TERAFORCE TECHNOLOGY CORP
Form 10-K
March 31, 2005

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10 - K

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

For the year ended December 31, 2004

Commission File Number 0-11630

TeraForce Technology Corporation
(Exact Name of Registrant as Specified in Its Charter)

Delaware	**76-0471342**
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)

1240 E. Campbell Road, Richardson, Texas
75081
(Address of Principal Executive Offices and Zip Code)

469-330-4960

(Registrant s Telephone Number, Including Area Code)

Securities Registered Pursuant to Section 12(b) of the Act
None

Securities Registered Pursuant to Section 12(g) of the Act

Common Stock par value $0.01 per share
(Title of Class)

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of 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 o

Indicate by check mark whether the Registrant is an accelerated filer (as defined in Rule 12b-2 of the Securities Exchange Act of 1934). Yes o No þ

The aggregate market value of voting stock held by non-affiliates of the Registrant was approximately $17,663,000 as of June 30, 2004 (based upon the average of the highest bid and lowest asked prices on such date as reported on the OTC Bulletin Board). All directors, officers and 5% or greater stockholders are presumed to be affiliates for purposes of this calculation.

There were 133,161,052 shares of Common Stock outstanding as of March 15, 2005.

DOCUMENTS INCORPORATED BY REFERENCE

None

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Code of Ethics
Subsidiaries
Consent of Grant Thornton LLP
Certification of CEO Pursuant to Section 302
Certification of CFO Pursuant to Section 302
Certification Pursuant to Section 906

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PART I

ITEM 1 BUSINESS

Forward-Looking Statement

The statements in this Annual Report on Form 10-K of TeraForce Technology Corporation (the Company) regarding future financial and operating performance and results, and other statements that are not historical facts, are forward-looking statements, as defined in Section 27A of the Securities Act of 1933, as amended (the Securities Act), and Section 21E of the Securities Exchange Act of 1934, as amended (the Exchange Act). We use the words may, expect, anticipate, believe, continue, estimate, project, intend, designed or other similar expressions to i forward-looking statements. You should read statements that contain such words carefully because they discuss future expectations, contain projections of results of operations or of our financial condition, and/or state other forward-looking information. These statements also involve risks and uncertainties, including, but not limited to:

- events, conditions and financial trends that may affect the Company s future plans and business strategy,
- results of expectations and estimates as to prospective events, and
- circumstances about which the Company can give no firm assurance.

Examples of types of forward-looking statements include statements on future levels of net revenue and cash flow, new product development, strategic plans and financing. These forward-looking statements involve risks and uncertainties that could cause actual results to differ materially from those projected or anticipated. Factors that might cause a difference include, but are not limited to:

- general economic conditions in the markets in which the Company operates;
- success in the development and market acceptance of new and existing products;
- dependence on suppliers, third party manufacturers and channels of distribution;
- customer and product concentration;
- fluctuations in customer demand;
- the ability to obtain and maintain access to external sources of capital;
- the ability to control costs;
- U. S. Government budget, procurement and contracting trends;
- overall management of the Company s expansion; and
- other risk factors detailed from time to time in the Company s filings with the Securities and Exchange Commission.

We believe it is important to communicate our expectations of future performance to our investors. However, events may occur in the future that we are unable to accurately predict, or that we cannot control. Any forward-looking statement speaks only as of the date the statement was made, and the Company undertakes no

obligation to update any forward-looking statement to reflect events or circumstances after the date the statement was made. Because it is not possible to predict every new factor that may emerge, forward-looking statements should not be relied upon as a prediction of actual future financial condition or results. When considering our forward-looking statements, keep in mind the risk factors and other cautionary statements in this Annual Report on Form 10-K. The risk factors noted in this section and other factors noted throughout this Annual Report on Form 10-K provide examples of risks, uncertainties and events that may cause our actual results to differ materially from those contained in any forward-looking statement. If one or more of these risks or uncertainties materialize, or if underlying assumptions prove incorrect, actual outcomes may vary materially from those forward-looking statements included in this Annual Report on Form 10-K. The terms we, our and us and similar terms refer to the Company and its consolidated subsidiaries, not to any individual or group of individuals.

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Available Information

Our website address is www.teraforcetechnology.com. You may obtain free electronic copies of our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and all amendments to those reports in the Investor Relations section of our website. These reports are available on our website as soon as reasonably practicable after we electronically file them with the SEC.

Overview

TeraForce Technology Corporation, through its wholly-owned subsidiary, DNA Computing Solutions, Inc. (DCS), designs, develops, produces and sells high-density, high-capacity embedded computing platforms and systems. Embedded computing generally refers to the physical integration of computing nodes (microprocessor and memory) into a host system or application. These nodes are often deployed in arrays. Embedded computing platforms and systems are widely applied in a number of industries including communications, medical imaging, seismic processing, industrial control, homeland security and defense electronics. Although we have sold our products into a number of these industries, our primary focus is in defense electronics and homeland security; therefore, we refer to this collectively as our Defense Electronics business. Prior to 2001 this business was referred to as the digital signal processor (DSP) business. Subsequent to 2001, all of our net revenue relates to the Defense Electronics business.

Prior to 2002, we were also involved in providing design engineering services through a wholly-owned subsidiary, DNA Enterprises, Inc. (DNA), and in designing and producing telecommunications equipment through other wholly-owned subsidiaries. (For more information see Item 1- Business- Prior Operations). We sell our products both in the United States and internationally. See Note 16 to our Consolidated Financial Statements for more information.

Recent Developments

In the first quarter of 2005 we restructured a portion of our outstanding bank debt, expanded our working capital facility and initiated discussions regarding restructuring other outstanding indebtedness. In the second half of 2004 and the first quarter of 2005 we experienced a decline in orders for our products and accordingly a decline in net revenue. This decline resulted in a need for additional working capital. To address this need we expanded our working capital facility (See Part II Item 7 Management s Discussion and Analysis of Financial Condition and Results of Operations).

Products

Embedded computing products, such as ours, are used for applications in which there is a need for high-density and high-capacity computing, especially in environments where limiting space, weight and power consumption are important considerations. Examples of defense and homeland security applications that utilize embedded computing products include the following:

Airborne radar	Ground based radar
Signal intelligence	Image processing
Unmanned aerial vehicles (UAV s)	Smart munitions
Automated fire control	Battlefield control

Airborne surveillance	Satellite communications
Electronic countermeasures	Infrared search and tracking
Ship based radar	Ship based sonar
Submarine based sonar	Missile interception

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Our products are organized in the following broad categories:

DSP Products DSP products consist of single-board computers utilizing digital signal processors produced by Texas Instruments Inc. These products are produced in versions with one, two or four digital signal processors per board. The boards include both VME and PCI versions, which are industry standard terms and describe the manner in which electronic systems interconnect.

PowerPC Single Board Computers PowerPC Single Board Computer products are VME single board computers with one, two or four processors per board. The microprocessors used in these products are the PowerPCã line of reduced instruction set, or RISC , processors. We also offer ruggedized versions of some of these products. Ruggedized products have been mechanically modified to withstand harsh operating environments such as temperature, shock and vibration. We call our primary product line of these products the VQG4. In January 2005 we introduced a new product line called Nexus . The Nexus products utilize a different architecture from the VQG4, and are intended to address a different set of applications.

Embedded Sub-Systems Embedded Sub-Systems are products that comprise an entire element of a larger system. These elements may include a number of single board computers, deployed in arrays, as well as other system components and enclosures. In 2003 we introduced the Eagle Iä product line. The Eagle products are designed for use as elements in embedded sub-systems. Eagle is based on the Company s Matched Heterogeneous Array Topology (MHAT) technology.

WingSpanä Software Suite WingSpan is software that we offer with our products in order to enhance functionality and to facilitate the customer s development process. WingSpan is a suite of software that includes (a) a board support package to facilitate testing and integration into the operating system, (b) a library of commonly used algorithms that have been optimized for our products and (c) tools to facilitate the development of application software or the porting of existing software to our products. We generally do not sell WingSpan separately from our hardware products. We do not supply the application software to be utilized on our products. The application software is generally designed to operate under certain commercially available operating systems, most often VxWorks or Linux. Our products are generally offered in versions that will support either of these two operating systems, as well as certain others.

Sales of our products are generally not seasonal in nature. In 2004 four customers, Pentek Inc., L-3 Communications, Telephonics Corporation and All Points Logistics, each accounted for more than 10% of our consolidated net revenue from product shipments and services. The loss of any of these customers could have a material adverse effect on our business.

As of March 15, 2005, our backlog of orders for Defense Electronic products amounted to approximately $1,135,000, as compared to approximately $2,200,000 at February 29, 2004. The decline in our backlog resulted primarily from a delay in orders from certain customers (See Part II Item 7 Management s Discussion and Analysis of Financial Condition and Results of Operations). We include in our backlog orders for products for which we have received a purchase order or similar commitment from the customer. Generally, purchase orders are received for products that are to ship within a relatively short period of time, usually 60 days or less. All of the backlog as of March 15, 2005 is scheduled to be shipped during 2005. We consider the backlog to be an indicator, but not the sole predictor, of future revenue. A variety of conditions, both specific to the individual customer and generally affecting the customer s industry, may cause our customers to cancel, reduce or delay orders that were previously made or anticipated. We cannot assure the timely replacement of canceled, delayed or reduced orders. Significant or numerous cancellations, reductions or delays in orders by a customer or group of customers could materially adversely affect our business, financial condition and results of operations. Our backlog alone should not be relied upon as indicative of our revenues for any future period.

In November 2003, we entered into a Technology License and Marketing Agreement with VISTA Controls, Inc. (Vista), a subsidiary of Curtiss-Wright Corporation (Curtiss-Wright). Pursuant to this agreement, and certain ancillary agreements, we have licensed to Vista technology related to the Company s

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VQG4 and Eagle I products. Pursuant to these agreements VISTA and we were to jointly develop and market variations of these products, designed to meet the requirements of harsh operating environments, also know as rugged products. The agreements contemplate that VISTA will produce the rugged versions of the VQG4 and Eagle I products. For any such products that we sell, we will source the products from Vista at prices determined by a formula specified in the agreements. For products sold by Vista to third parties, Vista will pay us residual rights fees pursuant to a formula specified in the agreements. In addition, the agreements call for VISTA to pay license and transfer fees to us aggregating $3,500,000. As of March 15, 2005 we have received payments from VISTA aggregating $3,400,000.

After entering into the agreements with us, Curtiss-Wright acquired two of our competitors, DY4 Systems and Synergy Microsystems. These acquisitions, as well as others, have been organized into a new division of Curtiss-Wright called Curtiss-Wright Embedded Computing. VISTA is a part of this division. We believe that because of these acquisitions it is unlikely that the jointly developed products will be marketed in the same manner by VISTA as they would have been if the acquisitions had not occurred. We had expected to have the ruggedized version of the VQG4 generally available by the end of 2004. However, while the development of this product is substantially complete, it is not yet in general production. There is also uncertainty as to whether or not VISTA will undertake the development activity to produce the ruggedized version of the Eagle I. We are working with VISTA in order to resolve this situation so that ruggedized versions of these products will become generally available. There is no certainty when, or if, these products will be available.

Markets and Customers

Our customers are usually large prime defense contractors and subcontractors to the prime defense contractors. We also sell directly to governmental agencies and to value added resellers who combine our products with other system components for re-sale to the prime or subcontractors. Certain of our DSP products are sold through an OEM arrangement with a reseller. Our sales to this reseller amounted to approximately 24% of our consolidated net revenues from product shipments for the year ended December 31, 2004. Three other customers accounted for approximately 18%, 16% and 11%, respectively, of our consolidated net revenues from product shipments in 2004.

Our sales and marketing activities are directed by in-house sales managers. We also utilize a network of manufacturer s representatives in the United States to sell our products. International sales amounted to less than 1% of our consolidated net revenue in 2004.

The selection of our products by a customer for use in a particular application, system or program is referred to as a design win. The sales cycle leading to a design win will often take a long time. Most often we will initially sell a limited number of units for testing and evaluation purposes. Sometimes we will provide a customer with a demonstration unit that they may evaluate and test. After the evaluation period ends, the customer will either return the unit or purchase it. If the customer determines that the initial evaluation is satisfactory, the customer will often purchase a number of units to use in the design, development and testing of the customer s larger system.

Even after a customer has elected to utilize our product, the customer will not usually purchase a significant number of units immediately. Although the production phase of a particular program may last several years and ultimately involve a significant number of units, at any one time the customer will usually only purchase the units it will need for a short period of time. There are still a number of factors that will determine whether the customer purchases a significant number of products, and when these products are purchased. These factors include:

the suitability of our products for a particular application, including performance and cost issues;

the technical performance of the final system;

the customer s ability to fund the final system;

the performance of the customer s other suppliers for the final system; and

the overall development and integration of the system by the customer.

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Sales are typically not made under long-term contracts, but are made under purchase orders.

Historically, products similar to ours were often developed internally by the large defense contractors. However, beginning in the mid-1990s the Department of Defense implemented a program to force the contractors to utilize commercial off the shelf (COTS) components wherever possible. This has fueled the growth in the Company s markets, and, while we can provide no certainty, we anticipate that this growth will continue. We expect the growth in the COTS market to continue as legacy systems that were developed years ago are upgraded or replaced with new systems with significant COTS content.

Competition

The market for our products is highly competitive and is characterized by rapidly changing technology and frequent product performance improvements. We have a number of competitors in the defense electronics market, including Mercury Computer Systems, Inc., Radstone Technology, PLC, CSPI Multi Computer Division of CSP Inc., and Curtiss-Wright Embedded Computing. Our competitors also include in-house design teams of large defense contractors. However, competition from in-house design teams has diminished in recent years because of the increased use of COTS products and the trend toward greater use of outsourcing. Despite this recent change, there can be no assurance that in-house development will not return as a major competitive force in the future. Increased use of in-house design teams by defense contractors may result in a more competitive market for our products, which could have a material adverse effect on our business, financial condition and results of operations.

All of the large defense contractors and many of our other competitors have substantially greater research and development resources, guaranteed long term supply capacity, marketing and financial resources, manufacturing capability and customer support organizations than we have. We believe our future ability to compete effectively will depend upon our ability to continue to improve product and process technologies, to develop new technologies that demonstrate performance advantages over our competitors, to adapt products and processes to changes in technology, to identify and adopt emerging industry standards and to adapt to our customers needs.

Many of our competitors have greater financial and other resources than we have. We may be operating at a cost disadvantage compared to those manufacturers who have greater direct buying power from component suppliers or who have lower cost structures. There can be no assurance that we will be able to compete successfully in the future with any of these competitors. In addition, there can be no assurance that competitive pressures will not result in price erosion, reduced margins, loss of market share or other factors that could have a material adverse effect on our business, financial condition and results of operations.

Manufacturing

We use third party electronic manufacturing service (EMS) providers to manufacture our products. Generally, we will acquire the components necessary for the manufacture of the product and provide the components to the EMS provider for assembly and initial testing. Completed units are normally then delivered to our facility in Richardson, Texas for final testing and shipment.

We normally use a particular EMS provider for a specific product family. A number of EMS providers are capable of producing our products; however, switching from one provider to another involves significant costs and risks related to product quality and timing.

Components are usually available from multiple sources. However, items such as processors and memory chips may be available from limited or sole sources. Historically, we have had to order some components a significant time in advance of the date we plan to use the components. Sometimes components may be discontinued by the manufacturer, requiring us to acquire a substantial supply or to alter our product design. These design changes can

render components in our inventory obsolete.

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Intellectual Property and Other Proprietary Rights

We believe that we have a substantial base of intellectual property, including software and hardware. Factors such as technological and creative skills of our personnel, new product developments, frequent product enhancements, name recognition, and reliable product manufacturing are essential to our ability to establish and maintain a technology leadership position.

We rely on a combination of patent, copyright, trademark and trade secret laws to establish and protect our products proprietary rights. In addition, we currently require our employees and consultants to enter into nondisclosure and assignment of invention agreements to limit the use of, access to and distribution of our proprietary information. There can be no assurance that our means of protecting our proprietary rights in the U.S. or abroad will be adequate. The laws of some foreign countries may not protect our proprietary rights as fully or in the same manner as do the laws of the U.S. Also, despite the steps we take to protect our proprietary rights, it may be possible for unauthorized third parties to copy or reverse engineer aspects of our products, develop similar technology independently or otherwise obtain and use information that we regard as proprietary. There can be no assurance that others will not develop technologies similar or superior to our technology or design around the proprietary rights we own.

Although we are not aware that our products infringe on the proprietary rights of third parties, there can be no assurance that others will not assert claims of infringement against us in the future, or that, if made, such claims will not be successful. We may seek to obtain a license under a third party s intellectual property rights. There can be no assurance that a license will be available under commercially reasonable terms or that a license will be available at all.

Any claims against us that result in litigation, whether or not such litigation is determined in favor of the Company, could result in significant expense to us and divert the efforts of our technical and management personnel from daily operations. Any adverse ruling regarding intellectual property may require us to pay substantial damages, discontinue the sale of infringing products, expend significant resources to develop non-infringing technology or obtain licenses to use infringing or substituted technology. The failure to develop, or license on acceptable terms, a substitute technology could have a material adverse effect on our business, financial condition and results of operations.

Litigation may also be necessary to enforce our patents and other intellectual property rights, to protect our trade secrets, and to determine the validity of and scope of the proprietary rights of others. Such litigation could result in substantial costs and diversion of resources and could have a material adverse effect on our business, financial condition or results of operations.

We currently hold 20 United States patents relating to telecommunications and computing technology and have 7 currently pending patents relating to telecommunications and computing technology. None of our patents will expire in the near future. We seek to protect our software, documentation and other written materials under trade secret and copyright laws, which afford only limited protection. Patent positions frequently are uncertain and involve complex and evolving legal and factual questions. The coverage sought in a patent application may be denied or significantly reduced before or after the patent is issued. There can be no assurance that:

- any patents from pending patent applications or from any future patent application will be issued,
- the scope of any patent protection will exclude competitors or provide competitive advantages to us,
- any of our patents will be held valid if subsequently challenged, or
- others will not claim rights in or ownership of the patents and other proprietary rights held by us.

Because publication of discoveries in the scientific or patent literature often lags behind actual discoveries, we cannot be certain that we were the first to make the inventions covered by each of our

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pending patent applications or that we were the first to file patent applications for such inventions. In addition, there can be no assurance that competitors, many of whom have substantial resources and have made substantial investments in competing technologies, will not seek to apply for and obtain patents that will prevent, limit or interfere with our ability to make, use or sell our products either in the United States or in international markets.

Employees

As of March 15, 2005 we had 39 full-time employees, of which fourteen were engaged in engineering and development, 8 were engaged in sales, marketing, and customer support, 8 were engaged in manufacturing operations, and 9 were engaged in administration and finance. None of our employees are represented by a labor organization. We have not experienced any material work stoppages and believe we have a good relationship with our employees.

Segments of Our Business

Our operations consist of one business segment, defense electronics, formerly referred to as digital signal processing (or DSP), in which we provide state-of-the-art digital signal processing products to system manufacturers and application developers. Prior to 2002 we were also actively engaged in the design, development, production and sale of optical networking equipment. During 2004, 2003 and 2002, our defense electronics segment accounted for 100% of our consolidated net revenue. For more information, see our Consolidated Financial Statements included under Part II Item 6 Financial Statements and Supplementary Information .

Prior Operations

Our name was changed to TeraForce Technology Corporation on January 30, 2001, from Intelect Communications, Inc. The Company was incorporated in Delaware on May 23, 1995. Its predecessor, Intelect Communications Systems Limited (Intelect (Bermuda)) was incorporated under the laws of Bermuda in April 1980 and operated under the name Coastal International, Ltd. until September 1985 and as Challenger International Ltd. until December 1995. On December 4, 1997, the shareholders of Intelect (Bermuda) approved a merger proposal that reincorporated Intelect (Bermuda) in Delaware and resulted in Intelect (Bermuda) becoming a publicly traded corporation. The merger was effected on December 4, 1997.

Engineering Design Services

Our engineering design services business was conducted through DNA, a 20-year old engineering design services organization located in Richardson, Texas that we acquired in 1996. Over its history DNA provided high-end engineering design services to both established companies and start-up organizations, primarily related to the telecommunications industry. During the course of 2001, DNA experienced a significant decline in the demand for its services. This was caused by the continued down-turn and uncertainty in the telecommunications business and the financing difficulties experienced by many start-up organizations. We determined that there was no longer adequate justification to continue to fund the costs associated with maintaining the DNA organization in light of the uncertainty in future demand for its services. Therefore, as of December 31, 2001 we commenced a plan to dispose of this business and on January 11, 2002 sold substantially all of the assets related to the design services business to Flextronics International, Ltd. (Flextronics).

Effective with the sale of substantially all the assets of DNA to Flextronics we no longer provide contract engineering design services. These services had been provided on a time and material basis and the customer retained all rights to the developed intellectual property.

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Telecommunications Equipment

Prior to 2001, a major focus of our business was the development, design, production and sale of optical networking equipment for application in telecommunication networks. We had specifically focused on our OmniLynx product line. The business related to OmniLynx, and predecessor products SonetLynx © and FibreTrax © , was conducted through a wholly-owned subsidiary, Intelect Network Technologies Company (INT). During 2000, opportunities in the telecommunications market began to decline dramatically. As a result of this, we determined that the long-term strategic value of the OmniLynx product line was not as promising as the Company s other businesses and implemented a plan to materially curtail the operations of INT and to sell INT or substantially all of the assets related to the OmniLynx product line. In August 2001, we completed a sale of the OmniLynx product line and substantially all of the related assets to a newly formed entity, Intelect Technologies, Inc. (ITI). ITI is a corporation initially owned 67% by Singapore Technology Electronics, Ltd. (STE) and 33% by the Company. In February 2003, STE made an additional investment in ITI increasing its ownership to approximately 78% and decreasing our ownership to approximately 22%. During 2004 we sold a portion of our interest in ITI to one of its officers, reducing our interest to approximately 12%. ITI is continuing with the active production and sale of the OmniLynx product line, primarily for use in purpose-built network applications such as highway systems, rail systems, airport communication systems and pipeline networks. We have minority representation in ITI s board of directors and have no involvement in day-to-day operations. Beginning in 2004 we account for our investment in ITI using the cost method of accounting.

During 2001, we continued development activities on a new generation of optical networking equipment through another wholly-owned subsidiary, Aegean Networks, Incorporated (Aegean). We funded all development activities, but had sought strategic investors to provide funding in order to allow full-scale development. We had received indications of interest from a number of potential strategic investors, but the uncertainties surrounding the recovery of markets for telecommunications equipment and other economic factors resulted in no firm commitments to provide funding for Aegean. In the fourth quarter of 2001 we curtailed development activities related to Aegean and in the second quarter of 2002 ceased all development activity related to Aegean.

During 2001, we launched development activities related to a line of products to provide high-density, telecommunications-grade solutions to the Internet server and storage markets. These activities were conducted through a wholly-owned subsidiary, Centauri NetSystems Corporation (Centauri). Economic and industry conditions made obtaining third party financing for this project difficult and in March 2002 we suspended all development activity related to the Centauri project.

See Item 7 - Management s Discussion and Analysis of Financial Condition and Results of Operations for a discussion of research and development expenditures over the past three years.

Risk Factors

In addition to the other information in this Annual Report on Form 10-K, the following are risk factors that should be considered in evaluating the Company and an investment in our common stock. The trading price of our common stock could decline due to any of these risks, and investors in our common stock could lose all or part of their investment.

RISK FACTORS RELATED TO OUR BUSINESS

A Number of Factors Could Cause Operating Results to Fluctuate Significantly.

Our net revenue and operating results in any reporting period may fluctuate significantly due to a variety of factors, including:

changes in the price or availability of components for our products;

the mix of products sold to the defense electronics markets and other markets;

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our ability to introduce new technologies and features ahead of competitors;

the timing and size of orders we receive from customers;

fluctuations in demand for our products;

delays in testing and evaluation by customers;

production delays due to quality problems with or availability of components;

changes in our pricing policies or the pricing policies of our competitors;

changes in customers requirements, including changes or cancellations of orders from customers;

manufacturing and shipment delays and deferrals;

our ability to efficiently produce and ship orders promptly on a price-competitive basis;

announcements or introductions of new products by our competitors;

changes in U.S. Government budget, procurement and contracting trends; and

changes in general economic conditions as well as those specific to the defense electronics industry.

Current economic conditions have made it more difficult to make reliable estimates of future revenues. Fluctuations in our revenue can lead to greater fluctuations in our operating profits. In addition, we expect to incur significant research and development expenses as we develop products to serve our markets, all of which are subject to rapidly changing technology, frequent product performance improvements and evolving industry standards. The ability to deliver superior technological performance on a timely and cost effective basis is a critical factor in securing design wins for future generations of defense electronics systems. Significant research and development spending by the Company does not ensure that our products will be designed into a customer s system. Because future production orders are usually contingent upon securing a design win, our operating results may fluctuate due to either obtaining or failing to obtain design wins for significant customer systems.

We Have Incurred Significant Losses in the Past and Are Not Currently Profitable.

We are not currently profitable. In 2004, 2003 and 2002 we have incurred net losses of $2,880,000, $8,559,000, and $4,350,000, respectively. These losses have been funded from borrowings under credit facilities and sales of debt and equity securities. It is not certain when we will become profitable. The ability to become profitable will depend, in part, on our ability to increase net revenue from sales of defense electronics products. If our need for capital exceeds available resources, there can be no assurance that additional capital will be available through public or private equity or debt financing.

Debt Service Obligations May Adversely Affect Our Cash Flow and We May Be Unable to Repay the Debt On Time.

We have approximately $8,200,000 of debt outstanding as of December 31, 2004. Of this amount, approximately $6,600,000 is due by December 31, 2005 and the balance is due in 2006. It is unlikely that we will be able to generate sufficient cash flow from operations to repay all of this debt when it comes due. We have had discussions with the holders of this debt regarding the extension or restructuring of these obligations and believe that we have reached

agreement in principal to extend the maturity of all such debt until 2006. There is no assurance, however, that we will be able to conclude these arrangements. Even if we are able to refinance or restructure this debt, we may still be subject to substantial interest and principal repayment obligations.

Our Auditors Have Expressed Doubt as to Our Ability to Continue as a Going Concern.

Our independent certified public accountants have added an explanatory paragraph to their audit opinion issued in connection with our consolidated financial statements. The opinion states that our ability to continue as a going concern is uncertain due to our history of operating losses and difficulty in generating operating cash flows. Our consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty. These adjustments might include changes in the possible future

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recoverability and classification of assets or the amounts and classification of liabilities that might result from the outcome of this uncertainty.

We May Not Be Able to Successfully Complete Development and Achieve Customer Acceptance of New Defense Electronics Products.

We must continually enhance our products and develop new products on a timely and cost effective basis. Certain enhancements to our products are in the development phase and are not yet ready for commercial manufacturing or deployment. The successful development and deployment of these products is subject to substantial risk. The development of these products, from laboratory prototype to customer trial, and subsequently to general availability, involves a number of steps including the following:

completion of product development;

the qualification and multiple sourcing of critical components;

validation of manufacturing methods and processes;

extensive quality assurance and reliability testing, and staffing of testing infrastructure;

validation of embedded software; and

establishment of systems integration and systems test validation requirements.

Each of these steps in turn presents serious risks of failure, rework or delay. Any one of these setbacks could decrease the speed and scope of product introduction and marketplace acceptance of the product. In addition, unexpected intellectual property disputes, failure of critical design elements, and other setbacks may delay or even prevent the introduction of these products. A lack of working capital may also negatively impact our ability to enhance our products in a timely manner.

Additionally, the markets for our new products may be undeveloped. The commercial acceptance of these types of products is uncertain. We cannot assure you that our sales and marketing efforts for these products will be successful.

We May Be Subject to Contingent Liabilities.

We have been a named party in a lawsuit in the past and may be subject to significant other contingent liabilities. Defending any such matters may require a substantial amount of our resources, and any judgments may materially affect our financial condition and results of operations. For more information see Item 3 Legal Proceedings.

Our Failure to Quickly Adapt to Rapidly Changing Competitive and Economic Conditions Could Have a Material Adverse Effect on Our Business and Results of Operations.

We operate in a rapidly changing and competitive and economic environment. Our future success will depend, in part, on our ability to enhance our current products and to develop new products on a timely and cost-effective basis that respond to technological developments and changing customer needs. The markets for sophisticated technology are constantly undergoing rapid competitive and economic changes. The full scope and nature of these changes are difficult to predict. The defense electronics market, in particular, demands constant technological improvements as a means of gaining military advantage. We believe that technological change will continue to attract new entrants to our market. Industry consolidation among competitors may increase their financial resources, which may allow our competitors to reduce their prices. This would require us to reduce the prices of our products or risk losing market

share.

We Have a Limited Customer Base.

We are dependent on a small number of customers for a large portion of our revenues. In 2004, four customers accounted for approximately 70% of our net revenue from product shipments. Customers in the defense electronics market purchase our products in connection with government programs that may

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have limited duration, leading to fluctuating sales to any particular customer in the defense electronics market from year to year. A significant decrease in our sales to any of our major customers, or the loss of any of our major customers, would have a material adverse effect on our business, financial condition and results of operations. In addition, our revenue is largely dependent upon the ability of our customers to develop and sell products and systems that incorporate our products. There is no assurance that our customers will not experience financial or other difficulties that could adversely affect our operations and, in turn, our results of operations.

We May Not Be Successful if We Do Not Attract New Customers.

Our future success will depend on our attracting additional customers. The growth of our customer base could be adversely affected by:

customer unwillingness to implement our defense electronics technology;

any delays or difficulties that we may incur in completing the development, introduction and production of our planned products or product enhancements;

new product introductions by our competitors;

any failure of our products to perform as expected;

any difficulty we may incur in meeting customers delivery, installation or performance requirements; or

customer concerns over our financial condition.

We Must Attract, Retain and Motivate Key Technical and Management Personnel in a Competitive Market in Order to Sustain and Grow Our Business.

Our success depends to a significant extent upon key technical and management employees. Competition for highly qualified employees can be intense and the process of locating key technical and management personnel with the required combination of skills and attributes can be lengthy and expensive. There can be no assurance that we will be successful in retaining our existing key personnel or in attracting and retaining the additional employees we may require. We must continue to recruit, train, assimilate, motivate, and retain qualified managers and employees to manage our operations effectively. If we do not successfully recruit, hire and retain key employees, we may be unable to execute our business plan effectively and our results of operations could be significantly adversely affected.

Our Agreement with VISTA May Not Produce the Expected Benefits.

We had expected that our relationship with VISTA would have a positive effect on our business because of new products and access to VISTA s market channels. We have not seen these benefits develop to date and there is substantial uncertainty if they will ever develop. The acquisition by Curtiss-Wright of two of our competitors creates additional uncertainty as to expected benefits of our arrangements with VISTA. The joint development of the new products and customer acceptance of those products is subject to the same risks and uncertainties as we have described above. Even if we are able to utilize VISTA s market channels, there is no assurance that this will result in material increased net revenue or that the margins generated from any such increase will be significant. The agreement with VISTA could prevent us from pursuing other opportunities.

We May Be Unable to Secure Necessary Components and Support Because We Depend Upon a Limited Number of Third-Party Manufacturers and Support Organizations.

We depend on a limited number of suppliers for components of our products, as well as for equipment used to design and test our products. Certain components used in our products are only available from a sole source or limited number of vendors. If these suppliers were to limit or reduce the sale of such components to us, or if these suppliers were to experience financial difficulties or other problems that prevented them from supplying us with the necessary components, these events could have a material adverse effect on our business, financial condition and results of operations. These sole source and other

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suppliers are each subject to quality and performance issues, materials shortages, excess demand, reduction in capacity and other factors that may disrupt the flow of goods to us or its customers; thereby adversely affecting our business and customer relationships. Some of the sole source and limited source vendors are companies who, from time to time, allocate parts to equipment manufacturers due to market demand for components and equipment. We have no guaranteed supply arrangements with its suppliers and there can be no assurance that our suppliers will continue to meet our requirements. Many of our competitors are much larger and may be able to obtain priority allocations from these shared vendors, thereby limiting or making our sources of supply unreliable for these components. If our supply arrangements are interrupted, there can be no assurance that we would be able to find another supplier on a timely or satisfactory basis. Any delay in component availability for any of our products could result in delays in deployment of these products and in our ability to recognize revenues. Suppliers may be concerned regarding our financial condition and therefore may be unwilling to sell components to us, or to grant trade credit to us.

If we are unable to obtain a sufficient supply of components from alternative sources, reduced supplies and higher prices of components will significantly limit our ability to meet scheduled product deliveries to customers. A delay in receiving certain components or the inability to receive certain components could harm our customer relationships and our results of operations.

Failures of components affect the reliability and performance of our products, can reduce customer confidence in our products, and may adversely affect our financial performance. From time to time, we have experienced delays in receipt of components and have received components that do not perform according to their specifications. Any future difficulty in obtaining sufficient and timely delivery of components could result in delays or reductions in product shipments that could harm our business. In addition, a consolidation among suppliers of these components or adverse developments in their businesses that affect their ability to meet our supply demands could adversely impact the availability of components that we depend on. Delayed deliveries from these sources could adversely affect our business.

Our defense electronics products are manufactured by a limited number of third-party manufacturers. If we were required to find alternative third-party manufacturers, we may be forced to incur significant costs and risks. There is no assurance that the alternative manufacturers could produce our products with quality or costs comparable to the existing manufacturers. In addition, the transfer of the manufacturing process to an alternative provider could result in significant delays that could cause us to miss deadlines imposed by our customers.

The Defense Electronics Products Business Is Subject to Special Risks.

We expect that the majority of our net revenue in the future will come from the sale of our defense electronics products. We supply products to sub-contractors and prime contractors whose ultimate customer is generally an agency of the United States government. The funding of U.S. government programs is subject to congressional appropriations. Although multiple-year contracts may be planned in connection with major procurements, Congress generally appropriates funds on a fiscal year basis even though a program may continue for several years. Consequently, programs are often only partially funded initially, and additional funds are committed only as Congress makes further appropriations and prime contracts receive such funding. The U.S. government could reduce or terminate a prime contract under which the Company is a subcontractor or team member irrespective of the quality of our products or services. The reduction in funding or termination of a government program we are involved in would result in a loss of anticipated future revenues attributable to that program and contracts or orders received by the Company. The termination of a program or the reduction in or failure to commit additional funds to a program the Company is involved in could increase our overall costs of doing business and have a material adverse effect on our financial condition and results of operations. The contracts with the United States government are subject to special risks including the following: delays or cancellations of funding for programs; ability of the government to unilaterally cancel the contract; reduction or modification as a result of budgetary restraints or political changes; and

other factors not under the control of us or the prime contractor. In addition, changes in government administration, and changes in national and international priorities including developments in the geo-political environment such as the current War on Terrorism, Operation Enduring Freedom,

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Operation Iraqi Freedom, and nuclear proliferation in North Korea, could have a significant impact on defense spending priorities and the efficient handling of routine contractual matters. These changes could have either a positive or negative impact on our business, financial condition or results from operations in the future.

The Failure to Develop and Introduce New Products That Meet Changing Customer Requirements and Address Technological Advances Would Limit Our Ability to Sell Our Products and Services.

New product development often requires long-term forecasting of market trends, and development and implementation of new technologies. If we fail or are late to respond to new technological developments, market acceptance of our products may be significantly reduced or delayed. The markets we participate in are characterized by rapidly changing technology, evolving industry standards, changes in end user requirements, and frequent new product introductions and enhancements. The introduction of products embodying new technologies or the emergence of new industry standards can render our existing products obsolete or unmarketable. There can be no assurance that we will be able to develop and introduce new products ahead of our competitors, or that our products will not be rendered obsolete. If we fail to invest sufficiently in research and development, our products could become less attractive to potential customers, and our business and financial condition could be materially adversely affected.

We May Not Be Able to Secure an Adequate Number of Design Wins.

Before buying our products, a customer will evaluate our products, and those of our competitors, as a part of designing a larger system. When a product is selected by a customer to be utilized in its system we refer to it as a design win. The design win process is typically lengthy and expensive, and there can be no assurance that we will be able to continue to meet the product specifications of our customers in a timely and adequate manner. In the defense electronics market, military planners have historically funded significantly more design projects than actual deployments of new equipment. There can be no assurance that we will secure an adequate number of design wins. Failure to secure future design wins could have a material adverse effect on our business, financial condition and results of operations.

Product Performance Problems Could Limit Sales Prospects.

The production of new products with high technology content involves occasional problems while the technology and manufacturing methods mature. If significant reliability or quality problems develop, including those due to faulty components, a number of negative effects on our business could result, including:

costs associated with reworking the manufacturing processes;

high service and warranty expenses;

high inventory obsolescence expense;

high levels of product returns;

delays in collecting accounts receivable;

reduced orders from existing customers; and

declining interest from potential customers.

Although we maintain accruals for product warranties, actual costs could exceed these amounts. From time to time, there will be interruptions or delays in the activation of products at a customer s site. These interruptions or delays may

result from product performance problems or from aspects of the installation and activation activities, some of which are outside our control. If we experience significant interruptions or delays that cannot be promptly resolved, confidence in our products could be undermined, which could have a material adverse effect on operations.

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Failure to Protect Our Intellectual Property Could Adversely Affect Our Ability to Compete in the Industry and Our Profitability.

We rely on a combination of patents, copyright, trademark and trade secret laws, and restrictions on disclosure to protect our intellectual property. We also enter into confidentiality or license agreements with our employees, consultants and corporate partners and control access to and distribution of our software, documentation and other proprietary information. These intellectual property protection measures may not be sufficient to prevent wrongful misappropriation of our technology. In addition, these measures will not prevent competitors from independently developing technologies that are substantially equivalent or superior to our technology. The laws of many foreign countries do not protect intellectual property rights to the same extent as the laws of the United States. Failure to protect proprietary information could result in, among other things, loss of competitive advantage, loss of customer orders and decreased revenues. Monitoring the unauthorized use of our products is difficult and we cannot be certain that the steps we have taken will prevent unauthorized use of our technology, particularly in foreign countries where the laws may not protect our proprietary rights as fully as in the United States. If competitors are able to use our technology, our ability to compete effectively could be impaired.

We May Be Subject to Intellectual Property Infringement Claims That Are Costly to Defend and Could Limit Our Ability to Use Some Technologies in the Future.

Like other participants in our industry, we may be subject to infringement claims and other intellectual property disputes as competition in the marketplace continues to intensify. In the future, we may be subject to litigation and may be required to defend against claimed infringements of the rights of others or to determine the scope and validity of the proprietary rights of others. Any such litigation could be costly and divert management s attention from operations. In addition, adverse determinations in such litigation could:

- § result in the loss of our proprietary rights to use the technology;
- § subject us to significant liabilities;
- § require us to seek licenses from third parties;
- § require us to redesign the products that use the technology; or · prevent manufacturing or sale of our products that employ the technology.

If we are forced to take any of the foregoing actions, our business may be seriously harmed. Any litigation to protect our intellectual property or to defend ourselves against the claims of others could result in substantial costs and diversion of resources and may not ultimately be successful.

We May Be Unable to License Third-Party Technology at a Reasonable Cost.

From time to time we may be required to license technology from third parties to develop new products or product enhancements. We cannot ensure that third-party licenses will be available to us on commercially reasonable terms. The inability to obtain any third-party license required to develop new products and product enhancements could require us to obtain substitute technology of lower quality or performance standards, or to license such technology at a greater cost. Both licensing inferior technology at a reasonable cost and licensing necessary technology at a higher cost could seriously harm the competitiveness of our products.

Our Products Are Subject to Government Regulation.

The export of our products and related technology may be subject at times to regulation and restriction by the Department of Commerce. Because our products are utilized in defense and intelligence gathering related applications, in some cases the export of our products and related technology may be subject to further regulation and restriction by the Department of State. Sales to foreign countries have not been material to date, but export controls could limit our ability to sell our products outside the United States

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or could delay such sales in the future. We also may be required to spend substantial time and resources in order to comply with the regulations and restrictions. We could be subject to fines if we fail to properly comply with these regulations.

In addition, our business and operating results may also be adversely affected by the imposition of certain tariffs, duties and other import restrictions on components that we obtain from non-domestic suppliers or by the imposition of export restrictions on products that we sell internationally. We do not believe we have material exposure to environmental laws. Changes in current or future laws or regulations, in the United States or elsewhere, could materially and adversely affect our business and results of operations.

If We Fail to Maintain an Effective System of Internal Controls, We May Not Be Able to Detect Fraud or Report Our Financial Results Accurately, Which Could Harm Our Business.

Effective internal controls are necessary for us to provide reliable financial reports and to detect and prevent fraud. We periodically assess our system of internal controls, and the internal controls of service providers upon which we rely, to review their effectiveness and identify potential areas of improvement. These assessments may conclude that enhancements, modifications or changes to our system of internal controls are necessary. Performing assessments of internal controls, implementing necessary changes, and maintaining an effective internal controls process is expensive and requires considerable management attention, particularly in the case of newly acquired entities. Internal control systems are designed in part upon assumptions about the likelihood of future events, and all such systems, however well designed and operated, can provide only reasonable, and not absolute, assurance that the objectives of the system are met. Because of these and other inherent limitations of control systems, there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions, regardless of how remote. If we fail to implement and maintain an effective system of internal controls or prevent fraud, we could suffer losses, could be subject to costly litigation, investors could lose confidence in our reported financial information and our brand and operating results could be harmed, which could have a negative effect on the trading price of our common stock.

We May Have Difficulty Implementing In a Timely Manner the Internal Controls Procedures Necessary to Allow Our Management to Report on the Effectiveness of Our Internal Controls, and We May Incur Substantial Costs in Order to Comply with the Requirements of the Sarbanes-Oxley Act of 2002.

The Sarbanes-Oxley Act of 2002 has introduced many new requirements applicable to us regarding corporate governance and financial reporting. Among many other requirements is the requirement under Section 404 of the Act for management to report on our internal controls over financial reporting and for our registered public accountant to attest to this report. We are required to comply with Section 404 effective the fiscal year ending December 31, 2006. Our management has begun the necessary processes and procedures for issuing its report on our internal controls. The costs of implementing these processes and procedures may be substantial and could have a material adverse effect on our results of operations.

While the Company Believes Its Control Systems are Effective, There are Inherent Limitations in All Control Systems, and Misstatements Due to Error or Fraud May Occur and Not Be Detected.

The Company continues to take action to assure compliance with the internal controls, disclosure controls and other requirements of the Sarbanes-Oxley Act of 2002. Our management, including our Chief Executive Officer and Chief Financial Officer, cannot guarantee that our internal controls and disclosure controls will prevent all possible errors or all fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. In addition, the design of a control system must reflect the fact that there are resource constraints and the benefit of controls must be relative to their costs. Because of the inherent limitations in all control systems, no system of controls can provide absolute assurance that all control

issues and instances of fraud, if any, within the Company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty and that breakdowns can occur because of simple error or mistake. Further, controls can be circumvented by individual acts of some persons, by collusion of two or more persons, or by

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management override of the controls**.** The design of any system of controls also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Over time, a control may be inadequate because of changes in conditions or the degree of compliance with the policies or procedures may deteriorate. Because of inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected.

RISK FACTORS RELATED TO THE SECURITIES MARKET

Our Common Stock Is Subject to Price Volatility.

The price of our common stock is volatile. Fluctuations in operating results, such as net revenue, or operating results being below the expectations of public market analysts and investors, may cause additional volatility in the price of the common stock. In such event, the market price of our common stock could decline significantly. A significant decline in the market price of the common stock could result in litigation that could also result in increased costs and a diversion of management s attention and resources from operations.

There May Not Be a Liquid Market for our Common Stock.

Our common stock currently is traded on the OTC Bulletin Board operated by Nasdaq. This market generally has less liquidity than the Nasdaq SmallCap Market and certain institutional investors are precluded from buying stock in this market. There can be no assurance that our investors will be able to sell our common stock at prices and times that are desirable.

Additional Capital May Dilute Current Stockholders.

In order to provide capital for the operation of our business we may enter into additional financing arrangements. These arrangements may involve the issuance of new common stock, preferred stock that is convertible into common stock, debt securities that are convertible into common stock or warrants for the purchase of common stock. Any of these items could result in a material increase in the number of shares of common stock outstanding which would in turn result in a dilution of the ownership interest of existing common shareholders. In addition these new securities could contain provisions, such as priorities on distributions and voting rights, which could affect the value of our existing common stock.

Outstanding Common Stock, Options and Warrants May Make it Difficult For Us to Obtain Additional Capital on Reasonable Terms.

As of March 15, 2005, we have 133,161,052 shares of common stock outstanding. Additionally, we had outstanding conversion rights, options and common stock warrants for the purchase of up to 115,120,245 shares of common stock at an average exercise price of $0.20 per share. If all of the outstanding conversion rights, options and common stock warrants were to be converted, they would represent, together with our common stock outstanding, approximately 99% of our authorized common shares on a fully diluted basis. Future investors will likely recognize that the holders of the options and warrants will only exercise their rights to acquire our common stock when it is to their economic advantage to do so. Therefore, even with lower current market prices for our common stock, the market overhang of such a large number of warrants and options may adversely impact our ability to obtain additional capital because any new investors will perceive that securities offer a risk of substantial potential future dilution. Additionally, we may be required to increase our authorized common shares in order to raise additional capital.

We May Propose a Reverse-Split of Our Common Stock.

In order to reduce the number of shares outstanding, increase the trading price of our common stock, qualify for listing on an exchange and possibly attract additional groups of investors we may at some time in the future propose a reverse-split of our common stock. Such a proposal would require the approval

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of the majority of the outstanding shares of voting stock. There can be no assurance that a reverse split would have the intended effect and therefore it could dilute the value of our common stock.

ITEM 2 PROPERTIES

All of our facilities are leased and are located in Richardson, Texas. We lease approximately 20,000 square feet under a lease agreement that expires in January 2009. These facilities include production, engineering, sales, marketing and administrative offices and we believe our facilities to be suitable for our current operations.

ITEM 3 LEGAL PROCEEDINGS

We are involved in various routine legal proceedings and claims arising in the ordinary course of business.

Shareholder Action. In December 2003 we reached agreement on the settlement of a lawsuit that was pending against the Company and certain former and current officers and directors in the U. S. District Court for the Northern District of Texas. The complaint was brought in November 1999 on behalf of all persons and entities who purchased the Company s common stock during the period between February 24, 1998 and November 17, 1998 and alleged that the defendants violated Sections 10(b) and 20(a) of the Exchange Act and Rule 10b-5 promulgated thereunder by making false and misleading statements concerning the Company s reported financial results during the period, primarily relating to revenue recognition, asset impairment and capitalization issues. In August 2004 the settlement was completed and the case was dismissed. Pursuant to the settlement arrangement we made payments aggregating approximately $189,000 to the plaintiffs in the case.

Zurich American Insurance Company (Zurich) provides excess liability coverage of up to $3,000,000, for amounts in excess of $2,000,000 related to this matter. We do not believe that the total costs related to this matter will invoke the coverage provided by Zurich. Nonetheless, Zurich agreed to advance to us the approximately $189,000 in settlement payments. The amounts advanced are evidenced by a note payable to Zurich, payable in two years and bear interest at 7% per annum, payable quarterly. The note is secured by warrants to purchase shares of our common stock. The warrants have an exercise price of $0.01 and expire upon the repayment of the advance.

Reliance Insurance Company (Reliance) provides the primary $2,000,000 of insurance coverage for this matter. Reliance has been ordered liquidated by the insurance commissioner of the State of Pennsylvania. We have previously received $300,000 from the Texas Property and Casualty Guaranty Association related to this claim. In March 2005 we received a Notice of Determination from the Reliance estate indicating the allowance of our claim in the amount of approximately $1,612,000. We do expect some recovery pursuant to this claim, however, the amount of such recovery cannot be estimated at this time and there is no assurance as to any recovery. In addition, the timing of any recovery is uncertain and could be a matter of years. Accordingly, we have not reflected any such recovery in our financial statements.

Contract Dispute. In March 2002, we entered into an agreement with LaBarge, Inc. (LaBarge) for the development and manufacture of a conduction cooled version of a certain model of our VQG4 product. In February 2003, we terminated the contract because we believe