product development and research, sales and marketing, and ongoing customer service and support to remain competitive. There can be no assurance that existing or future competitors will not be able to duplicate the Company's strategies or that competitive pressures faced by the Company will not have a material adverse effect on the Company.

Employees

As of September 30, 2002, the Company had a total of 3,340 employees. Of these employees, 183 were based at the Company's Maple Plain, Minnesota facility; 220 were based in Litchfield, Minnesota; and 2,937 were based in Thailand. The Company's future operating results depend in part upon its ability to attract and retain other qualified management, technical, manufacturing, sales and support personnel for its operations. Competition for such personnel is intense and there can be no assurance that the Company will be successful in attracting or retaining such personnel. The failure to attract or retain such persons could materially adversely affect the Company.

Intellectual Property

The Company believes that, due to its customers' demands for rapid technological advances and the resulting limited product life cycles, the success of its business generally depends more on the technical and engineering expertise, creativity and marketing, and service abilities of its employees than on patents, trademarks and copyrights. Nevertheless, the Company owns patents and has a policy of seeking patents when appropriate on inventions concerning new products and improvements as part of its ongoing research, development and manufacturing activities. The Company does control patents related to the FSA and new generation FgSA products and believes that these patents give the Company a competitive advantage within disk drive industry applications. There can be no assurance that any patents issued to the Company will provide a competitive advantage or will not be challenged by third parties, or that the patents of others will not have an adverse effect on the Company's ability to do business. Furthermore, there can be no assurance that others will not independently develop similar products, duplicate the Company's products or design around the patents issued to the Company. In addition, there can be no assurance that foreign intellectual property laws or the Company's agreements will protect the Company's intellectual property rights in any foreign country. Any failure to protect the Company's intellectual property rights could have a material adverse effect upon the Company.

Suppliers

The Company purchases raw circuit materials, process chemicals and various components from multiple outside sources. For components, the Company typically makes short-term purchasing commitments to key suppliers for specific customer

programs. These commitments are usually made for three to twelve month periods. These suppliers commit to providing cooperative engineering, as required, and in some cases maintain a local inventory to provide shorter lead times and reduced inventory levels for the Company. In most cases, suppliers are approved, and are often dictated by the Company's customers. For process chemicals, the Company relies on a limited number of key suppliers. Alternate chemical products are available from other sources, but process chemical changes would often require requalification of the processes, which could take weeks or months to complete. The Company has attempted to mitigate these risks by identifying stable companies with leading technology and delivery positions.

The Company currently purchases a number of its components, process chemicals and other materials from single sources. In the United States, these products are available only from a limited number of suppliers. There can be no assurance that these sources will continue to supply the Company with the materials needed at competitive prices. While viable alternate suppliers exist, because of the Company's limited inventory of raw materials, tight manufacturing cycles and the significant amount of time required to qualify new suppliers, single sourcing is expected to continue. Consequently, any unanticipated interruption of material supplies or components would have a short-term material adverse effect on the Company.

Technology

Design Technology. The flexible circuit interconnects manufactured by the Company are designed specifically for each application, requiring significant joint design activities between the Company and the customer at the start of a project. The Company has developed design methodologies that solve difficult interconnection problems and save the customer time and money. The Company also designs and produces, in volume, flexible circuits that range from high-density, single-sided circuits to more complex double-sided and multi-layer circuits. The Company is continually investing in and improving its computer-based design tools to more quickly design new flexible circuit interconnects, to enhance cooperative design and communication with its customers and to more closely link designs to the manufacturing process. The Company is recognized as a technology leader in fine-line, single-sided flexible circuit technology and flexible circuit assembly technology, including advanced chip-on-flex, flip-chip-on-flex and precision placement assembly technologies.

Circuit Fabrication Technology. The Company has extensive experience in fine-line polyimide flex and has pioneered manufacturing processes that deliver high unit volumes at cost-effective yields. At the core of the process is roll-to-roll subtractive fine-line circuit processing. The starting materials are flexible laminates composed of a thin dielectric film that is either adhesive-bonded to treated copper foil or metalized without the use of adhesives. Very accurate images (down to 0.001) are produced in volume in photoresist. Circuit conductors are then formed by chemically etching the underlying copper foil. A semi-additive process was developed during fiscal 2002 enabling the formation of finer lines in the future. Coverfilm materials are adhered to the circuitry to provide an insulative coating and to expose contact pads for surface metalization. The exposed surfaces are then coated with solder for surface mount or bondable gold for chip-on-flex applications. Laser processing is used to create various openings to drill vias and cut contoured peripheries in substrate materials.

The Company's key flexible circuit fabrication technologies include:

Fine Feature Roll-to-Roll Imaging and Etching. Allows the fabrication of circuits with very fine line widths and spaces. This is critical to meeting complex space constrained interconnection needs. Processing wide web (up to 24 inches) in a continuous roll-to-roll format (as opposed to discrete panels) allows fabrication of high circuit volumes with improved material utilization resulting in lower cost.

Semi-additive metallization. Allows the fabrication of flexible circuits with finer lines and spaces through the etching of thinner material and selective additive metallization of the etched lines.

Laser Processing. Laser technology is used to produce low cost, very fine openings, small vias and contoured shapes that solve density problems while avoiding more expensive traditional alternatives. Also, using a laser to cut the periphery of parts allows prototypes and low volume production parts to be built faster and without the cost of blanking die.

Bondable Gold Plating. Prepares flexible circuits for chip-on-flex bonding, a process which saves space and improves electrical performance (access time) by wire bonding an IC die directly to the flexible circuit.

Coverfilm, Lay-up and Lamination. A process where coverfilm materials are adhered to the circuitry to provide an insulative coating and to expose contact pads for surface metalization. This process allows accurate positioning of solder plated pads to support fine pitch surface mount assembly to the finished circuits.

Assembly and Test Technology. The Company applies advanced assembly and test technology to provide flexible circuit interconnect assemblies to its customers. The Company assembles passive electrical and various mechanical components, including connectors, stiffeners, diodes, formed metal parts and other devices to its flexible circuits using primarily manual processes in its plants in Thailand. The Company also performs advanced direct die attach and assembly of integrated circuit devices as well as the functional testing of these flexible circuit assemblies. Assembling these components directly onto the flexible circuit increases performance and reduces space, weight and cost.

Flex Suspension Assembly. The Company has a proprietary automated process to attach flexible circuits to suspensions for disk drive applications.

Manufacturing

The Company has developed a manufacturing process that combines the use of technology with the deployment of human resources in a geographic and organizational manner that allows the Company to compete on a pure cost basis, if necessary, with suppliers of similar products throughout the world. Quality systems are in place that are certified to standards set by demanding customers in the electronics industry. All operations have received ISO 9002 certification.

The Company believes it enjoys an advantage based on a manufacturing process designed to optimize the utilization of automation, labor and capital, and a manufacturing process and technology with better yield, material utilization and throughput relative to its competitors. Most of the automated circuit fabrication processes are performed in Minnesota where there is an ample supply of qualified technical resources with the more labor intensive processes performed in Thailand to remain competitive with low cost Asian based competitors. The Company also believes that integrating assembly technology with manufacturing technology and high-volume production capabilities will over time provide improvements in its production costs through higher product yields, faster production ramps, reduced inventories, shortened production cycle times and increased leverage over expenses.

(d) FOREIGN SALES AND OPERATIONS

The Company has finishing, assembly and inspection facilities located in Korat and Lamphun, Thailand. While the Company believes it has established good relationships with its local labor forces and the local governments, the spread of the manufacturing process over multiple countries subjects the Company to risks inherent in international operations. Those risks include currency fluctuations, inflationary pressures, unexpected changes in regulatory requirements, tariffs and barriers, potentially limited intellectual property protection, potential cross border shipment delays, changes in political climate, difficulties in coordinating and managing foreign operations, foreign labor issues, increases in employee turnover and potentially adverse tax consequences. Any of the foregoing could have a material adverse effect on the Company.

While Innovex transacts business predominantly in U.S. dollars a large portion of its sales and expenses are denominated in foreign currencies. Changes in the relation of foreign currencies to the U.S. dollar will affect the Company's cost of goods sold and operating margins and could result in exchange losses. To reduce the impact of certain foreign currency fluctuations, the Company enters into short-term forward foreign currency exchange contracts in the regular course of business. The forward exchange contracts generally require the Company to exchange Thailand baht for U.S. dollars or U.S. dollars for Thailand baht at maturity, at rates agreed to at inception of the contracts. These contracts are not designated as hedges, therefore, the gains and losses on foreign currency transactions are included in income as incurred. No assurance can be given that the Company's strategies will prevent future currency fluctuations from adversely affecting the Company.

A large portion of the sales and expenses for the Thailand operation are denominated in Thailand baht. The Thailand baht experienced significant fluctuations in relation to the U.S. dollar during portions of 2002, 2001 and 2000. The fluctuations did not have a significant impact on the Company's results of operations for those years. However, there can be no assurance that future currency fluctuations will not have a material adverse effect on the Company.

ITEM 2. PROPERTIES

In total, at September 30, 2002, the Company leased or owned approximately 564,000 square feet of manufacturing and other space. The Company's significant facilities are as follows:

| <u>Functions</u> | <u>Location (number of facilities)</u> | <u>Square Feet</u> | <u>Owned/ Leased</u> | <u>Expiration</u> |
|---|--|---|---|---------------------------------|
| Executive Offices, Research and Development and Circuit Fabrication | Maple Plain, Minnesota (one) | 96,000 | Owned | N/A |
| Held for disposition | Chandler, Arizona (one) | 150,000 | Leased | June 2003 |
| Circuit inspection and finishing | Korat Thailand (two) | 12,000 8,000 | Owned Owned | N/A N/A |
| Circuit Finishing and Assembly; Sales and Support | Lamphun Thailand (two) | 15,000 140,000 | Owned Owned | N/A N/A |
| Circuit Fabrication | Litchfield, Minnesota (five) | 63,000 15,000 10,000 51,000 4,000 | Owned Owned Owned Owned Owned | N/A N/A N/A N/A N/A |

The Company constructed the building in Maple Plain, Minnesota to be used for manufacturing, research and development and corporate offices. The Company obtained the Arizona and Lamphun Thailand facilities during fiscal 1999 as part of the ADFlex acquisition. The Lamphun Thailand facility was completed in February 1999 and is used for circuit finishing and assembly. Operations have been discontinued at the Arizona facility to reduce excess manufacturing capacity. The Korat Thailand facilities were obtained in fiscal 2000 as part of the Thailand subcontractor purchase. The Company believes that the facilities in Minnesota and Thailand are adequate to meet its current requirements and that suitable additional space or substitute space is readily available as needed.

ITEM 3. LEGAL PROCEEDINGS

Neither the Company nor any of its subsidiaries is a party to, and none of its property is the subject of, any material pending legal proceedings.

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

The Registrant did not submit any matter to a vote of its security holders during the fourth quarter of the fiscal year covered by this Report.

ITEM 4A. EXECUTIVE OFFICERS OF REGISTRANT

| Name | Age | Position |
|--------------------|------------|--|
| Thomas W. Haley | 66 | Chairman, and Director of the Company |
| William P. Murnane | 40 | President and Chief Executive Officer |
| Thomas Paulson | 46 | Chief Financial Officer |
| Allan J. Chan | 52 | Senior Vice President, General Manager, Consumer Electronics |
| Brian R. Dahmes | 42 | Vice President, Research and Development |
| Douglas W. Keller | 44 | Vice President, Finance |
| Srinivas Kuchipudi | 34 | Vice President, Operations |
| Kelly S. Schuller | 37 | Vice President, General Manager, New Ventures |
| Vasu Velayuthan | 38 | Vice President, Asia Operations |

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Mr. Haley served as President of the Company from 1972 to 1988 and Chief Executive Officer from 1988 through 1999. He has been a Director and Chairman of the Company since its inception in 1972.

Mr. Murnane was promoted to President and Chief Operating Officer in July 1998 and to Chief Executive Officer in January 2000. Mr. Murnane joined the Company in July 1995 as Vice President. From June 1993 to June 1995, Mr. Murnane was Chief Operating Officer of Boutwell, Owens & Co., a private manufacturer of packaging, in Fitchburg, Massachusetts. From June 1992 to June 1993, Mr. Murnane was Director of Operations for Uniform Printing & Supply, Inc. in Acton, Massachusetts. Prior to that, he held various operating and corporate planning positions during a ten-year career at United Parcel Service.

Mr. Paulson joined the Company in February 2001 as Chief Financial Officer. Prior to Innovex, Mr. Paulson spent 19 years at The Pillsbury Company (TPC) where he held a variety of executive positions managing complex financial and business issues in multi-operational and multinational divisions including Vice President of Finance.

Mr. Chan joined the Company in June 1988 as Director of Sales and Marketing for the Precision Products Division. Since that time Mr. Chan has held various management positions with the Company including Vice President of Sales and Marketing of the Precision Products Division, Vice President and General Manager of Precision Products Division, Senior Vice President, Sales and Marketing and General Manager of Consumer Electronics.

Mr. Dahmes joined the Company in July 1997 as Plant Manager. Mr. Dahmes was promoted to Director of Manufacturing in July 1998 and to Vice President, Quality in March of 1999. In November 1999, he was promoted to Vice President, Managing Director Innovex (Thailand). In August 2001, Mr. Dahmes was named Vice President of Research and Development. From 1992 to 1995, Mr. Dahmes served as Process Engineering Manager for Sheldahl Interconnect, and from 1995 to 1997, he was an Engineering Manager with Sheldahl Microproducts.

Mr. Keller joined the Company in January 1990 as Corporate Controller. In May 1992, Mr. Keller was made an officer of the corporation and in October 1996, he was promoted to Vice President, Finance. From July 1988 to January 1990, Mr. Keller was Manager of Financial Accounting and Tax for UFE, Inc., a manufacturer of injection molded plastic components. From 1983 to 1988, Mr. Keller was a Senior Auditor for the Pillsbury Company. From 1980 to 1983, he was a Senior Accountant with Deloitte Haskins & Sells, a CPA firm.

Mr. Kuchipudi joined the Company in September 1999 as Vice President, Operations. From July 1996 to August 1999, Mr. Kuchipudi was a management consultant for Pittiglio Rabin Todd & McGrath. Prior to that, he held various engineering and marketing positions during a five-year career at Motorola, Inc.

Mr. Schuller joined the Company in April 2001 as Vice President, Strategic Marketing and New Business Development. Prior to joining Innovex, Mr. Schuller spent five years at McKinsey & Company where he led a number of major strategy and business development engagements for Fortune 500 companies. Before McKinsey, he worked for The Pillsbury Company in Strategic and Financial Planning as well as Ernst & Young as a certified public accountant. In August 2001, Mr. Schuller was named General Manager of New Ventures.

Mr. Velayuthan joined the Company in March, 2001 as Vice President, Asia Operations. Prior to Innovex, Mr. Velayuthan spent six years at Seagate Technology where he held a variety of management positions in manufacturing and quality.

PART II

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

Common Stock Information

The Company's common stock is traded in the over-the-counter market under the symbol INVX. The table below sets forth the high and low closing sale prices as reported by NASDAQ. As of November 15, 2002, the Company had 544 shareholders of record. The Company has not paid a dividend since November 1999. The Company's intention is to continue this policy.

Price Range of Common Stock

| | 2002 | | 2001 | |
|----------------|---------|---------|----------|---------|
| | High | Low | High | Low |
| First Quarter | \$4.200 | \$1.260 | \$16.438 | \$5.438 |
| Second Quarter | 5.170 | 3.310 | 11.563 | 4.563 |
| Third Quarter | 7.425 | 3.600 | 5.150 | 3.500 |
| Fourth Quarter | 4.100 | 1.950 | 4.270 | 1.280 |

Securities Authorized for Issuance Under Equity Compensation Plans:

| Plan category | Number of shares of common stock to be issued upon exercise of outstanding options, warrants and rights | Weighted-average exercise price of outstanding options, warrants and rights | Number of shares of common stock remaining available for future issuance under equity compensation plans(1) |
|---|---|---|---|
| Equity compensation plans approved by stockholders: | 1,785,511 | \$8.35 | 727,368 |
| Equity compensation plans not approved by stockholders: | | | |
| Total | 1,785,511 | \$8.35 | 727,368 |

(1) Excludes shares of common stock listed in the first column.

ITEM 6. SELECTED FINANCIAL DATA

The following selected consolidated financial data has been derived from the consolidated financial statements of the Company for each of the years in the five-year period ended September 30, 2002. The following information should be read in conjunction with Management's Discussion and Analysis of Financial Condition and Results of Operations and the consolidated financial statements of the Company and related notes thereto included elsewhere in this report.

| <u>Years Ended September 30,</u> | <u>2002</u> | <u>2001</u> | <u>2000</u> | <u>1999</u> | <u>1998</u> |
|---|----------------|----------------|----------------|----------------|---------------|
| Net sales | \$ 134,727,529 | \$ 145,635,446 | \$ 164,461,510 | \$ 103,197,766 | \$ 96,277,930 |
| Net income (loss) | (3,835,065) | (28,875,680) | (11,054,410) | 6,558,534 | 15,911,079 |
| Net income (loss) per share: | | | | | |
| Basic | (\$ 0.25) | (\$ 1.93) | (\$ 0.75) | \$ 0.44 | \$ 1.08 |
| Diluted | (\$ 0.25) | (\$ 1.93) | (\$ 0.75) | \$ 0.44 | \$ 1.05 |
| Cash dividends per share | \$ 0.00 | \$ 0.00 | \$ 0.04 | \$ 0.155 | \$ 0.135 |
| Total assets | 114,927,864 | 142,666,541 | 167,679,892 | 178,806,124 | 109,651,849 |
| Long-term debt, less current maturities | 15,371,841 | 26,403,021 | 21,003,284 | 26,375,546 | 755,024 |
| Stockholders' equity | 64,421,454 | 68,174,772 | 96,396,047 | 107,134,199 | 102,418,060 |

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

Management's Discussion and Analysis of Financial Condition and Results of Operations discusses the consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires management to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses and related disclosure of contingent assets and liabilities.

Critical Accounting Policies

We believe that the estimates, assumptions and judgments involved in the accounting policies described below have the greatest potential impact on our financial statements, so we consider these to be our critical accounting policies. Because of the uncertainty inherent in these matters, actual results could differ from the estimates we used in applying the critical accounting policies. Within the context of these critical accounting policies, we are not currently aware of any reasonably likely event that would result in materially different amounts being reported.

Allowance for Excess and Obsolete Inventory:

Inventories, which are composed of raw materials, work in process and finished goods, are valued at the lower of cost or market with cost being determined by the first-in, first-out method. On a periodic basis, the Company analyzes the level of inventory on hand, its cost in relation to market value and estimated customer requirements to determine whether write-downs for excess or obsolete inventory are required. Actual customer requirements in any future periods are inherently uncertain and thus may differ from estimates. If actual or expected requirements were significantly greater or lower than the established reserves, a reduction or increase to the obsolescence allowance would be recorded in the period in which such a determination was made.

Goodwill:

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The Company adopted Statement of Financial Accounting Standards (SFAS) 142, *Goodwill and Intangible Assets* and as a result discontinued the amortization of goodwill and any other intangible assets determined to have indefinite lives. The Company has determined goodwill relates to one reporting unit for purposes of impairment testing. Goodwill and other intangible assets with indefinite lives are tested for impairment annually or whenever an impairment indicator arises. If events or circumstances change, including reductions in anticipated cash flows generated by operations, goodwill could become impaired and result in a charge to earnings.

Deferred Taxes:

The Company accounts for income taxes using the liability method. Deferred income taxes are provided for temporary differences between the financial reporting and tax bases of assets and liabilities. A valuation allowance is set up where the realization of any deferred taxes become less likely than not to occur. The valuation allowance is analyzed periodically by the Company and may result in income tax expense different than statutory rates.

Earnings Summary

The Company reported a net loss of (\$3,835,000) or (\$0.25) basic and diluted net loss per share for the fiscal year ended September 30, 2002. This compares to a net loss of \$(28,876,000) or (\$1.93) basic and diluted net loss per share in fiscal 2000 and a net loss of (\$11,054,000) or (\$0.75) basic and diluted net loss per share in 2000. Fiscal 2002 results improved as compared to fiscal 2001 primarily due to lower restructuring charges and a lower fixed cost basis resulting from cost reduction measures taken by the Company in fiscal 2001 impacting manufacturing, selling, general and administrative and engineering costs. Fiscal 2002 results were negatively impacted by the reduction in 2002 revenue primarily caused by lower worldwide information technology infrastructure spending.

Fiscal 2001 results decreased as compared to fiscal 2000 primarily due to charges to restructure the Company's manufacturing operations by closing the Company's manufacturing facility in Chandler, Arizona and moving those operations to Minnesota and Thailand. In addition, a portion of the decrease was due to lower revenue generated by standard flexible circuit product lines associated with the ADFlex Solutions acquisition in late 1999. The Company took a number of steps during fiscal 2001 to reduce its fixed costs including closing the high cost Chandler facility and reducing the world wide work force. Although the costs of making these changes were reflected in fiscal 2001, many of the benefits were not realized until fiscal 2002.

Results of Operations

Net Sales. The Company's net sales of \$134,728,000 for fiscal 2002 decreased 7% from fiscal 2001 net sales of \$145,635,000. The largest portion of the decline was due to a reduction in flexible circuit revenue for high end tape library, tape backup and array applications as a result of lower worldwide information technology infrastructure spending. In addition, fiscal 2002 did not include any Bridge Flex revenue as the product was phased out in early fiscal 2001. The Bridge Flex was a transitional product that completed the connection from the suspension to the actuator flex for disk drive head interconnect solutions that terminated at the back of the suspension. The need for Bridge Flex products was eliminated as the conductors from subsequent versions of these disk drive head interconnect solutions extended beyond the suspension. In fiscal 2002, the Company also experienced a continued decline in flexible circuit revenue from hand held telecommunications applications as the telecommunications market continues to be depressed. Revenue increases in fiscal 2002 were experienced in a number of areas including disk drive actuator flex, DVD, integrated circuit packaging and solid ink printer applications to offset a portion of the decreases. Revenue from disk drive actuator flex products increased as the result of market share gains. DVD related revenue increased due to a customer's new product introduction. Integrated circuit packaging revenue improved as a result of increased demand for stacked memory for high end server applications.

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Net sales of \$145,635,000 for fiscal 2001 decreased 11% from fiscal 2000 net sales of \$164,462,000. The decrease in 2001 from 2000 was due to lower revenue generated by standard flexible circuit product lines associated with the ADFlex Solutions acquisition in late 1999. Revenue generated by the acquired ADFlex Solutions operation declined in early fiscal 2001 and throughout fiscal 2000 as a result of quality, cost and customer service issues existing at the time of purchase. In addition, revenue from the acquired consumer and telecommunication product lines was significantly impacted by the current economic downturn during the second, third and fourth quarters of fiscal 2001.

Revenue from the disk drive industry generated 74% of fiscal 2002 revenue as compared to 68% in fiscal 2001. This portion should remain similar in fiscal 2003 as FSA and actuator flex revenue is expected to increase in proportion to overall revenue. Consumer related revenue was 14% of revenue in fiscal 2002 as compared to 10% in 2001 due to the DVD and solid ink printer revenue increases. Revenue generated from network system applications was 6% in fiscal 2002 down from 13% in fiscal 2001 due to the drop in tape storage related revenue. Revenue from other applications was 6% in fiscal 2002 compared to 9% in fiscal 2001. The September 1999 acquisition of ADFlex reduced the Company's dependence on the disk drive industry significantly from its historical levels of 85-90% of revenue. Fiscal 2003 revenue is expected to increase over 2002 levels. The Company anticipates that disk drive related revenue will increase as a result of market share improvements for its FSA, Flex Gimbal Suspension Assembly (FgSA) and actuator flex product lines. Revenue increases are also expected as a result of the Company's qualification as a supplier of flexible circuits for liquid crystal display applications.

Export sales accounted for 82% of the Company's revenue in fiscal 2002 as compared to 80% for 2001 and 73% for 2000, reflecting the high level of interconnect shipments to electronic manufacturers in Asia. A significant portion of the remaining domestic sales are subsequently shipped internationally by the Company's customers.

Gross Margin. The Company's gross margin as a percent of sales for fiscal 2002 increased to 11.9%, from the 11.4% reported for fiscal 2001. The improved gross margin percent was primarily due to a lower fixed cost basis resulting from cost reduction measures taken by the Company in fiscal 2001. This cost reduction was partially offset by lower fixed cost leverage caused by the reduction in revenue. The cost reduction measures included the transfer of manufacturing operations from Arizona to the Minnesota and Thailand facilities and a reduction of the Company's workforce. The benefit of the lower cost base was also partially offset by an increase in variable material costs caused by an increased proportion of FSA products in the product mix. FSA products have a higher variable material cost component than products including only flexible circuits due to the cost of the purchased suspension to which the flexible circuit is attached.

The Company's gross margin as a percent of sales for fiscal 2001 decreased to 11.4%, from the 15.0% reported for fiscal 2000. The decrease was primarily due to reduced fixed cost leverage resulting from lower revenue levels of the standard flexible circuits and duplicate costs related to the transfer of manufacturing operations from Chandler, Arizona to the Company's Minnesota facility. The lower gross margin percent was also impacted by the increased proportion of high material content FSA products in the product mix.

Gross margins in fiscal 2003 are expected to improve due to improved fixed cost leverage resulting from the expected increase in revenue.

Operating Expenses. Selling, general and administrative expenses were 12.3% of net sales in 2002 as compared to 12.7% in 2001 and 9.8% in 2000. Selling, general and administrative spending was \$16.6 million in 2002, \$18.5 million in 2001 and \$16.1 million in 2000. Fiscal 2002 expenses were lower than 2001 expenses as a result of the 2001 restructuring that closed the Company's Arizona facility and reduced the Company's workforce. A portion of the increase in selling, general and administrative expenses in fiscal 2001 over 2000 is the result of increased spending due to hiring, relocation and duplicate personnel costs related to the Chandler to Minnesota move. In addition, the increase as a percent of revenue was due to lower revenues in 2001 as a result of the current economic slowdown. Fiscal 2003 operating expenses should not change significantly from 2002 levels and should decrease as a percent of sales as a result of the expected increase in fiscal 2003 revenue.

Engineering expense decreased to 4.2% of net sales in fiscal 2002 from 4.4% in 2001 and 4.7% in 2000. Engineering spending was \$5.7 million in 2002, \$6.4 million in 2001 and \$7.7 million in 2000. Fiscal 2002 expenses were lower than 2001 expenses as a result of the 2001 restructuring that closed the Company's Arizona facility and reduced the Company's workforce.

The decrease in engineering expenses as a percent of sales for fiscal 2001 as compared to 2000 is a result of reduced spending due to the completion of the effort to develop a materials manufacturing process. Fiscal 2002 engineering spending was focused on manufacturing process improvements, further FSA and FgSA technology improvements, qualifying products and processes for new applications including liquid crystal displays, printers and semiconductor packaging substrates and other high-end flexible circuit technology development related to new products. The fiscal 2001 and 2000 spending was concentrated on FSA development and the development of a process to manufacture material for use in producing double sided, plated through-hole flexible circuits. Fiscal 2003 engineering spending is expected to continue to concentrate on manufacturing process improvements, further FSA and FgSA technology improvements, qualifying products and processes for new applications including liquid crystal displays, printers and semiconductor packaging substrates and other high-end flexible circuit technology development related to new products.

Restructuring Charges. During the fiscal 2002 second quarter, an additional \$950,000 restructuring charge was recorded due to an increase of \$876,000 in the estimate of the leased Chandler facility disposition costs and \$74,000 for costs to complete the disposal of the Agua Prieta, Mexico facility.

The fiscal 2001 second quarter includes asset impairment and restructuring charges of \$9,754,000 and \$10,124,000 related to the restructuring of the Company's manufacturing operations. The restructuring is primarily related to closing the Company's Chandler, Arizona facility and moving manufacturing operations to the Company's Minnesota and Thailand locations. The charges were recorded pursuant to a plan announced in January 2001. The charge included approximately \$6,380,000 related to asset impairment of property and equipment and \$3,374,000 for the impairment of the remaining unamortized balance of the goodwill recorded at the time of the Company's September 1999 acquisition of ADFlex Solutions, Inc. The charge also includes \$1,636,000 of inventory written off related to discontinued product lines and accrued liabilities of \$2,156,000 for employee severance and benefits and \$6,332,000 for facility abandonment costs. During the fiscal 2002 second quarter, an additional \$876,000 restructuring charge was recorded due to an increase in the estimate of the leased Chandler facility disposition costs. The restructuring is substantially complete with the exception of the costs accrued to maintain the leased Chandler facility until its disposition. The lease terminates in June 2003 if it is not disposed prior to that time.

The fiscal 2000 first quarter includes a \$13,785,085 restructuring charge related to restructuring the Company's manufacturing operations. The restructuring is primarily related to closing the Company's Agua Prieta, Mexico facility and moving operations to its facility in Lamphun, Thailand. The charge included approximately \$6,605,000 related to asset impairment of property and equipment, \$356,000 for the write off of inventory and supplies, \$176,000 for increasing the accounts receivable reserve, and accrued liabilities of \$2,101,000 for facility abandonment costs and \$4,547,000 in employee severance and benefits. A change in estimate was recorded in the quarter ending September 2000 increasing the facility abandonment accrual by \$1,435,000 and decreasing the accrued employee severance by \$1,485,000. The estimate changes were due to higher costs than expected to discontinue the operation of the Mexican facility and higher turnover than expected prior to the payment of severance. The restructuring was substantially complete as of September 2000 with the exception of completing the disposition of the Mexican facility. During the quarter ending March 31, 2001, the Company had a \$495,000 increase in the estimate of the facility abandonment charges relating to the length of time required to complete the disposition of the facility located in Agua Prieta, Mexico. The facility was sold during the fiscal 2002 second quarter with an additional \$74,000 restructuring charge recorded at that time due to the cost of disposition.

Interest Income (Expense). Interest income decreased to \$119,000 in fiscal 2002 from \$127,000 and \$524,000 in fiscal 2001 and 2000 respectively. The decreases in fiscal 2002 and 2001 correspond to the reduction in the Company's excess cash. Interest expense decreased to \$2,735,000 in 2002, from \$3,550,000 in 2001 and \$3,193,000 in 2000. Interest decreased in 2002 due to lower interest rates on the Company's U.S. based debt facilities which have floating interest rates and the reduction in interest bearing debt by over \$14 million during fiscal 2002. Interest expense increased in fiscal 2001 as compared to 2000 due to the new \$27 million credit facility put in place in Thailand during fiscal 2001.

Other Income (Expense). Fiscal 2002 net other income of \$351,000 was primarily income from the Company's 35% investment in Applied Kinetics Incorporated. Net other expense in fiscal 2001 of \$266,000 was primarily due to increased foreign currency transaction costs as a result of the high level of revenue recorded in Thailand baht and foreign currency translation losses related to the volatility of the Thailand baht/US dollar relationship during the year.

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Income (Loss) Before Provision For Income Taxes. Income (loss) before provision for income taxes was (\$9,441,000) for fiscal 2002 as compared to (\$32,349,000) and (\$15,570,000) for 2001 and 2000, respectively. As a percent of net sales, income before provision for income taxes was (7.0%) for 2002 as compared to (22.2%) for 2001 and (9.5%) for 2000.

Benefit (Provision) For Income Taxes. The income tax benefit for fiscal 2002 was \$5,606,000 reflecting an effective tax rate of 59.4%. The effective tax benefit rate is higher than the statutory federal rate primarily due to the exclusion of income generated from Innovex's foreign operating corporation and a reduction in the Company's deferred tax allowance. The deferred tax allowance was reduced as a result of the estimated improvement in deferred tax asset recoverability in light of the receipt of a \$13 million tax refund resulting from the carry-back of the fiscal 2001 net operating loss. The carry-back was allowed as part of the economic relief act that was passed into law during the second quarter. The fiscal 2001 income tax benefit was \$3,473,000 resulting in an effective tax rate of 10.7%. The effective tax benefit rate was lower than the statutory federal rate primarily due to an increase in the deferred tax allowance.

Net Income (Loss). The fiscal 2002 net loss was (\$3,835,000) as compared to (\$28,876,000) and (\$11,054,000) for 2001 and 2000, respectively.

Liquidity and Capital Resources

Cash and equivalents increased by \$566,000 to \$2,364,000 at September 30, 2002 from the prior year. Net cash provided by operating activities increased in 2002 to \$15,866,000 from \$1,412,000 in 2001 and \$766,000 in 2000. The increase in 2002 net cash provided by operations was primarily due to the receipt of a \$13 million tax refund and decreases in accounts receivables and inventory as compared to the prior year. Accounts receivable and accounts payable decreased due to the lower level of revenue during fiscal 2002. The \$4.5 million inventory reduction was due to a concentrated effort to better manage inventory in addition to the lower level of revenue activity. Other current and long-term liabilities decreased by \$6.6 million during fiscal 2002 primarily due to the payment of liabilities accrued as part of the fiscal 2001 manufacturing restructuring. The increase in cash and equivalents as well as net cash provided by operating activities during fiscal 2001 as compared to 2000 was primarily due to the reduction in accounts receivable and inventories more than offsetting the reduction in accounts payable.

Working capital improved to (\$453,000) at September 30, 2002 from (\$5,883,000) at September 30, 2001. The Company's current ratio was 1.0 at fiscal 2002 year-end, compared to 0.9 at the end of fiscal 2001. The improvement is primarily due to the reduced line of credit balances and the reduction of other current liabilities including the accrual set up at the time of the January 2001 manufacturing restructuring.

The Company invested approximately \$4 million, \$12 million and \$24 million in capital expenditures in fiscal 2002, 2001 and 2000. Fiscal 2002 expenditures primarily included technological upgrades, selected capacity increases and facility improvements. The fiscal 2001 expenditures were primarily related to additional FSA attachment equipment and the Minnesota and Thailand facility additions related to the move of operations from Arizona to Minnesota and Thailand. The capital expenditures in fiscal 2000 include additional equipment to increase the capacity of the automated flexible circuit production facility in Litchfield, Minnesota and the costs to construct and equip the Maple Plain manufacturing facility. In addition, fiscal 2000 included capital expenditures to increase the capacity of the Lamphun Thailand facility as part of the manufacturing restructuring plan to close the Mexican facility and move the operation to Thailand. The Company also acquired the assets and operations of its Thailand subcontractor in October 1999 for \$3,750,000.

Net property, plant and equipment decreased by \$13.0 million to \$73,692,000 at September 30, 2002. The decrease was due to depreciation of \$13.4 million and the sale of the Mexican facility more than offsetting fiscal 2002 capital expenditures of \$3.5 million.

In April 2001 the Company entered into a 1.2 billion Thailand baht (approximately \$27 million) credit facility agreement with Bank of Ayudhya Public Company Limited and The Industrial Finance Corporation of Thailand. The facility is comprised

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of a 590 million baht long-term facility, a 530 million baht packing credit facility, a 70 million baht short term working capital facility and a 10 million baht overdraft facility. The Thailand based facility is secured by certain receivables, inventory and assets held by the Company in Thailand. In June 2002, the Company completed a 300 million Thailand baht (approximately \$6.8 million) expansion of its Thailand credit facilities also secured by certain receivables and inventory held by the Company. As of September 30, 2002, the Company had \$14 million of borrowing capacity available under the existing credit facilities.

Long-term debt, net of current maturities, decreased by \$10.2 million. The decrease is primarily the result of the \$7.8 million payments made on the existing Wells Fargo facility with the remainder being scheduled principal payments made on the Thailand credit facilities and other long term lease financing. The ratio of long-term debt, net of current maturities, to stockholders' equity was .24 at September 30, 2002 compared to .39 at the end of fiscal 2001.

The Company believes that with the existing U.S. and Thailand credit facilities and cash generated from operations, it will have adequate funds to support projected working capital and capital expenditures for fiscal 2003. The Company is considering alternatives for generating additional working capital and long term financing and will continue to pursue financing opportunities in both Thailand and the U.S to better leverage its assets. The Company's financing needs and the financing alternatives available to it are subject to change depending on, among other things, general economic and market conditions, changes in industry buying patterns, customer acceptance of the FSA product and cash flow from operations. The Company failed to comply with certain covenants under its U.S. credit facility during the current quarter. The attached Ninth Amendment to Credit Agreement includes the bank's waiver of this non-compliance as of September 30, 2002. The Thailand based credit facilities were modified to require compliance with two financial ratios rather than require an increase in registered capital. The Company is in compliance with the covenants under its Thailand based financing agreements as of September 30, 2002.

New Pronouncements

In June 2001, the Financial Accounting Standards Board (FASB) issued SFAS 143, *Accounting for Retirement Obligations*. This statement addresses financial accounting and reporting for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs. The statement is effective for the Company on October 1, 2002 and is not expected to have a material impact.

In June 2002, the FASB issued SFAS 146, *Accounting for Costs Associated with Exit or Disposal Activities*. SFAS 146 clarifies the accounting for costs associated with exit or disposal activities. This statement is effective for the Company beginning in January 2003 and is not expected to have a material impact.

Recently Passed Legislation

On July 30, 2002, President Bush signed into law the Sarbanes-Oxley Act of 2002 (the Act), which immediately impacts Securities and Exchange Commission registrants, public accounting firms, lawyers and securities analysts. This legislation is the most comprehensive since the passage of the Securities Acts of 1933 and 1934. It has far reaching effects on the standards of integrity for corporate management, board of directors, and executive management. Additional disclosures, certifications and possibly procedures will be required of the Company. The Company does not expect any material adverse effect as a result of the passage of this legislation; however, the full scope of the Act has not been determined. The Act provides for additional regulations and requirements of publicly-traded companies many of which have yet to be issued.

Forward-Looking Information

Statements included in this Management's Discussion and Analysis of Financial Condition and Results of Operations, elsewhere in this report and in future filings by the Company with the SEC, except for the historical information contained herein and therein, are forward-looking statements that involve risks and uncertainties. These risks and uncertainties include the

timely availability and acceptance of new products including the FgSA and semiconductor packaging substrates, the impact of competitive products and pricing, interruptions in the operations of the Company's single source suppliers, changes in manufacturing efficiencies and other risks detailed from time to time in this report and in other reports filed by the Company with the Securities and Exchange Commission. In addition, a significant portion of the Company's revenue is generated from the disk drive, consumer electronics, computer and data storage industries and the global economic downturn has had and a continued economic downturn will continue to have an adverse impact on the Company's operations. The Company disclaims any obligation subsequently to revise any forward-looking statements to reflect subsequent events or circumstances or the occurrence of unanticipated events.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company's earnings and cash flows are subject to fluctuations due to changes in foreign currency exchange rates. While the Company transacts business predominately in U.S. dollars a portion of its sales and expenses are denominated in foreign currencies. Changes in the relation of foreign currencies to the U.S. dollar will affect the Company's cost of goods sold and operating margins and could result in exchange gains or losses. To reduce the impact of certain foreign currency fluctuations, the Company enters into short-term forward foreign currency exchange contracts in the regular course of business to manage its risk exposure, not as speculative instruments. Typically, these contracts have maturities of 6 months or less. The forward exchange contracts generally require the Company to exchange Thailand baht for U.S. dollars or U.S dollars for Thailand baht at maturity, at rates agreed to at inception of the contracts. These contracts are not designated as hedges, therefore, the gains and losses on foreign currency transactions are included in income.

The Company periodically reviews the outlook for expected currency exchange rate movements as well as the policy on desired future foreign currency cash flow positions (long, short, balanced) for those currencies in which the Company has significant activity. Expected future cash flow positions and strategies are continuously monitored. At September 30, 2002, the Company had one open forward exchange contract to buy a total of 550,000,000 Thai baht. No assurance can be given that the Company's strategies will prevent future currency fluctuations from adversely affecting the Company's business, financial condition, results of operations and cash flows.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

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Report of Independent Certified Public Accountants

Board of Directors
Innovex, Inc.

We have audited the accompanying consolidated balance sheets of Innovex, Inc. and Subsidiaries as of September 30, 2002 and 2001, and the related consolidated statements of operations, stockholders' equity, and cash flows for each of the three years in the period ended September 30, 2002. These financial statements are the responsibility of the company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Innovex, Inc. and Subsidiaries as of September 30, 2002 and 2001, and the consolidated results of their operations and their cash flows for each of the three years in the period ended September 30, 2002, in conformity with accounting principles generally accepted in the United States of America.

\s\ Grant Thornton LLP

Minneapolis, Minnesota
October 23, 2002

**CONSOLIDATED BALANCE SHEETS
INNOVEX, INC. AND SUBSIDIARIES**

| | September 30, | |
|--|----------------|----------------|
| | 2002 | 2001 |
| Assets | | |
| Current assets: | | |
| Cash and equivalents | \$ 2,364,136 | \$ 1,798,272 |
| Accounts receivable, less allowance for doubtful accounts of \$425,000 (2001 \$670,000) | 16,773,103 | 19,315,306 |
| Inventories | 9,285,600 | 13,782,195 |
| Income taxes receivable | 1,362,329 | |
| Deferred income taxes - current | 3,147,691 | 3,817,663 |
| Other current assets | 1,748,962 | 2,647,538 |
| | 34,681,821 | 41,360,974 |
| Property, plant and equipment - at cost: | | |
| Land and land improvements | 3,620,545 | 3,969,992 |
| Buildings and leasehold improvements | 38,829,134 | 40,273,598 |
| Machinery and equipment | 69,078,164 | 68,677,626 |
| Office furniture and fixtures | 1,479,936 | 1,351,608 |
| | 113,007,779 | 114,272,824 |
| Less accumulated depreciation and amortization | 39,316,085 | 27,533,854 |
| | 73,691,694 | 86,738,970 |
| Net property, plant and equipment | 73,691,694 | 86,738,970 |
| Goodwill | 3,000,971 | 3,000,971 |
| Deferred income taxes - long-term | 1,236,038 | 9,602,867 |
| Other assets | 2,317,340 | 1,962,759 |
| | \$ 114,927,864 | \$ 142,666,541 |
| Liabilities and Stockholders' Equity | | |
| Current liabilities: | | |
| Current maturities of long-term debt | \$ 10,798,096 | \$ 9,467,354 |
| Line of credit | 7,302,352 | 11,900,000 |
| Accounts payable | 13,075,040 | 16,438,885 |
| Accrued compensation | 1,653,223 | 1,617,672 |
| Other accrued liabilities | 2,305,858 | 7,819,837 |
| | 35,134,569 | 47,243,748 |
| Total current liabilities | 35,134,569 | 47,243,748 |
| Other long-term liabilities | | 845,000 |
| Long-term debt, less current maturities | 15,371,841 | 26,403,021 |
| Commitments and contingencies | | |
| Stockholders' equity: | | |
| Common stock, \$.04 par value; 30,000,000 shares authorized, 15,108,283 shares issued and outstanding (2001 - 15,044,249) | 604,331 | 601,770 |
| Capital in excess of par value | 17,815,641 | 17,736,455 |
| Retained earnings | 46,001,482 | 49,836,547 |
| | 64,421,454 | 68,174,772 |
| Total stockholders' equity | 64,421,454 | 68,174,772 |
| | \$ 114,927,864 | \$ 142,666,541 |

The accompanying notes are an integral part of these statements.

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**CONSOLIDATED STATEMENTS OF OPERATIONS
INNOVEX, INC. AND SUBSIDIARIES**

For the years ended September 30,

| | 2002 | 2001 | 2000 |
|---|--------------------|---------------------|---------------------|
| Net Sales | \$134,727,529 | \$145,635,446 | \$164,461,510 |
| Costs and Expenses: | | | |
| Cost of sales | 118,671,425 | 128,977,986 | 139,842,670 |
| Selling, general and administrative | 16,617,803 | 18,513,296 | 16,088,830 |
| Engineering | 5,665,207 | 6,430,505 | 7,730,571 |
| Restructuring charges | 950,000 | 20,372,939 | 13,601,157 |
| Interest expense | 2,734,750 | 3,550,295 | 3,193,158 |
| Interest income | (119,356) | (126,786) | (524,300) |
| Other (income) expense | (351,345) | 265,841 | 99,029 |
| | <u>144,168,484</u> | <u>177,984,076</u> | <u>180,031,115</u> |
| Income (Loss) Before Provision for Income Taxes | (9,440,955) | (32,348,630) | (15,569,605) |
| Benefit (Provision) for Income Taxes | 5,605,890 | 3,472,950 | 4,515,195 |
| | <u>(3,835,065)</u> | <u>(28,875,680)</u> | <u>(11,054,410)</u> |
| Net Income (Loss) | (\$ 3,835,065) | (\$ 28,875,680) | (\$ 11,054,410) |
| Net Income (Loss) Per Share: | | | |
| Basic | (\$ 0.25) | (\$ 1.93) | (\$ 0.75) |
| Diluted | (\$ 0.25) | (\$ 1.93) | (\$ 0.75) |
| Weighted Average Shares Outstanding: | | | |
| Basic | 15,080,441 | 14,987,395 | 14,838,082 |
| Diluted | 15,080,441 | 14,987,395 | 14,838,082 |

The accompanying notes are an integral part of these statements.

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**CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY
INNOVEX, INC. AND SUBSIDIARIES**

| For the years ended September 30, 2002, 2001 and 2000 | Common Stock | Capital in Excess of Par Value | Retained Earnings | Total Stockholders Equity |
|---|-----------------|--------------------------------------|----------------------|---------------------------------|
| Balance at October 1, 1999 | \$ 592,884 | \$ 16,181,730 | \$ 90,359,585 | \$ 107,134,199 |
| Shares issued through exercise of stock options | 3,902 | 639,243 | | 643,145 |
| Tax benefits derived from exercise of stock options | | 179,058 | | 179,058 |
| Shares issued through employee stock purchase plan | 425 | 86,578 | | 87,003 |
| Dividends paid (\$0.155 per share) | | | (592,948) | (592,948) |
| Net loss | | | (11,054,410) | (11,054,410) |
| Balance at September 30, 2000 | 597,211 | 17,086,609 | 78,712,227 | 96,396,047 |
| Shares issued through exercise of stock options | 2,358 | 260,472 | | 262,830 |
| Tax benefits derived from exercise of stock options | | 142,983 | | 142,983 |
| Shares issued through employee stock purchase plan | 2,201 | 246,391 | | 248,592 |
| Net loss | | | (28,875,680) | (28,875,680) |
| Balance at September 30, 2001 | 601,770 | 17,736,455 | 49,836,547 | 68,174,772 |
| Shares issued through exercise of stock options | 364 | 16,562 | | 16,926 |
| Shares issued through employee stock purchase plan | 2,197 | 62,624 | | 64,821 |
| Net loss | | | (3,835,065) | (3,835,065) |
| Balance at September 30, 2002 | \$ 604,331 | \$ 17,815,641 | \$ 46,001,482 | \$ 64,421,454 |

The accompanying notes are an integral part of these statements.

**CONSOLIDATED STATEMENTS OF CASH FLOWS
INNOVEX, INC. AND SUBSIDIARIES**

For the years ended September 30,

| | 2002 | 2001 | 2000 |
|--|----------------|----------------|----------------|
| Cash Flows From Operating Activities: | | | |
| Net income (loss) | (\$ 3,835,065) | (\$28,875,680) | (\$11,054,410) |
| Adjustments to reconcile net income (loss) to net cash provided by operating activities: | | | |

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For the years ended September 30,

| | | | |
|---|--------------|--------------|--------------|
| Depreciation and amortization | 13,359,337 | 13,155,347 | 11,617,362 |
| Restructuring charges | 950,000 | 20,372,939 | 13,601,157 |
| Other non-cash items | (123,983) | 288,462 | (833,546) |
| Changes in operating assets and liabilities, net of business acquisition: | | | |
| Accounts receivable | 2,542,203 | 4,519,232 | 4,482,715 |
| Inventories | 4,496,595 | 6,152,929 | (6,008,555) |
| Deferred income taxes | 9,036,801 | (1,609,744) | 2,078,647 |
| Income taxes | 685,842 | 2,166,609 | (2,775,188) |
| Other current assets | (1,281,147) | 870,023 | (2,007,031) |
| Accounts payable | (3,363,845) | (8,433,257) | (232,375) |
| Other current and long-term liabilities | (6,600,678) | (7,194,652) | (8,102,443) |
| Net cash provided by operating activities | 15,866,060 | 1,412,208 | 766,333 |
| Cash Flows From Investing Activities: | | | |
| Capital expenditures | (3,535,356) | (11,743,419) | (23,887,714) |
| Business acquisition | | (256,000) | (3,750,000) |
| Proceeds from sale of assets | 2,451,499 | 192,460 | 713,549 |
| Sales and maturities of held-to-maturity securities | | | 19,305,000 |
| Other | | (3,548) | (75,886) |
| Net cash used in investing activities | (1,083,857) | (11,810,507) | (7,695,051) |
| Cash Flows From Financing Activities: | | | |
| Principal payments on long-term debt | (10,167,262) | (7,651,057) | (889,342) |
| Net (payments) proceeds on line of credit | (4,597,648) | 2,200,000 | 536,069 |
| Issuance of long-term debt | 466,824 | 15,319,737 | 2,407,789 |
| Proceeds from exercise of stock options | 16,926 | 405,813 | 822,203 |
| Proceeds from employee stock purchase plan | 64,821 | 248,592 | 87,003 |
| Dividends paid | | | (592,948) |
| Net cash provided by (used in) financing activities | (14,216,339) | 10,523,085 | 2,370,774 |
| Increase (decrease) in cash and equivalents | 565,864 | 124,786 | (4,557,944) |
| Cash and equivalents at beginning of year | 1,798,272 | 1,673,486 | 6,231,430 |
| Cash and equivalents at end of year | \$ 2,364,136 | \$ 1,798,272 | \$ 1,673,486 |

Supplemental Disclosures:

Cash paid for interest was approximately \$2,834,000; \$3,508,000; and \$2,743,000 in 2002, 2001 and 2000.

Income tax payments were approximately \$29,000; \$86,000; and \$0 in 2002, 2001 and 2000.

Tax benefits derived from exercise of stock options totaling approximately \$0, \$143,000 and \$179,000 in 2002, 2001 and 2000 were recorded as a reduction of current income taxes payable and an increase in capital in excess of par value.

The accompanying notes are an integral part of these statements.

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
INNOVEX, INC. AND SUBSIDIARIES**

September 30, 2002, 2001 and 2000

Note A. Summary of Significant Accounting Policies

Innovex Inc. and Subsidiaries (the Company) is a diversified manufacturer of electrical components for the computer, data storage, consumer, medical, telecommunications and other electronic industries. Substantially all of the Company's revenues, operating profits and assets relate to one operating unit involved in the manufacture of flexible circuit interconnects. Company customers are located throughout the United States, Europe and the Pacific Rim. The Company has manufacturing facilities in Litchfield and Maple Plain, Minnesota and Lamphun and Korat, Thailand.

A summary of the significant accounting policies consistently applied in the preparation of the accompanying consolidated financial statements follows:

Principles of Consolidation and Fiscal Year The consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries. All significant intercompany transactions have been eliminated in consolidation.

The Company utilizes a fiscal year that ends on the Saturday nearest to September 30. For clarity of presentation, the Company has described all periods as if the year ended September 30. The fiscal years ended September 30, 2002, 2001 and 2000 all include fifty-two weeks of operations.

Foreign Currency Translation The Company uses the United States dollar as its functional currency for its subsidiary in Thailand. Re-measurement gains and losses, resulting from the process of re-measuring the financial statements of these foreign subsidiaries into U.S. Dollars, are included in operations. Net foreign currency remeasurement and foreign exchange instrument gains (losses) of \$71,000, (\$457,000) and (\$142,000) were included in other income (expense) in the fiscal years ended September 30, 2002, 2001 and 2000.

Foreign Exchange Instruments The Company enters into short-term forward foreign currency exchange contracts in the regular course of business to manage its exposure against foreign currency fluctuations, primarily relating to nonfunctional currency monetary assets and liabilities. The forward exchange contracts generally require the Company to exchange Thailand baht for U.S. dollars or U.S. dollars for Thailand baht at maturity, at rates agreed to at the inception of the contracts. The contracts are not designated as hedges, therefore, the gains and losses on foreign currency transactions are included in other income (expense). The Company does not enter into forward contracts for trading purposes.

Cash Equivalents The Company considers all highly liquid temporary investments with an original maturity of three months or less to be cash equivalents. The Company had no cash equivalents at September 30, 2002 and 2001. Approximately \$1.7 million and \$1.0 million were on deposit in foreign financial institutions at September 30, 2002 and 2001.

Accounts Receivable The Company grants credit to customers in the normal course of business and generally does not require collateral or any other security to support amounts due. Management performs ongoing credit evaluations of customers. The Company maintains allowances for potential credit losses.

Inventories Inventories which are composed of raw materials, work-in-progress and finished goods, are stated at the lower of cost or market, with cost determined by the first-in, first-out method.

Property, Plant and Equipment Depreciation is provided using the straight-line method over the estimated useful lives of the assets for financial reporting and accelerated methods for tax purposes. Estimated service lives range from 5 to 30 years for buildings and leasehold improvements, from 2 to 7 years for machinery and equipment and from 3 to 7 years for office furniture and fixtures.

Goodwill Prior to October 1, 2001, goodwill was amortized on the straight-line basis over 10 years. On October 1, 2001, the Company adopted Statement of Financial Accounting Standards (SFAS) 142, *Goodwill and Intangible Assets*. As a result, the Company discontinued the amortization of goodwill and any other intangible assets determined to have indefinite useful lives. For the twelve month period ended September 30, 2001, the Company would have reported adjusted net loss and diluted net loss per share of \$28,509,000 and \$1.90 respectively, had it discontinued amortization of intangibles at October 1, 2000. Adjusted net loss and diluted net loss per share excludes, from previously reported financial information, goodwill amortization of \$366,000, net of tax, for the twelve month period ended September 30, 2001. The Company has determined goodwill relates to one reporting unit for purposes of impairment testing. Goodwill and other intangible assets with indefinite lives are tested for impairment annually or whenever an impairment indicator arises.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Fair values of Financial Instruments Due to their short-term nature, the carrying value of current financial assets and liabilities approximates their fair values. The fair value of borrowings, if recalculated based on current interest rates, would not significantly differ from the recorded amounts.

Net Income (Loss) Per Share The Company's basic net income (loss) per share is computed by dividing net income (loss) by the weighted average number of outstanding common shares. The Company's diluted net income (loss) per share is computed by dividing net income (loss) by the weighted average number of outstanding common shares and common share equivalents related to stock options, when dilutive. Options to purchase 1,312,812, 1,226,222 and 631,543 shares of common stock with weighted average exercise purchase prices of \$11.19, \$12.34 and \$15.20 were outstanding during 2002, 2001 and 2000, but were excluded from the computation of common share equivalents because they were antidilutive.

Revenue Recognition Sales are recorded at the time of shipment and provision for anticipated returns, net of exchanges, is recorded based on historical experience.

Use of Estimates Preparation of the Company's consolidated financial statements requires management to make estimates and assumptions that affect reported amounts of assets and liabilities and related revenues and expenses and disclosure about contingent assets and liabilities at the date of the financial statements. Actual results could differ from these estimates.

Income Taxes The Company records income taxes in accordance with the liability method of accounting. Deferred taxes are recognized for the estimated taxes ultimately payable or recoverable based on enacted tax law. Changes in enacted tax rates are reflected in the tax provision as they occur.

Stock Based Compensation The Company utilizes the intrinsic value method of accounting for its employee stock based compensation plans. Pro forma information related to the fair value based method of accounting is contained in Note D.

New Pronouncements In June 2001, the Financial Accounting Standards Board (FASB) issued SFAS 143, *Accounting for Retirement Obligations*. This statement addresses financial accounting and reporting for obligations associated with the retirement of tangible long-lived assets and the associated asset retirement costs. The statement is effective for the Company on October 1, 2002 and is not expected to have a material impact.

In June 2002, the FASB issued SFAS 146, *Accounting for Costs Associated with Exit or Disposal Activities*. SFAS 146 clarifies the accounting for costs associated with exit or disposal activities. This statement is effective for the Company beginning in January 2003 and is not expected to have a material impact.

Note B. Inventories

Inventories are comprised of the following at September 30:

| | <u>2002</u> | <u>2001</u> |
|------------------------------------|---------------------|----------------------|
| Raw materials and purchased parts | \$ 3,938,671 | \$ 6,155,408 |
| Work-in-process and finished goods | 5,346,929 | 7,626,787 |
| | <u>\$ 9,285,600</u> | <u>\$ 13,782,195</u> |

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**Note C. Line of Credit and Long-Term Debt**

On April 23, 2001 the Company entered into a 1.2 billion Thailand baht (approximately \$28 million) credit facility agreement with Bank of Ayudhya Public Company Limited and The Industrial Finance Corporation of Thailand. The facility is comprised of a 590 million baht term loan, a 530 million baht packing credit facility, a 70 million baht short term working capital facility, and a 10 million baht overdraft facility. On March 1, 2002 the Company entered into a supplemental agreement with Bank of Ayudhya and The Industrial Finance Corporation, increasing the packing credit facility to 830 million baht (approximately \$19 million). Under the terms of the credit facility, any outstanding balance on the term loan bears interest at 7.00% annually until April 23, 2003, at which time the outstanding balance will bear interest at the Thailand MLR rate, 7.00% at September 30, 2002. The term loan is serviced by quarterly payments commencing September 28, 2001 and continuing through December 30, 2005. Payments will be 22 million baht per quarter for the first year, 27 million baht per quarter for the second year, 35 million baht per quarter for the third year, 40 million baht per quarter for the fourth year, and 47 million baht for the remaining two quarterly payments. The packing credit, working capital and overdraft facilities bear interest at the Thailand MOR market rate, 7.25% at September 30, 2002. The Thailand based facility is secured by certain receivables, inventory and assets held by the Company in Thailand. The Company is required to maintain certain financial ratios and meet certain net worth levels. A requirement to increase registered capital was replaced by additional financial ratios. At September 30, 2002, 502 million baht or \$11.6 million was outstanding under the term loan, 317 million baht or \$7.3 million was outstanding under the packing credit facility and there were no outstanding balances under the working capital and overdraft facilities. The interest rate for the term loan was 7.00% and the interest rate for the packing credit facility was 5.00% at September 30, 2002. At September 30, 2001, 568 million baht or \$12.8 million was outstanding under the term loan, 422 million baht or \$9.5 million was outstanding under the packing credit facility and there were no outstanding balances under the working capital and overdraft facilities.

On September 15, 1999 the Company entered into a credit facility to pay off all outstanding balances existing at the time of the ADFlex acquisition as required by the ADFlex merger agreement. As amended, the credit facility consists of a \$25.0 million, five-year term loan with equal principal payments of \$1,562,500 due each quarter currently and continuing through April 1, 2004. Under the terms of the amended credit facility, the term facility bears interest at the prime interest rate plus 3.0%. The credit facility is collateralized by all U.S. based accounts receivable, inventory, equipment, real property and general intangibles of the Company. The Company is required to maintain certain financial ratios and meet certain net worth and indebtedness tests that were waived at September 30, 2002. At September 30, 2002, \$10.9 million was outstanding under the term loan. At September 30, 2001, \$18.75 million was outstanding under the term loan and \$2.4 million was outstanding under a revolving line of credit. The interest rate for the term loan was 6.75% at September 30, 2002 and 5.88% at September 30, 2001.

Other long-term debt consists of capitalized equipment leases. Assets under capital lease as of September 30, 2002 had an acquisition cost of \$6.4 million and a net book value of \$4.4 million. Interest rates on these leases range from 7.5% to 9.1%. Aggregate maturities of long-term debt including capitalized leases for the next five years are as follows (in thousands): 2003

\$10,798; 2004 \$9,232; 2005 \$4,929; 2006 \$1,186; 2007 \$25. The recorded value of long-term debt approximates fair market value.

Note D. Stockholders Equity

Stock Option Plans The Company has stock option plans that provide for incentive and non-qualified stock options to be granted to directors, officers and other key employees or consultants. The stock options granted generally have a ten-year life, vest over a period of six months to five years, and have an exercise price equal to the fair market value of the stock on the date of grant. At September 30, 2002, the Company had 613,518 shares of common stock available for issue under the plans.

Restricted Stock Plan The Company also has a restricted stock plan that provides for grants of common stock to key employees of the Company other than the Chief Executive Officer and the four highest paid executives of the Company other than the Chief Executive Officer. The common stock grants generally vest over five years. At September 30, 2002, the Company had 113,850 shares of common stock available for issue under the plan.

Transactions under the plans during each of the three years in the period ending September 30, 2002 are summarized as follows:

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

| | Number of Shares Under Option | Weighted Average Exercise Price |
|---------------------------------------|--|---------------------------------------|
| | <u> </u> | <u> </u> |
| Outstanding at October 1, 1999 | 1,138,414 | \$12.23 |
| Granted | 546,750 | 8.33 |
| Forfeited | (196,570) | 10.86 |
| Exercised | (97,646) | 6.38 |
| | <u> </u> | |
| Balance at September 30, 2000 | 1,390,948 | 11.30 |
| Granted | 535,100 | 8.42 |
| Forfeited | (291,550) | 11.11 |
| Exercised | (58,139) | 6.63 |
| | <u> </u> | |
| Balance at September 30, 2001 | 1,576,359 | 10.54 |
| Granted | 521,850 | 2.91 |
| Forfeited | (303,598) | 9.55 |
| Exercised | (9,100) | 1.86 |
| | <u> </u> | |
| Balance at September 30, 2002 | 1,785,511 | 8.35 |
| | <u> </u> | |

Options exercisable at September 30:

| Number Exercisable | Weighted Average Exercise |
|-----------------------------|---------------------------------|
| <u> </u> | |

| | | <u>Price</u> |
|------|---------|--------------|
| 2000 | 499,908 | \$11.20 |
| 2001 | 587,849 | 11.81 |
| 2002 | 754,745 | 11.32 |

The following table summarizes information concerning currently outstanding and exercisable stock options:

| <u>Range of Exercise Prices</u> | <u>Options Outstanding</u> | | | <u>Options Exercisable</u> | |
|---------------------------------|----------------------------|--|--|----------------------------|--|
| | <u>Number Outstanding</u> | <u>Weighted Average Remaining Contractual Life</u> | <u>Weighted Average Exercise Price</u> | <u>Number Exercisable</u> | <u>Weighted Average Exercise Price</u> |
| \$ 0.00 \$ 2.71 | 436,311 | 8.8 years | \$ 1 .66 | 9,136 | \$ 1.38 |
| 3.35 4.60 | 240,750 | 8.6 years | 3 .98 | 98,700 | 3.94 |
| 5.04 9.38 | 379,800 | 5.7 years | 7 .51 | 207,200 | 7.63 |
| 10.16 11.53 | 421,050 | 5.1 years | 11 .11 | 302,129 | 10.96 |
| 12.59 15.00 | 202,600 | 7.3 years | 13 .11 | 46,980 | 13.23 |
| 18.87 31.31 | 105,000 | 4.2 years | 29 .01 | 90,600 | 29.06 |
| | <u>1,785,511</u> | | | <u>754,745</u> | |

The Company's 2002, 2001 and 2000 pro forma net income (loss) and diluted net income (loss) per share would have been (\$4,622,503), (\$29,868,000), and (\$11,927,000), or (\$0.32), (\$2.06) and (\$0.82) had the fair value method been used for valuing options granted during those years. The impact on net income (loss) may differ in future disclosures because they do not take into effect pro forma compensation expense related to grants made before 1996. The weighted average fair value of options granted in 2002, 2001 and 2000 was \$1.46, \$5.11 and \$4.26. The value was computed by applying the following weighted average assumptions to the Black Scholes options pricing model: volatility of 90%, 72% and 54%; dividend yields of 0.0%; risk-free rate of return of 4.0%, 5.2% and 6.1%; and an average term of 4.5 years for 2002, 2001 and 2000.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Employee Stock Purchase Plan The Company has an Employee Stock Purchase Plan (ESPP) which is available to eligible employees. Under terms of the plan, eligible employees may designate from 1% to 10% of their compensation to be withheld through payroll deductions for the purchase of common stock at 85% of the lower of the market price on the first or last day of the offering period. Under the plan, 250,000 shares of common stock have been reserved for issuance. As of September 30, 2002, 120,594 shares have been issued under the plan. Fair value disclosures under SFAS No. 123 have not been disclosed for shares under the ESPP as such values are immaterial.

Note E. Income Taxes

The effective income tax rates differed from the federal statutory income tax rate as follows for the years ended September 30:

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| | <u>2002</u> | <u>2001</u> | <u>2000</u> |
|--|----------------|----------------|----------------|
| Federal statutory rate | (34.0%) | (34.0%) | (34.0%) |
| State income taxes | (3.3) | (0.5) | (5.6) |
| FSC benefit | | | (4.4) |
| Tax exempt interest | | | (0.8) |
| Foreign operating income benefit | (11.7) | | (4.0) |
| Allowances | (9.0) | 20.1 | 16.2 |
| Adjustments to income tax provision accruals | (1.8) | | 1.6 |
| Non-deductible intangibles | 0.4 | 3.0 | 1.0 |
| Other | | 0.7 | 1.0 |
| | <u>(59.4%)</u> | <u>(10.7%)</u> | <u>(29.0%)</u> |

Components of the (benefit) provision for income taxes are as follows for the years ended September 30 (thousands of dollars):

| | <u>2002</u> | <u>2001</u> | <u>2000</u> |
|----------|-------------------|------------------|------------------|
| Current: | | | |
| Federal | (\$14,165) | (\$1,647) | (\$5,284) |
| State | (478) | (216) | (1,310) |
| | <u>(14,643)</u> | <u>(1,863)</u> | <u>(6,594)</u> |
| Deferred | 9,037 | (1,610) | 2,079 |
| | <u>(\$ 5,606)</u> | <u>(\$3,473)</u> | <u>(\$4,515)</u> |

During fiscal year 2002, the Company received an income tax refund for approximately \$13.2 million as part of an economic relief act that was passed into law.

Deferred taxes recognize the impact of temporary differences between the amounts of assets and liabilities recorded for financial statement purposes and such amounts measures in accordance with tax laws. Realization of net operating loss carryforward and other deferred tax temporary differences are contingent on future taxable earnings. The Company's deferred tax asset was reviewed for expected utilization using a more likely than not approach as required by SFAS 109 by assessing the available positive and negative evidence surrounding its recoverability. Accordingly, the Company recorded a valuation allowance of \$18,415,000 and \$19,263,000 on the deferred tax asset at September 30, 2002 and 2001. The Company continues to assess and evaluate strategies that will enable the deferred tax asset, or portion thereof, to be utilized, and will reduce the valuation allowance appropriately at such time when it is determined that the more likely than not approach is satisfied. The net operating loss and tax credit carry-forwards expire at various dates through September 2022.

The cumulative temporary differences between the tax bases of assets and liabilities and their carrying amounts for financial statement purposes are as follows at September 30 (thousands of dollars):

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

| | <u>2002</u> | <u>2001</u> |
|--|-----------------|-----------------|
| Current deferred tax assets: | | |
| Inventories | \$ 405 | \$ 158 |
| Receivables | 68 | 53 |
| Compensation and benefits | 266 | 334 |
| Restructuring | 113 | 1,316 |
| NOL carryforwards | 2,046 | 1,736 |
| Other | 250 | 221 |
| | <u>\$ 3,148</u> | <u>\$ 3,818</u> |
| Long-term deferred tax assets (liabilities) net: | | |
| Accelerated depreciation | \$ (4,953) | \$ (4,561) |
| Intangibles | 6,171 | 7,021 |
| Restructuring | 126 | 126 |
| Tax credit and NOL carryforwards | 18,307 | 26,280 |
| Allowances | (18,415) | (19,263) |
| | <u>\$ 1,236</u> | <u>\$ 9,603</u> |

Note F. Retirement and Profit-Sharing Plans

The Company sponsors a 401K retirement plan for all of its employees meeting minimum eligibility requirements. The plan provides Company matching contributions of 50% of the first 6% of employee contributions to the plan. An additional 401K retirement plan was also in effect for the first 13 weeks of fiscal 2000 relating to the ADFlex acquisition. This plan was sponsored for all employees of the ADFlex's United States operation. Under this plan, the Company made contributions each year up to a maximum of 4% of an employee's total compensation. The Company merged the ADFlex plan into the Company plan on December 31, 1999. Company contributions for both these plans were approximately \$301,000, \$621,000 and \$547,000 for the years ended September 30, 2002, 2001 and 2000.

Note G. Research and Development Costs

The Company incurred research and development costs of approximately \$4,786,000, \$4,518,000 and \$3,472,000 for the years ended September 30, 2002, 2001 and 2000.

Note H. Foreign Operations and Significant Customers

As part of the September 1999 ADFlex acquisition, the Company acquired an Asian operation, located in Lamphun, Thailand. The Company has continued to increase the functions performed at this location in order to take advantage of the proximity to customers and favorable labor and operating costs. In addition, the Company purchased the assets of its Thailand subcontractor, Boron Public Limited Company in October 1999. The Company had aggregate export sales of \$110,751,000, \$116,405,000 and \$119,603,000 for the years ending September 30, 2002, 2001 and 2000, principally to Pacific Rim customers. With respect to foreign operations for the years ended September 30, 2002 and 2001, long-lived assets of \$27,683,000 and \$30,330,000 were located in Thailand and \$2,000 and \$2,855,000 were located Mexico, respectively.

Revenues from two customers made up a significant portion of the Company's total net sales during the years ending September 30:

| | <u>2002</u> | <u>2001</u> | <u>2000</u> |
|------------|-------------|-------------|-------------|
| Customer A | 64% | 54% | 33% |
| Customer B | 9 | 8 | 18 |

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Accounts receivable from the above two customers are 75% and 63% of the Company's accounts receivable at September 30, 2002 and 2001.

Note I. Commitments and Contingencies

The Company paid rent of \$2,113,000 in fiscal 2002 under facility and equipment operating leases that expire at various dates through January 2007. As of September 30, 2002, the future minimum lease commitments under the operating leases are payable as follows (in thousands): 2003 \$1,811; 2004 \$1,273; 2005 \$1,155; 2006 \$1,153; 2007 \$288; 2008 \$0.

The nature of the Company's business exposes the Company to potential environmental remediation liabilities arising from the manufacture, use and disposal of hazardous materials used to manufacture flex interconnect products. Management believes that any cost associated with maintaining the Company's compliance with current environmental remediation laws will not have a material adverse effect on the Company's financial statements.

Note J. Derivative Instruments

The Company enters into forward exchange contracts that are recorded at fair value with related fair value gains or losses recorded in earnings within the caption other (income) expense. Generally, these contracts have maturities of six months or less. These contracts are entered into to offset the gains or losses on foreign currency denominated assets and liabilities. The Company does not enter into forward exchange contracts for trading purposes and the contracts are not designated as hedges. At September 30, 2002, the Company had an open forward exchange contract to buy Thailand baht maturing January 3, 2003 with notional amounts totaling 550,000,000 Thailand baht (approximately \$12.7 million U.S. dollars). At September 30, 2001, the Company had an open forward exchange contract to buy Thailand baht maturing October 4, 2001 with notional amounts totaling 425,000,000 Thailand baht (approximately \$9.6 million U.S. dollars).

Note L. Restructuring Charges

Manufacturing operations restructuring The fiscal 2001 second quarter included asset impairment and restructuring charges of \$9,754,000 and \$10,124,000 related to the restructuring of the Company's manufacturing operations. The restructuring is primarily related to moving manufacturing operations from the Company's Chandler, Arizona facility to the Company's Minnesota locations. The charges were recorded pursuant to a plan announced in January 2001. The charge included approximately \$6,380,000 related to asset impairment of property and equipment and \$3,374,000 for the impairment of the remaining unamortized balance of the goodwill recorded at the time of the Company's September 1999 acquisition of ADFlex Solutions, Inc. The charge also includes \$1,636,000 of inventory written off related to discontinued product lines and accrued liabilities of \$2,156,000 for employee severance and benefits and \$6,332,000 for facility abandonment costs. During the fiscal 2002 second quarter, an additional \$876,000 restructuring charge was recorded due to an increase in the estimate of the leased Chandler facility disposition costs. The restructuring is substantially complete with the exception of the costs to maintain the leased Chandler facility until its disposition. The lease terminates in June 2003 if it is not disposed prior to that time.

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The fiscal 2000 first quarter includes a \$13,785,000 restructuring charge related to restructuring the Company's manufacturing operations. The restructuring is primarily related to closing the Company's Agua Prieta, Mexico facility and moving operations to its facility in Lamphun, Thailand. The charge was recorded pursuant to a plan announced in November 1999. The charge included approximately \$6,605,000 related to asset impairment of property and equipment, \$356,000 for the write off of inventory and supplies, \$176,000 for increasing the accounts receivable reserve, and accrued liabilities of \$2,101,000 for facility abandonment costs and \$4,547,000 in employee severance and benefits. A change in estimate was recorded in the quarter ending September 2000 increasing the facility abandonment accrual by \$1,435,000 and decreasing the accrued employee severance by \$1,485,000. The estimate changes were due to higher costs than expected to discontinue the operation of the Mexican facility and higher turnover than expected prior to the payment of severance. The restructuring was substantially complete as of September 2000 with the exception of completing the disposition of the Mexican facility. During the quarter ending March 31, 2001, the Company had a \$495,000 increase in the estimate of the facility abandonment charges relating to the length of time required to complete the disposition of the facility located in Agua Prieta, Mexico. The facility was sold during the fiscal 2002 second quarter with an additional \$74,000 restructuring charge recorded at that time due to the cost of disposition.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Lead wire assembly product line disposition In fiscal 1999, a restructuring charge was recorded primarily related to the discontinuation of the lead wire assembly product line. The disposition was substantially completed by June 30, 2000.

The remaining restructuring accrual as of September 30, 2002 totaled \$303,000. Selected information regarding the restructuring follows (in thousands):

| | Lead Wire Assembly Product Line Disposition | | Manufacturing Operations Restructuring Arizona | | Manufacturing Operations Restructuring Mexico | | Total |
|-------------------------------|---|-------------------------------------|--|-------------------------------------|---|-------------------------------------|----------|
| | Facility Abandonment Charges | Employee Termination Benefits | Facility Abandonment Charges | Employee Termination Benefits | Facility Abandonment Charges | Employee Termination Benefits | |
| Accrual at October 1, 2000 | \$ | \$ 64 | \$ | \$ | \$ 1,412 | \$ 250 | \$ 1,726 |
| Establishment of accrual | | | 6,332 | 2,156 | | | 8,488 |
| Payments | | (64) | (2,956) | (2,515) | (1,521) | (114) | (7,170) |
| Change in estimate | | | (1,183) | 1,183 | 495 | | 495 |
| Accrual at September 30, 2001 | | | 2,193 | 824 | 386 | 136 | 3,539 |
| Payments | | | (2,737) | (853) | (475) | (121) | (4,186) |
| Change in estimate | | | 769 | 107 | 89 | (15) | 950 |
| Accrual at September 30, 2002 | \$ | \$ | \$ 225 | \$ 78 | \$ | \$ | \$ 303 |

Note M. Recently Passed Legislation

On July 30, 2002, President Bush signed into law the Sarbanes-Oxley Act of 2002 (the Act), which immediately impacts Securities and Exchange Commission registrants, public accounting firms, lawyers and securities analysts. This legislation is the most comprehensive since the passage of the Securities Acts of 1933 and 1934. It has far reaching effects on the standards

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of integrity for corporate management, board of directors, and executive management. Additional disclosures, certifications and possibly procedures will be required of the Company. The Company does not expect any material adverse effect as a result of the passage of this legislation; however, the full scope of the Act has not been determined. The Act provides for additional regulations and requirements of publicly-traded companies many of which have yet to be issued.

Quarterly Financial Data

(Unaudited)

| 2002 | 1st Quarter | 2nd Quarter* | 3rd Quarter | 4th Quarter | Year |
|---------------------|--------------------|---------------------|--------------------|--------------------|----------------|
| Net sales | \$ 37,842,859 | \$ 34,971,762 | \$ 31,823,731 | \$ 30,089,177 | \$ 134,727,529 |
| Gross profit | 5,773,364 | 5,025,189 | 3,556,788 | 1,700,763 | 16,056,104 |
| Net loss | (296,917) | 341,993 | (1,277,516) | (2,602,625) | (3,835,065) |
| Net loss per share: | | | | | |
| Basic | (\$ 0.02) | \$ 0.02 | (\$ 0.08) | (\$ 0.17) | (\$ 0.25) |
| Diluted | (\$ 0.02) | \$ 0.02 | (\$ 0.08) | (\$ 0.17) | (\$ 0.25) |

* The second quarter includes restructuring charges of \$950,000 related to the restructuring of the Company's manufacturing operations and a \$1.7 million tax benefit related to the reduction of the deferred tax allowance due to receipt of a \$13 million income tax refund received as part of the economic relief act that was passed into law during the quarter.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

| 2001 | 1st Quarter | 2nd Quarter** | 3rd Quarter | 4th Quarter | Year |
|------------------------------|--------------------|----------------------|--------------------|--------------------|----------------|
| Net sales | \$ 38,576,884 | \$ 34,936,271 | \$ 36,250,675 | \$ 35,871,616 | \$ 145,635,446 |
| Gross profit | 6,026,704 | 3,097,789 | 3,057,488 | 4,475,479 | 16,657,460 |
| Net income (loss) | (626,947) | (23,266,023) | (2,891,465) | (2,091,245) | (28,875,680) |
| Net income (loss) per share: | | | | | |
| Basic | (\$ 0.04) | (\$ 1.55) | (\$ 0.19) | (\$ 0.14) | (\$ 1.93) |
| Diluted | (\$ 0.04) | (\$ 1.55) | (\$ 0.19) | (\$ 0.14) | (\$ 1.93) |

** The second quarter includes restructuring charges of \$20,372,939 related to the restructuring of the Company's manufacturing operations.

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE.

Not applicable.

PART III

ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

Reference is made to the section entitled "Election of Directors" in the Registrant's definitive proxy statement to be mailed to shareholders on or about December 15, 2002, and to be filed with the Securities and Exchange Commission within 120 days after September 30, 2002. The information required by Item 10 is incorporated herein by reference from the proxy statement.

ITEM 11. EXECUTIVE COMPENSATION

Reference is made to the section entitled "Executive Compensation" and "Election of Directors" in the Registrant's definitive proxy statement to be mailed to the Shareholders on or about December 15, 2002, and to be filed with the Securities and Exchange Commission within 120 days after September 30, 2002. The information required by Item 11 is incorporated herein by reference from the proxy statement.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

Reference is made to the section entitled "Security Ownership of Certain Beneficial Owners and Management" and "Election of Directors" in the Registrant's definitive proxy statement to be mailed to Shareholders on or about December 15, 2002, and to be filed with the Securities and Exchange Commission within 120 days after September 30, 2002. The information required by Item 12 is incorporated herein by reference from the proxy statement.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

Reference is made to the section entitled "Certain Transactions" in the Registrant's definitive proxy statement to be mailed to Shareholders on or about December 15, 2002, and to be filed with the Securities and Exchange Commission within 120 days after September 30, 2002. The information required by Item 13 is incorporated herein by reference from the proxy statement.

ITEM 14. CONTROLS AND PROCEDURES

(a) Evaluation of Disclosure Controls and Procedures.

The Company's Chief Executive Officer, William P. Murnane, and Chief Financial Officer, Thomas Paulson, have reviewed the Company's disclosure controls and procedures within 90 days prior to the filing of this report. Based upon this review, these officers believe that the Company's disclosure controls and procedures are effective in ensuring that material information related to the Company is made known to them by others within the Company.

(b) Changes in Internal Controls.

There were no significant changes in the Company's internal controls or in other factors that could significantly affect these controls during the quarter covered by this report or from the end of the reporting period to the date of this Form 10-K.

PART IV

ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES AND REPORTS ON FORM 8-K

(a) LIST OF DOCUMENTS FILED AS PART OF THIS REPORT

| (1) | Financial Statements | Page(s) |
|-------|--|----------------|
| | The following Consolidated Financial Statements of the Registrant, Innovex, Inc. and subsidiaries, are included in Item 8: | |
| | Consolidated Balance Sheets at September 30, 2002 and 2001 | 20 |
| | Consolidated Statements of Operations for each of the three years in the period ended September 30, 2002 | 21 |
| | Consolidated Statements of Stockholders' Equity for each of the three years in the period ended September 30, 2002 | 22 |
| | Consolidated Statements of Cash Flows for each of the three years in the period ended September 30, 2002 | 23 |
| | Notes to Consolidated Financial Statements | 24-32 |
| | | |
| (2) | Financial Statement Schedules | |
| | <i>All schedules for which provision is made in the applicable accounting regulation of the Securities and Exchange Commission have been omitted because they are not required, are inapplicable or the information is included in the Consolidated Financial Statements or Notes thereto.</i> | |
| | | |
| (3) | Exhibits | |
| 3(a) | Articles of Incorporation, as amended, are incorporated by reference to Exhibit 3 of the Registrant's Form 10Q for the Quarter Ended December 31, 1996 | |
| 3(b) | Bylaws, as amended, are incorporated by reference to Exhibit 3(b) of the Registrant's Form S-1 Registration Statement dated June 19, 1986 (Commission File No. 33-6594) | |
| 10(a) | 1983 Employee Incentive Stock Option Plan is incorporated by reference to Exhibit 4(a) of the Registrant's Form S-8 dated June 3, 1987 (Commission File No. 33-14776) | |
| 10(b) | 1987 Employee Stock Option Plan, as amended, is incorporated by reference to Exhibit 4(a) of the Registrant's Form S-8 dated March 17, 1989 (Commission File No. 33-27530) | |
| 10(c) | Innovex, Inc. and Subsidiaries Employees' Retirement Plan is incorporated by reference to Exhibit 10(i) of the Registrant's Form 10-K for the Year Ended September 30, 1992 | |
| 10(d) | 1994 Stock Option Plan, as amended, is incorporated by reference to Exhibit 4.1 of the Registrant's Form S-8 dated February 27, 2002 (Commission File No. 333-83452) | |
| 10(e) | Innovex, Inc. Employee Stock Purchase Plan is incorporated by reference to Exhibit 4.1 of the Registrant's Form S-8 dated May 19, 2000 (Commission File No. 333-37380) | |
| 10(f) | Innovex, Inc. Restricted Stock Plan is incorporated by reference to Exhibit 4.1 of the Registrant's Form S-8 dated August 23, 2001 (Commission File No. 333-68228) | |
| 10(g) | Form of Employment Agreement between certain executive officers and the Company is incorporated by reference to Exhibit 10(g) of the Registrant's Form 10-K for the year ended September 30, 1996 | |

(a) LIST OF DOCUMENTS FILED AS PART OF THIS REPORT

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10(h) Agreement and Plan of Merger, dated July 1, 1999, by and among ADFlex Solutions, Inc. and Innovex, Inc. and Innovex Acquisition Corp. is incorporated by reference to Exhibit (c)(1) of the Registrant's Schedule 14(d)(1) filed on July 7, 1999

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10(i) Lease dated June 28, 1993 between ADFlex Solutions, Inc. and TL Properties, Inc. and the First Amendment to Lease, dated June 1994, incorporated by reference to the ADFlex Solutions, Inc. Registration Statement on Form S-1 (SEC file No. 33-80324) or amendments thereto, filed on June 16, 1994

10(j) Credit Agreement dated as of September 15, 1999 among Innovex, Inc. as Borrower and the Banks Named Herein, as Banks, and Norwest Bank Minnesota, N.A., as Agent is incorporated by reference to Exhibit 10(i) of the Registrant's Form 10-K for the Year Ended September 30, 1999

10(k) First Amendment to Credit Agreement is incorporated by reference to Exhibit 10(j) of the Registrant's Form 10-K for the year ended September 30, 2000

10(l) Second Amendment to Credit Agreement is incorporated by reference to Exhibit 10 of the Registrant's Form 10-Q for the quarter ended December 31, 2000

10(m) Third Amendment to Credit Agreement is incorporated by reference to Exhibit 10(a) of the Registrant's Form 10-Q for the quarter ended March 31, 2001

10(n) Fourth Amendment to Credit Agreement is incorporated by reference to Exhibit 10(a) of the Registrant's Form 10-Q for the quarter ended June 30, 2001

10(o) Fifth Amendment to Credit Agreement is incorporated by reference to Exhibit 10(o) of the Registrant's Form 10-K for the year ended September 30, 2001

10(p) Sixth Amendment to Credit Agreement is incorporated by reference to Exhibit 10 of the Registrant's Form 10-Q for the quarter ended December 31, 2001

10(q) Seventh Amendment to Credit Agreement is incorporated by reference to Exhibit 10 of the Registrant's Form 10-Q for the quarter ended March 31, 2002

10(r) Eighth Amendment to Credit Agreement is incorporated by reference to Exhibit 10 of the Registrant's Form 10-Q for the quarter ended June 30, 2002

10(s) Ninth Amendment to Credit Agreement

10(t) Credit Facilities Agreement between Innovex (Thailand) Limited as the Borrower and The Industrial Finance Corporation of Thailand and Bank of Ayudhya Public Company Limited as the Creditor is incorporated by reference to Exhibit 10(b) of the Registrant's Form 10-Q for the quarter ended March 31, 2001

10(u) Option Agreement between Innovex, Inc. and Concorde PAPE II

21 Subsidiaries of Registrant

23 Consent of Grant Thornton LLP

99.1 Certificate pursuant to 18 U.S.C. § 1350

(b) REPORTS ON FORM 8-K

(a) LIST OF DOCUMENTS FILED AS PART OF THIS REPORT

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None.

(c) EXHIBITS

Reference is made to Item 14 (a) 3

(d) SCHEDULES

Reference is made to Item 14 (a) 2

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SIGNATURES

Pursuant to the requirements of Section 13 or 15 (d) 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.

INNOVEX, INC.

By /s/ WILLIAM P. MURNANE

William P. Murnane
President and Chief Executive Officer

Date December 10, 2002

By /s/ THOMAS PAULSON

Thomas Paulson
Chief Financial Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities indicated on this 10th day of December, 2002.

/s/ WILLIAM P. MURNANE

President, Chief Executive Officer and Director
(principal executive officer)

William P. Murnane

/s/ THOMAS PAULSON

Chief Financial Officer
(principal financial officer)

Thomas Paulson

/s/ THOMAS W. HALEY

Chairman and Director

Thomas W. Haley

/s/ ELICK EUGENE HAWK

Director

Elick Eugene Hawk

SIGNATURES

/s/ RAJ K. NOOYI

Director

Raj K. Nooyi

/s/ MICHAEL C. SLAGLE

Director

Michael C. Slagle

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I, William P. Murnane, certify that:

1. I have reviewed this annual report on Form 10-K of Innovex, Inc.;
2. Based on my knowledge, this annual report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this annual report;
3. Based on my knowledge, the financial statements, and other financial information included in this annual report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this annual report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and have:
 - a) Designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this annual report is being prepared;
 - b) Evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this annual report (the Evaluation Date); and
 - c) Presented in this annual report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):
 - a) All significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
6. The registrant's other certifying officers and I have indicated in this annual report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

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Date: December 10, 2002

/s/ William P. Murnane

President and Chief Executive Officer

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I, Thomas Paulson, certify that:

1. I have reviewed this annual report on Form 10-K of Innovex, Inc.;
2. Based on my knowledge, this annual report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this annual report;
3. Based on my knowledge, the financial statements, and other financial information included in this annual report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this annual report;
4. The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-14 and 15d-14) for the registrant and have:
 - a) designed such disclosure controls and procedures to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this annual report is being prepared;
 - b) evaluated the effectiveness of the registrant's disclosure controls and procedures as of a date within 90 days prior to the filing date of this annual report (the Evaluation Date); and
 - c) presented in this annual report our conclusions about the effectiveness of the disclosure controls and procedures based on our evaluation as of the Evaluation Date;
5. The registrant's other certifying officers and I have disclosed, based on our most recent evaluation, to the registrant's auditors and the audit committee of registrant's board of directors (or persons performing the equivalent function):
 - a) all significant deficiencies in the design or operation of internal controls which could adversely affect the registrant's ability to record, process, summarize and report financial data and have identified for the registrant's auditors any material weaknesses in internal controls; and
 - b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal controls; and
6. The registrant's other certifying officers and I have indicated in this annual report whether or not there were significant changes in internal controls or in other factors that could significantly affect internal controls subsequent to the date of our most recent evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

Date: December 10, 2002

/s/ Thomas Paulson

Chief Financial Officer

SIGNATURES

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15 (d)

OF THE SECURITIES EXCHANGE ACT OF 1934

OF

INNOVEX, INC.

FOR

FISCAL YEAR ENDED SEPTEMBER 30, 2002

EXHIBITS
