

SI TECHNOLOGIES INC
Form 10-Q
June 14, 2004
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SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Commission file number 0-12370

F O R M 10-Q

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

For the Quarterly period ended April 30, 2004

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

Commission file number 0-12370

SI TECHNOLOGIES, INC.

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

95-3381440
(I.R.S. Employer
Identification Number)

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14192 Franklin Avenue, Tustin, CA 92780

(Address of principal executive offices) (Zip Code)

714-505-6483

Registrant's telephone number, including area code

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

None

Securities registered pursuant to Section 12 (g):

Common Stock, par value \$.01 per share

(Title of Class)

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

Indicate by checkmark whether the registrant is an accelerated filer (as defined in A Rule 12b-2 of the Exchange Act). Yes No

The number of shares outstanding of the registrant's common stock as of May 15, 2004 was 4,126,996.

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SI TECHNOLOGIES, INC.

Consolidated Balance Sheets

(in thousands)

| | <u>April 30, 2004</u> | <u>July 31, 2003</u> |
|--|-----------------------|----------------------|
| | <u>(Unaudited)</u> | |
| ASSETS | | |
| Current assets: | | |
| Cash | \$ 243 | \$ 284 |
| Trade accounts receivable, less allowance for doubtful Accounts of \$325 and \$296, respectively | 5,565 | 5,516 |
| Inventories, net | 9,553 | 10,234 |
| Other current assets | 354 | 337 |
| | <u>15,715</u> | <u>16,371</u> |
| Total current assets | 15,715 | 16,371 |
| Property and equipment, net | 1,321 | 1,679 |
| Deferred income taxes | 1,509 | 1,509 |
| Other assets | | |
| Goodwill | 7,002 | 7,002 |
| Other intangibles, net | 88 | 91 |
| Other assets | 250 | 291 |
| | <u>25,885</u> | <u>26,943</u> |
| TOTAL ASSETS | \$ 25,885 | \$ 26,943 |
| LIABILITIES AND STOCKHOLDERS EQUITY | | |
| Current liabilities: | | |
| Revolving lines of credit | \$ 7,445 | \$ 8,242 |
| Current maturities of long-term debt | 1,367 | 1,898 |
| Accounts payable | 3,494 | 3,050 |
| Accrued liabilities | 1,687 | 1,557 |
| | <u>13,993</u> | <u>14,747</u> |
| Total current liabilities | 13,993 | 14,747 |
| Long-term debt, less current maturities | 2,868 | 3,366 |
| Other liabilities | 198 | 408 |
| Stockholders equity | | |
| Preferred stock, par value \$0.01 per share; authorized, 2,000,000 shares; none outstanding | | |
| Common stock, par value \$.01 per share; authorized 10,000,000 shares; 4,126,996-2004; 4,026,996 2003 issued and outstanding | 41 | 40 |
| Additional paid-in capital | 11,343 | 11,163 |
| Accumulated deficit | (2,579) | (2,798) |

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| | | |
|---|------------------|------------------|
| Accumulated other comprehensive income | 21 | 17 |
| Total stockholders' equity | 8,826 | 8,422 |
| TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY | \$ 25,885 | \$ 26,943 |

See accompanying condensed notes to consolidated financial statements

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SI TECHNOLOGIES, INC.

Consolidated Statements of Income

(in thousands except share and per share data)

(Unaudited)

| | For the three months ended April 30, | | For the nine months ended April 30, | |
|--|---|-----------|--|-----------|
| | 2004 | 2003 | 2004 | 2003 |
| Net sales | \$ 9,288 | \$ 8,663 | \$ 26,342 | \$ 24,729 |
| Cost of sales | 5,909 | 5,786 | (1) 17,160 | 15,765 |
| Gross profit | 3,379 | 2,877 | 9,182 | 8,964 |
| Operating expenses: | | | | |
| Selling, general and administrative | 2,372 | 2,044 | 6,741 | 6,338 |
| Research, development and engineering | 404 | 432 | 1,319 | 1,125 |
| Amortization of intangibles | 2 | 8 | 6 | 24 |
| | 2,778 | 2,484 | 8,066 | 7,487 |
| Income from operations | 601 | 393 | 1,116 | 1,477 |
| Interest expense | (198) | (235) | (650) | (738) |
| Other income (expense), net | (109) | 61 | (1) (193) | 142 |
| Income before income tax benefit (provision) | 294 | 219 | 273 | 881 |
| Income tax benefit (provision) | (63) | 24 | (55) | 29 |
| Net income | \$ 231 | \$ 243 | \$ 218 | \$ 910 |
| Income per common share-basic | \$ 0.06 | \$ 0.07 | \$ 0.06 | \$ 0.25 |
| Income per common share-diluted | \$ 0.05 | \$ 0.07 | \$ 0.05 | \$ 0.25 |
| Weighted average shares outstanding basic | 4,044,774 | 3,599,456 | 4,032,922 | 3,586,442 |
| Weighted average shares outstanding-diluted | 4,206,358 | 3,664,301 | 4,210,473 | 3,621,394 |

(1) Reclassification of custom freight expenses in 2nd quarter between cost of sales and other income (expense)

See accompanying condensed notes to consolidated financial statements

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SI TECHNOLOGIES, INC.

Consolidated Statements of Cash Flows

(in thousands)

(Unaudited)

| | For the nine months ended | |
|---|---------------------------|--------------|
| | April 30, | |
| | 2004 | 2003 |
| Cash flows from operating activities: | | |
| Net income | \$ 218 | \$ 910 |
| Adjustments to reconcile net income to net cash provided by (used in) operating activities: | | |
| Depreciation and amortization | 364 | 496 |
| Loss on sale of equipment | 30 | |
| Deferred lease cost | (210) | (196) |
| Deferred income taxes | | (384) |
| Provision for doubtful accounts | 68 | 34 |
| Changes in operating assets and liabilities: | | |
| Trade accounts receivable | (117) | (206) |
| Inventories | 682 | (2,358) |
| Other current assets | 24 | 25 |
| Accounts payable | 442 | 1,329 |
| Accrued liabilities and customer advances | 133 | 3 |
| Net cash provided by (used in) operating activities | 1,634 | (347) |
| Cash flows from investing activities: | | |
| Proceeds from sale of equipment | 101 | |
| Purchase of equipment | (132) | (209) |
| Net cash (used in) investing activities | (31) | (209) |
| Cash flows from financing activities: | | |
| Stock options granted to consultant | 26 | |
| Proceeds from sale of common stock | 156 | 540 |
| Net (repayments) borrowings on line of credit | (797) | 654 |
| Payments on long-term debt | (1,030) | (730) |
| Net cash provided by (used in) financing activities | (1,645) | 464 |
| Effect of translation adjustments on cash | 1 | 13 |
| Net (decrease) in cash | (41) | (79) |
| Cash at beginning of period | 284 | 238 |

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| | | |
|------------------------------|---------------|---------------|
| Cash at end of period | <u>\$ 243</u> | <u>\$ 159</u> |
| Cash paid during period for: | | |
| Interest | <u>\$ 610</u> | <u>\$ 734</u> |

See accompanying condensed notes to consolidated financial statements

Table of Contents**SI TECHNOLOGIES, INC.****Condensed Notes to Consolidated Financial Statements****April 30, 2004****(In thousands except share and per share data)**

(Unaudited)

Note 1. Basis of Presentation

The accompanying unaudited consolidated financial statements of SI Technologies, Inc. and its subsidiaries (the Company) have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to such rules and regulations. These financial statements reflect all adjustments, consisting of only normal recurring adjustments which, in the opinion of management, are necessary to fairly present the financial position results of operations and the cash flows of the company for the periods presented. The results of operations for interim periods are not necessarily indicative of the results to be expected for the entire fiscal year ending July 31, 2004. This Form 10-Q should be read in conjunction with the Company's Annual Report and Form 10-K for the year ended July 31, 2003.

Note 2. Equity Compensation Plan Information

The Company accounts for stock-based employee compensation under the requirements of APB Opinion No. 25, which does not require compensation to be recorded if the consideration to be received is at least equal to fair value of the Company's common stock at the measurement date. Non-employee stock-based transactions and stock warrants are accounted for under the requirements of SFAS No. 123, *Accounting for Stock-Based Compensation*, which requires compensation to be recorded based on the fair value of the securities issued or the services received, whichever is more reliably measurable.

The following table shows the pro forma effect of stock based compensation on net income had the Company used the fair value method of accounting for stock options:

| | For the three | | For the nine | |
|--|----------------------|-------------|---------------------|-------------|
| | months ended | | months ended | |
| | April 30, | | April 30, | |
| | 2004 | 2003 | 2004 | 2003 |
| Net Income, as reported | \$ 231 | \$ 243 | \$ 218 | \$ 910 |
| Deduct total stock-based employee compensation expense determined under the fair value method for all awards, net of related tax effects | (21) | 45 | (192) | (75) |

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| | | | | |
|----------------------|---------------|---------------|--------------|---------------|
| Pro Forma net income | <u>\$ 210</u> | <u>\$ 288</u> | <u>\$ 26</u> | <u>\$ 835</u> |
| Income per share: | | | | |
| Basic: | | | | |
| As reported | \$ 0.06 | \$ 0.07 | \$ 0.06 | \$ 0.25 |
| Pro forma | \$ 0.05 | \$ 0.08 | \$ 0.00 | \$ 0.23 |
| Diluted: | | | | |
| As reported | \$ 0.05 | \$ 0.07 | \$ 0.05 | \$ 0.25 |
| Pro forma | \$ 0.05 | \$ 0.08 | \$ 0.00 | \$ 0.23 |

Table of Contents**Note 3. Earnings per share**

Basic earnings per share is computed by dividing the net income attributable to the common stockholders by the weighted average number of shares outstanding during the period. There is no adjustment in the net income attributable to common stockholders. Diluted earnings per share reflect the potential dilution that could occur from common shares issuable through stock options (177,551 and 34,835 equivalent shares in 2004 and 2003 respectively, and 161,584 and 64,125 for the three months ended April 30, 2004 and 2003 respectively).

Note 4. Inventories

Inventories are stated at the lower of cost (on a first-in, first-out basis) or market and consist of the following at:

| | <u>April 30, 2004</u> | <u>July 31, 2003</u> |
|--|-----------------------|----------------------|
| | <u>(Unaudited)</u> | |
| Raw Materials | \$ 4,434 | \$ 4,769 |
| Work in Process | 1,126 | 1,257 |
| Finished Goods | 4,874 | 4,810 |
| | <u>10,434</u> | <u>10,836</u> |
| Less reserve for excess and obsolete inventories | (881) | (602) |
| | <u>\$ 9,553</u> | <u>\$ 10,234</u> |

Note 5. Industry And Geographic Area Segment Information

The Company applies the principles of SFAS No. 131, Disclosure about Segments of an Enterprise and Related Information. The Company operates in three operating segments, two of which are combined, resulting in two reportable business segments (1) industrial measurement, and (2) industrial automation. The Company's reportable segments are strategic business units that offer different products. They are managed separately based on the fundamental differences in their operations. The accounting policies of the segments are the same as those described in the Company's Annual Report on Form 10-K, Note A Summary of Significant Accounting Policies.

As of April 30, 2004, approximately 59% of the sales are within the United States, 5% are within Canada, 6% to Pacific Rim and 30% of sales are to European customers. No single customer or control group represents more the 10% of total sales. As of April 30, 2004, \$5.1 million of the Company's assets were held outside the United States.

Included in the industrial measurement segment are industrial sensors and controls products consisting of a wide range of National Type Evaluation (NTEP) and International Organization of Legal Metrology (IOLM) approved, load cells, transducers, translators and sensors. The products measure forces such as pressure, weight, mass and torque when matched with microprocessor controlled digital electronics. Weighing Systems products constitute the combination of load cells and microprocessor-controlled digital electronics that in combination provide for an integrated system providing weight data in both dynamic and static industrial weighing applications.

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The industrial automation segment consists of load handling, moving and positioning equipment and systems for applications in manufacturing, construction and other environments in which heavy bulky materials are being transported and positioned.

Table of Contents**Segment Information 2004 (Unaudited)**

| | Industrial Measurement | Industrial Automation | SI Consolidated |
|---|-----------------------------------|----------------------------------|------------------------|
| Three months ended April 30, 2004: | | | |
| Sales | \$ 7,320 | \$ 1,968 | \$ 9,288 |
| Cost of goods sold | 4,661 | 1,248 | 5,909 |
| Gross profit | 2,659 | 720 | 3,379 |
| Gross profit % | 36% | 37% | 36% |
| Operating expenses | 2,179 | 599 | 2,778 |
| Operating profit | \$ 480 | \$ 121 | 601 |
| Interest expense | | | (198) |
| Other income, net | | | (109) |
| Income before provision for taxes | | | 294 |
| Income tax provision | | | (63) |
| Net income | | | \$ 231 |
| Depreciation and amortization | \$ 111 | \$ 9 | \$ 120 |
| Assets | \$ 22,203 | \$ 3,682 | \$ 25,885 |
| | Industrial Measurement | Industrial Automation | SI Consolidated |
| Nine months ended April 30, 2004: | | | |
| Sales | \$ 21,081 | \$ 5,261 | \$ 26,342 |
| Cost of goods sold | 13,985 | 3,175 | 17,160 |
| Gross profit | 7,096 | 2,086 | 9,182 |
| Gross profit % | 34% | 40% | 35% |
| Operating expenses | 6,375 | 1,691 | 8,066 |
| Operating profit | \$ 721 | \$ 395 | 1,116 |
| Interest expense | | | (650) |
| Other expense, net | | | (193) |
| Income before provision for taxes | | | 273 |
| Income tax provision | | | (55) |
| Net income | | | \$ 218 |
| Depreciation and amortization | \$ 336 | \$ 28 | \$ 364 |



Table of Contents**Segment Information 2003 (Unaudited)**

| | <u>Industrial Measurement</u> | <u>Industrial Automation</u> | <u>SI Consolidated</u> |
|---|-----------------------------------|----------------------------------|------------------------|
| Three months ended April 30, 2003: | | | |
| Sales | \$ 6,796 | \$ 1,867 | \$ 8,663 |
| Cost of goods sold | 4,639 | 1,147 | 5,786 |
| Gross profit | 2,157 | 720 | 2,877 |
| Gross profit % | 32% | 39% | 33% |
| Operating expenses | 1,977 | 507 | 2,484 |
| Operating profit | \$ 180 | \$ 213 | 393 |
| Interest expense | | | (235) |
| Other income, net | | | 61 |
| Income before benefit for taxes | | | 219 |
| Income tax benefit | | | 24 |
| Net income | | | \$ 243 |
| Depreciation and amortization | \$ 159 | \$ 11 | \$ 170 |
| Assets | \$ 23,834 | \$ 4,610 | \$ 28,444 |
| | <u>Industrial Measurement</u> | <u>Industrial Automation</u> | <u>SI Consolidated</u> |
| Nine months ended April 30, 2003: | | | |
| Sales | \$ 19,617 | \$ 5,112 | \$ 24,729 |
| Cost of goods sold | 12,712 | 3,053 | 15,765 |
| Gross profit | 6,905 | 2,059 | 8,964 |
| Gross profit % | 35% | 40% | 36% |
| Operating expenses | 5,979 | 1,508 | 7,487 |
| Operating profit | \$ 926 | \$ 551 | 1,477 |
| Interest expense | | | (738) |
| Other income, net | | | 142 |
| Income before benefit for taxes | | | 881 |
| Income tax benefit | | | 29 |
| Net income | | | \$ 910 |
| Depreciation and amortization | \$ 454 | \$ 42 | \$ 496 |

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

Preliminary Note Regarding Forward-Looking Statement

The following discussion and analysis should be read in conjunction with our Consolidated Financial Statements and related Notes included in this report. This report contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. The statements contained in this report that are not historical in nature, particularly those that utilize terminology such as may, will, should, expects, anticipates, estimates, believes or plans, or comparable terminology, are forward-looking statements based on current expectations and assumptions.

Various risks and uncertainties could cause actual results to differ materially from those expressed in forward-looking statements. These risks and uncertainties include our ability to hire and retain qualified management, technology and other personnel; and impact of competition from existing and new technologies and companies.

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Overview

We develop, design, manufacture and market high-performance industrial sensors, weighing, and factory automation systems. Our products are used in a wide variety of industries including aerospace, aviation, food processing and packaging, forestry manufacturing, mining, transportation, warehousing, distribution, and waste management.

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

We expect demand for our products to continue, but the near term outlook for our markets remain clouded by uncertain economic conditions and competition. Therefore, we are in process of searching for a facility in Southern California that is smaller than the one currently being leased in conjunction with the continuing outsourcing of certain high volume, low margin component products to manufacturing partners in low labor cost countries. We believe a recovery in global capital spending will allow us to leverage our more efficient operating structure into greater sales and profitability.

Results of Operations-three months ended April 30, 2004 vs. April 30, 2003

Sales

Net sales increased by approximately 7% to \$9.3 million for the quarter ended April 30, 2004 from \$8.7 million for the same period in the prior fiscal year. A general global economy betterment, and an exchange rate gain at the Company's European operations were the contributing items for the sales increase for the quarter over the prior year's quarter.

Gross Profit

Gross profit in the third quarter increased by approximately 17% to \$3.4 million from \$2.9 million of gross profit reported for the same period in the prior fiscal year. Increase of gross profit for the quarter as compared to the prior year were due to volume of sales, and the continuing transfer of manufacturing to outsourced contract manufacturer which has resulted in lower cost. The outsourcing continues to improve on quality which reduces rework cost. Offsetting the increase in gross profit was an increase in our reserve for excess and obsolete inventory of \$187,000 for the three month period

Selling, General and Administrative/Other Expenses

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Selling, general and administrative/other expenses increased approximately 25% to \$2.5 million in the quarter ended April 30, 2004 as compared to \$2.0 million for the same period in the prior fiscal year. The quarter had increases in expenses mainly due to audit and tax fees, bank charges, consulting fees and insurance.

Research, Development and Engineering Expenses

Research, development and engineering expenses decreased by approximately 6% to \$404,000 for the quarter ended April 30, 2004, as compared to \$432,000 for the same period in the prior fiscal year. This was the result of reclassifying personnel from engineering to manufacturing for incoming inspection.

Interest Expense

For the three month period ended April 30, 2004, interest expense was \$198,000 as compared to \$235,000 in the prior year's period. The main cause for the decrease in both periods was reduction in debt.

Income Tax Expense

The provision for income taxes for the three months ended April 30, 2004 was \$63,000 as compared to a tax benefit of \$24,000 in the prior year. The tax benefit in the prior year period was for valuation allowance adjustments, and the tax provision for the current year period is the statutory tax rates less adjustments mainly from foreign sales tax credits.

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Net Income

Reflecting all of the matters discussed above, net income was \$231,000 (or \$0.06 per share basic, and \$0.05 per share diluted) for the quarter ended April 30, 2004.

Comparison of the Nine Months Ended April 30, 2004 to the Nine Months Ended April 30, 2003

Sales

For the nine months ended April 30, 2004, net sales were \$26.3 million, an increase of 7%, or \$1.6 million from the prior year's period. A general global economy uptick, and an exchange rate gain at the Company's European operations were the contributing items for the sales increase for the nine months over the prior year period.

Gross Profit

For the nine months ended April 30, 2004, gross profit was \$9.2 million, an increase of 2% or \$200,000 over the prior year's period. The increase was due primarily to volume of sales, and the continuing transfer of manufacturing to outsourced contract manufacturers which has resulted in lower cost. The outsourcing continues to improve on quality which reduces rework cost, offsetting the increase in gross profit was an increase in our reserve for excess and obsolete inventory of \$279,000.

Selling, General and Administrative/Other Expenses

For the nine months these expenses increased to \$6.7 million as compared to \$6.3 million for the same period in the prior year. The increase was due to a severance fee of \$125,000 during the second quarter, plus increases in expenses mainly due to audit and tax fees, bank charges, consulting fees and insurance.

Research, Development and Engineering Expenses

For the nine months, the expenses were \$1.3 million as compared to \$1.1 million in the prior year's period. The increase was attributable to personnel increases to support manufacturing activities; however, the third quarter reclassification of personnel mentioned above offset this increase.

Interest Expense

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For the nine months ended, interest was \$650,000 as compared to \$738,000 in the prior year's period, reflecting the effect of lower outstanding debt.

Income Tax Expense

For the nine months, the tax provision was \$55,000 as compared to a benefit of \$29,000 in the prior period. The tax benefit in the prior year period was for valuation allowance adjustments, and the tax provision for the current year period is the statutory tax rates less adjustments for mainly foreign sales tax credits.

Net Income

Reflecting all of the matters discussed above, net income was \$218,000 (or \$0.06 per share basic, and \$0.05 per share diluted) for the nine months ended April 30, 2004.

Inflation

Historically, the impact of inflation has been negligible, as the Company has been able to offset the effects through efficiency improvements.

Liquidity and Capital Resources

At April 30, 2004 the Company's cash position was \$243 thousand compared to \$284 thousand at July 31, 2003. Cash required in excess of that provided for general corporate purposes is provided by borrowings under the Company's line of credit. Working capital increased to \$1.7 million at April 30, 2004 from \$1.6 million at July 31, 2003.

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The Company's existing capital resources consist of cash balances and funds available under its line of credit, which are increased or decreased by cash provided by or used in operating activities. Cash provided by operating activities for the nine months ended April 30, 2004 was \$1.6 million as compared with \$347 thousand used by operations in the same period in the prior fiscal year. Cash provided by or used in operating activities consists of net income, primarily increased or decreased by the collection of trade accounts receivable, inventories and accounts payable. The Company's trade accounts receivable are generally collectable within 60 days. The increase in cash provided by operations for the nine months ended April 30, 2004 of \$1.9 million was mainly offset by debt payment over the prior year period.

The Company's cash requirements consist of its general working capital needs, capital expenditures, and obligations under its leases and notes payable. Working capital requirements include the salary costs of employees and related overhead and the purchase of material and components.

In March 2004, the Company agreed upon an extension to the principal credit agreement with its bank to July 31, 2004. The Company is current with all provisions of the current debt agreement and had excess borrowing capacity of \$.3 million at April 30, 2004. The credit agreement provides for a revolving line of credit up to a maximum of \$6 million with interest at prime (4% at April 30, 2004) plus 2.75%. Monthly payments on the line are interest only with principal due July 31, 2004. The credit agreement continues the \$1.5 million term note (balance at April 30, 2004 of \$.7 million, however as of May 3, 2004 the balance is \$.5 million) with interest at prime 4% at April 30, 2004 plus 3.25%. Monthly payments are \$175 thousand principal plus interest with the balance due July 31, 2004. Monthly payments on the second note payable of \$3.9 million are \$56 thousand plus interest at prime plus 1.75%. The line and both notes are secured by substantially all of the Company's assets and are cross-collateralized and cross-defaulted. The Company is required to maintain certain levels of earnings before interest, taxes, depreciation and amortization, tangible net worth and fixed charge coverage and, may not pay any cash dividends. The Company plans to extend the credit facility at renewal.

The Company also maintains a revolving line of credit with a bank to support the Company's European operations for 2.3 million Euros, secured by certain of the Company's inventories and receivables. As of April 30, 2004, there was a balance outstanding of 1.4 million Euros or \$1.8 million.

Critical Accounting Policies and Estimates

We reaffirm the critical accounting policies and our use of estimates as reported in our annual report on Form 10-K for the year ended July 31, 2003.

Item 3. Quantitative And Qualitative Disclosures About Market Risk

Market risk represents the potential loss that may impact our financial position, results of operations or cash flows due to adverse changes in the financial markets. The Company is exposed to market risk from changes in the base rates on our variable rate debt.

The domestic bank revolving line of credit and term debt bear interest at a variable interest rate equal to prime plus an additional amount, as defined in each respective debt agreement. At April 30, 2004, the interest rate on our revolving line of credit was 6.75%, and the interest rate on our term loans were 5.75% and 7.25%. We do not believe the risk associated with interest rate fluctuations related to these financial instruments poses a risk to the Company.

Item 4. Controls and Procedures

The Company maintains disclosure controls and procedures that are designed to ensure that information required to be disclosed in the Company's Exchange Act reports is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to the Company's management, including its Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure. In designing and evaluating the disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management necessarily was required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

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At the end of the period covered by this report, the Company carried out an evaluation, under the supervision and with the participation of the Company's management, including the Company's Chief Executive Officer and the Company's Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures. Based on the foregoing, the Company's Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures were effective.

No changes in the Company's internal control over financial reporting were identified in connection with the evaluation that has materially affected or is reasonably likely to materially affect the Company's internal control over financial reporting.

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PART II-OTHER INFORMATION

Item 1. Legal Proceedings

From time to time, the Company is involved in various legal matters in the normal course of business. Management does not believe any matter exists at April 30, 2004, which would result in any significant adverse effect to the financial statements.

Item 2. Changes in Securities, Use of Proceeds and Issuer Purchases of Equity Securities

On April 14, 2004, Rick A. Beets, a member of the Board of Directors, exercised a stock option for 100,000 shares of Common Stock with an exercise price of \$1.5625 per share. The total consideration paid to the Company upon the exercise of the stock option was \$156,250. This issuance of the Common Stock upon the exercise of the stock option was exempt from the registration requirements of the Securities Act of 1933, as amended (the "1933 Act"), pursuant to section 4(2) of the 1933 Act.

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits to Part II

- Exhibit 31.1 - Certificate of Chief Executive Officer of SI Technologies, Inc. pursuant to Exchange Act Rule 13a-14(a).
- Exhibit 31.2 - Certificate of Chief Financial Officer of SI Technologies, Inc. pursuant to Exchange Act Rule 13a-14(a).
- Exhibit 32.1 - Certificate of Chief Executive Officer of SI Technologies, Inc. pursuant to Exchange Act Rule 13a-14(b) and 18 U.S.C. Section 1350.
- Exhibit 32.2 - Certificate of Chief Financial Officer of SI Technologies, Inc. pursuant to Exchange Act Rule 13a-14(b) and 18 U.S.C. Section 1350.

(b) Reports on Form 8-K

None

