

***Semco***

***INSTRUMENTS, INC.***

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***ANNUAL  
REPORT  
2002***

*SEMCO INSTRUMENTS, INC. was founded in December 1965 as an engineering based aerospace manufacturer of precision sensors and electronic controls. Our primary market has been the gas turbine engine manufacturers and the related commercial aircraft industry. Company efforts continue to be directed toward the expansion of our market share of temperature sensors and speed sensors in the commercial and military markets.*

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## To Our Shareholders:

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Net sales achieved by your Company in 2002 were \$8,850,951 as compared to 2001 sales of \$8,710,586. In 2002, net income was \$730,687 or \$0.17 per share as compared to a 2001 net income of \$569,736 or \$0.14 per share.

In a difficult economic environment the Company's 2002 sales increased 1.6% over 2001 levels and the Company was able to increase its net return on sales to 8.25% in 2002 as compared with 6.54% in 2001. The Company continued to focus on growth in the marketplace as well as continued improvement in all our business processes.

As part of the on-going focus on growth the Company recognized that broader product offerings would enhance both the Company's position in the marketplace as well as provide a platform for increased revenue. As a result, the Company directed efforts at the acquisition of the Atlas-Aero Corporation. In business since 1959, the Atlas-Aero Corporation has as its primary product electrical wiring harnesses for aircraft airframes and engines. The Atlas-Aero Corporation maintains a unique market position based on its ability to provide specialized types of wiring harnesses that are extremely reliable in environments of high vibration and moisture. Sharing many of the same customers of Semco Instruments, the acquisition of this business will enhance the Company's position with these customers who continue to seek suppliers able to provide the broadest possible product offerings. The acquisition was completed on 17 February 2003 and the integration of the operations is on-going.

We remain optimistic about the future of the Company. The recent acquisition and the culture of the Company which is focused on technical expertise, continuous improvement, and world-class levels of quality, delivery, and customer support, will provide a basis for continued success.

I am thankful for your continued interest and support.

Sincerely,



Michael G. Moore  
President

# Balance Sheets

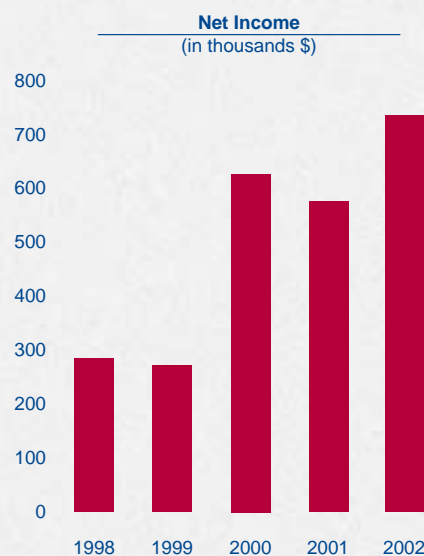
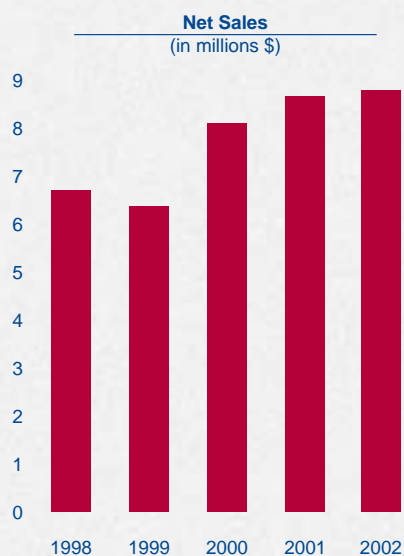
ASSETS	December 31	
	2002	2001
Current Assets		
Cash and cash equivalents	\$ 1,316,930	\$ 939,209
Trade receivables	1,565,047	1,258,279
Inventories	2,212,574	2,260,505
Prepaid expenses and other	118,801	45,680
Deferred taxes	171,000	244,000
<b>Total current assets</b>	<b>5,384,352</b>	<b>4,747,673</b>
Investment in Available-for-sale Securities	75,000	347,938
Property, Plant and Equipment		
Land	898,993	898,993
Building and improvements	2,095,172	2,095,172
Machinery and equipment	1,622,507	1,578,052
Automotive equipment	80,403	80,403
Furniture, fixtures and computers	644,007	619,297
	5,341,082	5,271,917
Less accumulated depreciation	2,744,529	2,504,651
	2,596,553	2,767,266
Deferred Acquisition Costs	129,349	—
	<b>\$ 8,185,254</b>	<b>\$ 7,862,877</b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current Liabilities		
Current maturities of long-term debt	\$ 38,100	\$ 35,388
Accounts payable and accrued expenses	832,503	942,124
Dividends payable	—	260,352
<b>Total current liabilities</b>	<b>870,603</b>	<b>1,237,864</b>
Long-term Debt, less current maturities	1,707,928	1,745,977
Deferred Taxes	398,000	401,000
Stockholders' Equity		
Common stock, \$0.01 par value; 6,000,000 shares authorized	44,258	44,258
Additional paid-in capital	833,626	833,626
Retained earnings	4,347,893	3,617,206
	5,225,777	4,495,090
Less treasury stock, at cost, 86,625 shares	(17,054)	(17,054)
<b>Total stockholders' equity</b>	<b>5,208,723</b>	<b>4,478,036</b>
	<b>\$ 8,185,254</b>	<b>\$ 7,862,877</b>

See Notes to Financial Statements.

# Statements of Income

	Years Ended December 31		
	2002	2001	2000
Net sales	\$ 8,850,951	\$ 8,710,586	\$ 8,053,746
Cost of sales	6,272,577	6,285,290	5,671,844
<b>Gross profit</b>	<b>2,578,374</b>	<b>2,425,296</b>	<b>2,381,902</b>
Selling, general and administrative expenses	1,320,634	1,224,764	1,261,513
<b>Operating income</b>	<b>1,257,740</b>	<b>1,200,532</b>	<b>1,120,389</b>
Financial (income) expense:			
Interest expense	137,411	163,742	161,796
Interest income	(29,574)	(50,009)	(42,468)
Other	2,735	3,063	(3,626)
	<b>110,572</b>	<b>116,796</b>	<b>115,702</b>
Income before income taxes	1,147,168	1,083,736	1,004,687
Federal and state income taxes	416,481	514,000	394,000
<b>Net income</b>	<b>\$ 730,687</b>	<b>\$ 569,736</b>	<b>\$ 610,687</b>
Earnings per common share:			
Basic earnings per share	\$ 0.17	\$ 0.14	\$ 0.15
Diluted earnings per share	\$ 0.16	\$ 0.13	\$ 0.14
Weighted average number of common shares outstanding, basic	4,339,204	4,182,969	4,110,510
Weighted average number of common shares outstanding, diluted	4,428,637	4,269,574	4,380,122

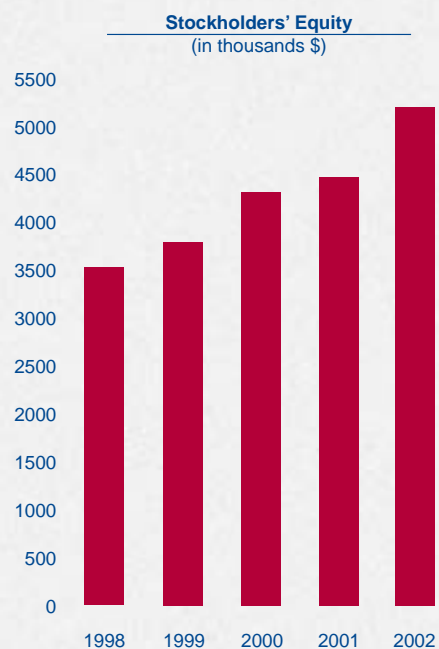
See Notes to Financial Statements.



# Statements of Stockholders' Equity

	Common Stock		Additional Paid-in Capital	Retained Earnings	Treasury Stock, at Cost		Total
	Shares Outstanding	Amount			Shares	Amount	
Balance, December 31, 1999	4,390,576	\$ 43,905	\$ 867,785	\$ 2,910,322	(151,625)	\$ (39,599)	\$ 3,782,413
Net income	-	-	-	610,687	-	-	610,687
Retirement of previously repurchased treasury stock	(35,200)	(352)	(17,248)	-	35,200	17,600	-
Repurchase of common stock	-	-	-	-	(172,700)	(75,803)	(75,803)
Balance, December 31, 2000	4,355,376	43,553	850,537	3,521,009	(289,125)	(97,802)	4,317,297
Common stock issued for exercise of options	300,000	3,000	53,887	-	-	-	56,887
Net income	-	-	-	569,736	-	-	569,736
Dividends	-	-	-	(473,539)	-	-	(473,539)
Retirement of previously repurchased treasury stock	(229,547)	(2,295)	(94,798)	-	229,547	97,093	-
Repurchase of common stock	-	-	-	-	(27,047)	(16,345)	(16,345)
Tax benefits from option activity	-	-	24,000	-	-	-	24,000
Balance, December 31, 2001	4,425,829	44,258	833,626	3,617,206	(86,625)	(17,054)	4,478,036
Net income	-	-	-	730,687	-	-	730,687
Balance, December 31, 2002	<b>4,425,829</b>	<b>\$ 44,258</b>	<b>\$ 833,626</b>	<b>\$ 4,347,893</b>	<b>(86,625)</b>	<b>\$ (17,054)</b>	<b>\$ 5,208,723</b>

See Notes to Financial Statements.



# Statements of Cash Flows

	Years Ended December 31		
	2002	2001	2000
Cash Flows from Operating Activities			
Net income	\$ 730,687	\$ 569,736	\$ 610,687
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	239,879	232,168	272,633
Gain on disposal of available-for-sale securities	(4,714)	-	-
Deferred taxes	70,000	27,000	(48,000)
Tax benefits related to employee stock options	-	24,000	-
Changes in working capital components:			
(Increase) in trade receivables	(306,768)	(81,025)	(138,143)
(Increase) decrease in inventories	47,931	(176,911)	77,782
(Increase) decrease in prepaid expenses and other current assets	(73,121)	19,161	23,913
Increase (decrease) in accounts payable and accrued expenses	(109,622)	(31,067)	284,426
<b>Net cash provided by operating activities</b>	<b>594,272</b>	<b>583,062</b>	<b>1,083,298</b>
Cash Flows from Investing Activities			
Purchase of equipment	(69,165)	(323,758)	(159,985)
Proceeds from sale (purchase) of short-term investments	352,652	600,000	(600,000)
Purchase of available-for-sale securities	(75,000)	(347,938)	-
Deferred acquisition costs related to the Atlas-Aero transaction	(129,349)	-	-
<b>Net cash provided by (used in) investing activities</b>	<b>79,138</b>	<b>(71,696)</b>	<b>(759,985)</b>
Cash Flows from Financing Activities			
Dividends paid	(260,352)	(213,187)	-
Principal repayments of long-term debt	(35,337)	(32,778)	(30,402)
Issuance of common stock for options	-	56,887	-
Repurchase of common stock	-	(16,345)	(75,803)
<b>Net cash (used in) financing activities</b>	<b>(295,689)</b>	<b>(205,423)</b>	<b>(106,205)</b>
<b>Net increase in cash and cash equivalents</b>	<b>377,721</b>	<b>305,943</b>	<b>217,108</b>
Cash and cash equivalents			
Beginning	939,209	633,266	416,158
Ending	\$ 1,316,930	\$ 939,209	\$ 633,266
Supplemental Disclosures of Cash Flow Information			
Cash payments for:			
Interest	\$ 142,621	\$ 155,619	\$ 161,268
Income taxes	\$ 505,776	\$ 701,114	\$ 94,206

See Notes to Financial Statements.

# Notes to Financial Statements

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## **1 NATURE OF BUSINESS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

### ***NATURE OF BUSINESS***

Semco Instruments, Inc. (the Company) manufactures and sells precision sensors and systems for measurement and control, principally to original equipment manufacturers in aerospace and commercial industries primarily located in North America. All sales are denominated in U.S. dollars.

**A summary of the Company's significant accounting policies follows:**

### ***Use of estimates***

The preparation of financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities and the reported amounts of revenue and expenses. Actual results could differ from those estimates and could materially affect the reported amount of assets, liabilities and future operating results.

### ***Cash and cash equivalents***

The Company considers all highly liquid investments with a maturity of less than three months when purchased to be cash equivalents. The Company maintains its cash in bank deposit accounts which, at times, may exceed federally insured limits. The Company has not experienced any losses in such accounts. The Company believes it is not exposed to any significant risk relative to its cash accounts.

### ***Trade receivables and concentrations of credit risk***

The Company's customers are concentrated in the commercial aviation industry. Trade receivables are carried at original invoice amount less allowances made for sales returns and doubtful accounts. The Company performs periodic credit evaluations of its customers' financial condition and does not require collateral. Receivables are generally due in 30 days, with the exception of one major customer. For this major customer, the Company receives payments at the end of each calendar year quarter for all open invoices as of that date. Bad debt losses have generally been within management's expectations. Management determines the allowance for doubtful accounts by identifying troubled accounts and by using historical experience applied to an aging of accounts. Accounts receivable are written off when deemed uncollectible. Management has determined that no allowance for doubtful accounts was necessary at December 31, 2002 and 2001. Recoveries of accounts receivable previously written off are recorded when received. An accounts receivable is considered to be past due if any portion of the receivable balance is outstanding for more than 60 days beyond terms. The Company does not charge interest on past due balances.

### ***Concentrations***

The Company derived 54% of its sales from two customers during 2002 (59% in 2001 and 58% in 2000 from the top two). These two customers represented 59% of trade receivables at December 31, 2002. Individually, the two customers accounted for 29% and 25% of 2002 sales (34% and 25% in 2001 and 37% and 21% in 2000).

### ***Fair value of financial instruments***

The Company's financial instruments consist of cash, accounts receivable, available-for-sale securities, accounts payable and debt. The values reported in the financial statements approximate fair value due to their short-term nature and/or relative rates of interest.

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## NATURE OF BUSINESS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

### *Available-for-sale securities*

Securities classified as available for sale are those debt securities that the Company intends to hold for an indefinite period of time, but not necessarily to maturity. Available-for-sale securities are stated at fair value, and unrealized holding gains or losses, net of the related deferred tax effect, are reported as a separate component of stockholders' equity, if any.

### *Employee stock option plan*

The Company has a stock-based compensation plan, which is described more fully in Note 8. The Company accounts for employee stock option grants under the recognition and measurement principles of Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees*, and related interpretations. Because options granted under the plan generally have an exercise price equal to or greater than the market value of the underlying common stock on the date of grant, no stock-based compensation cost has been recognized in determining net income. The following table illustrates the effect on net income had compensation cost for the stock-based compensation plan been recorded using the fair value recognition provisions of Statement of Financial Accounting Standards (SFAS) No. 123, *Accounting for Stock-based Compensation*, as amended:

	<u>2001</u>	<u>2000</u>	<u>1999</u>
Net income			
As reported	<b>\$ 730,687</b>	\$ 569,736	\$ 610,687
Pro forma	<b>\$ 726,576</b>	\$ 565,361	\$ 606,312
Basic earnings per share:			
As reported	<b>0.17</b>	0.14	0.15
Pro forma	<b>0.17</b>	0.14	0.15
Diluted earnings per share:			
As reported	<b>0.16</b>	0.13	0.14
Pro forma	<b>0.16</b>	0.13	0.14

In determining pro forma net income, the fair value of each option granted in prior years was estimated at the grant date using the Black-Scholes option pricing method described in SFAS No. 123, with the following assumptions: estimated volatility of 21%, risk-free interest rate of 4.75%, the options would be exercised at the end of the exercise period and the Company would declare and pay no dividends. The fair value of each option granted in 2002 was estimated at the grant date using the Black-Scholes option pricing method described in SFAS No. 123, with the following assumption: estimated volatility of 17%, risk-free interest rate of 4.25%, the options would be exercised at the end of the exercise period and the Company would declare and pay no dividends.

### *Inventories*

Inventories are stated at the lower of weighted average cost or market. The Company periodically reviews the age and turnover of its inventory to determine whether any inventory has become obsolete or has declined in value, and records a charge to operations for known and anticipated inventory obsolescence.

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## NATURE OF BUSINESS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

### *Property, plant and equipment*

Property, plant and equipment are recorded at cost. The Company uses the straight-line depreciation method for financial reporting purposes. The estimated useful lives by classes of assets used in computing depreciation are as follows:

	<u>Years</u>
Building and improvements	30
Machinery and equipment	5 – 7
Furniture and fixtures	7 – 10
Automotive equipment	5
Molds and tooling	3 – 5

### *Revenue recognition*

Revenue is recognized as product is shipped and title has transferred to the customer.

### *Income taxes*

Deferred taxes are provided on a liability method whereby deferred tax liabilities are recognized for taxable temporary differences and deferred tax assets are recognized for deductible temporary differences and operating loss and tax credit carryforwards. Temporary differences are the differences between the reported amounts of assets and liabilities and their tax bases. Deferred tax assets are reduced by a valuation allowance when it cannot be demonstrated that the deferred tax assets are more likely than not to be realized. Deferred tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of enactment.

### *Product warranty*

The Company offers warranties to its customers for a period of one to five years from the date of purchase. The Company's warranties require it to repair or replace defective parts or components during the warranty period at no cost to the customer. The Company records a liability for estimated costs that may be incurred under its warranties. The costs are estimated based on historical experience and any specific warranty issues that have been identified. Although historical warranty costs have been within expectations, and have not been significant, there can be no assurance that future warranty costs will not exceed historical amounts. The Company periodically assesses the adequacy of its recorded warranty liability and adjusts the balance as necessary.

### *Segment information*

The Company operates as one segment, manufacturing and selling precision sensors and systems for measurement and control. For purposes of reporting and aggregating revenue to foreign countries, sales are attributed to the country of the headquarters of the customer, all of which are headquartered in the United States.

### *Earnings per common share (EPS)*

Basic EPS excludes dilution and is computed by dividing income available to common stockholders by the weighted average number of common shares outstanding for the year. Diluted EPS is based upon the weighted average number of common shares outstanding during the year plus the additional weighted average common equivalent shares during the year, if any. Common equivalent shares are not included in the diluted EPS calculations where the effect of their inclusion would be antidilutive. Common equivalent shares result from the assumed exercise of outstanding stock options, the proceeds of which are then assumed to have been used to repurchase outstanding stock using the treasury-stock method.

## NATURE OF BUSINESS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

The following table sets forth the computation of the denominator (in shares of common stock) for basic and fully diluted earnings per share as of December 31:

	2002	2001	2000
Denominator for basic earnings per share	4,339,204	4,182,969	4,110,510
Effect of dilutive securities, employee stock options	89,433	86,605	269,612
Denominator for diluted earnings per share	<u>4,428,637</u>	<u>4,269,574</u>	<u>4,380,122</u>
Andilutive employee stock options not included in diluted earnings per share	<u>150,000</u>	—	—

## 2 INVENTORIES

Inventories consist of the following at December 31:

	2002	2001
Raw materials and fabricated parts	\$ 1,463,563	\$ 1,542,546
Work in process	280,040	419,685
Finished goods	468,971	298,274
	<u>\$ 2,212,574</u>	<u>\$ 2,260,505</u>

The reserve for obsolescence was \$60,000 and \$112,000 at December 31, 2002 and 2001, respectively.

## 3 AVAILABLE-FOR-SALE SECURITIES

The amortized cost and fair value of securities available for sale as of December 31, are summarized as follows:

	2002	2001
Certificates of deposit	\$ —	\$ 198,125
Corporate bonds	75,000	149,813
	<u>\$ 75,000</u>	<u>\$ 347,938</u>

The amortized cost and fair value of securities available for sale as of December 31, 2002 by contractual maturities are shown below.

Due after ten years	<u>\$ 75,000</u>
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## 4 LINES OF CREDIT AND SUBSEQUENT EVENT

The Company has a revolving line-of-credit agreement with a bank for borrowings up to a maximum of \$1,000,000. No amounts were outstanding at December 31, 2002 and 2001. The agreement provides for interest, payable monthly, at the bank's prime rate (4.25% at December 31, 2002). The line of credit is collateralized by all assets of the Company, including trade receivables, inventories, equipment and fixtures. The line of credit expires June 15, 2003.

Under the line-of-credit agreement, the Company agrees to maintain certain minimum financial ratios related to working capital, stockholders' equity and profitability. In addition, the Company is subject to restrictions related to paying dividends, purchases of treasury stock and fixed assets, and entering into new lease obligations.

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## LINES OF CREDIT AND SUBSEQUENT EVENT (continued)

The Company also has a \$250,000 line-of-credit facility available for equipment purchases with terms similar to the revolving line of credit. Outstanding balances accrue interest at the bank's prime rate, and interest is payable monthly. The equipment line of credit expires June 15, 2003, at which time any outstanding principal may be converted to a four-year term loan with principal and interest payable monthly. There was no balance outstanding under the equipment line of credit at December 31, 2002 and 2001.

### *Subsequent event*

During February 2003, in conjunction with the Atlas-Aero acquisition discussed in Note 11, the Company's line of credit was increased to \$4,000,000. Borrowings are subject to a borrowing base of 75% of eligible receivables, 30% to 40% of eligible inventory and a maximum inventory borrowing of \$1,000,000. The revised line of credit expires June 30, 2004 and bears interest at the bank's prime rate or LIBOR plus 2.25%. The line of credit is secured by the assets of the Company and requires the Company to meet the financial covenants of the credit agreement and restricts dividends.

## 5 ACCOUNTS PAYABLE AND ACCRUED EXPENSES

Accounts payable and accrued expenses at December 31 consist of:

	<u>2002</u>	<u>2001</u>
Accounts payable	\$ 424,230	\$ 314,275
Compensation and related payroll taxes	370,139	494,571
Federal and state income taxes	-	76,295
Interest	26,567	40,188
Other, in 2002 principally the benefit from from reduced tax rate on foreign export sales	11,567	16,795
	<u>\$ 832,503</u>	<u>\$ 942,124</u>

## 6 LONG-TERM DEBT

Long-term debt at December 31 is as follows:

	<u>2002</u>	<u>2001</u>
Note payable, bank, secured by first deed of trust on real estate, payable in monthly installments of \$14,045 including interest at 7.5%, maturing in September 2005	\$ 1,746,028	\$ 1,781,365
Less current maturities	38,100	35,388
interest at 7.5%, maturing in September 2005	<u>\$ 1,707,928</u>	<u>\$ 1,745,977</u>

Aggregate maturities of long-term debt as of December 31, 2002 are as follows:

<u>Year Ending December 31,</u>	<u>Amount</u>
2003	\$ 38,100
2004	41,074
2005	1,666,854
	<u>\$ 1,746,028</u>

## 7 INCOME TAXES

Components of income tax expense for the years ended December 31 are as follows:

	<u>2002</u>	2001	2000
Currently paid or payable:			
Federal	<b>\$ 276,526</b>	\$ 427,000	\$ 364,000
State	<b>69,955</b>	60,000	78,000
	<b>346,481</b>	487,000	442,000
Deferred	<b>70,000</b>	27,000	(48,000)
	<b><u>\$ 416,481</u></b>	<b><u>\$ 514,000</u></b>	<b><u>\$ 394,000</u></b>

The following table presents a reconciliation of income tax determined by applying the U.S. federal income tax rate to pretax income:

	<u>2002</u>	2001	2000
Computed expected statutory rate	<b>35 %</b>	35 %	35 %
Increase (decrease) in rate resulting from:			
State taxes, net of federal benefit	<b>4</b>	4	5
Undistributed domestic international sales corporation (DISC) income adjustment	-	8	-
Other, in 2002 principally benefit from reduced rate on foreign export sales	<b>(3)</b>	-	(1)
	<b><u>36%</u></b>	<b><u>47%</u></b>	<b><u>39%</u></b>

Net deferred tax liabilities as of December 31 consist of the following components:

	<u>2002</u>	2001
Deferred tax liabilities:		
Property, Plant and Equipment	<b>\$ (134,000)</b>	\$ (115,000)
Undistributed DISC income	<b>(269,000)</b>	(300,000)
	<b><u>(403,000)</u></b>	<b><u>(415,000)</u></b>
Deferred tax assets:		
Inventories	<b>61,000</b>	91,000
Compensation	<b>93,000</b>	132,000
Other	<b>22,000</b>	35,000
	<b><u>176,000</u></b>	<b><u>258,000</u></b>
	<b><u>\$ (227,000)</u></b>	<b><u>\$ (157,000)</u></b>

Net deferred tax liabilities have been included in the accompanying balance sheets at December 31 as follows:

	<u>2002</u>	2001
Current assets	<b>\$ 171,000</b>	\$ 244,000
Long-term liabilities	<b>(398,000)</b>	(401,000)
	<b><u>\$ (227,000)</u></b>	<b><u>\$ (157,000)</u></b>

## INCOME TAXES (continued)

During 2001 the company revoked its election pertaining to the maintenance of its DISC. As a result of terminating the DISC, the Company is required to pay federal tax on the undistributed DISC income of \$800,000, or approximately \$34,000 per year, through 2010. A deferred income tax liability has been provided for all of the undistributed DISC income.

## 8 STOCK OPTION PLAN

The Company has adopted a stock option plan covering the Company's common shares. Nonqualified stock options may be issued to officers, directors or key employees of the Company. Qualified stock options may be issued to employees of the Company. Qualified and nonqualified stock options are exercisable at prices not less than the fair market value on the date of grant (not less than 110% of the fair market value for participating individuals who own more than 10% of the outstanding voting stock of the Company).

Options granted under the Company's stock option plan generally are exercisable beginning one year from the date of grant and vest at the rate of 25% per year on a cumulative basis. The options expire at the earlier of five years from the date of grant or three months from the stock-option holder's termination of employment.

A summary of stock option activity during the years ended December 31 is as follows:

	2002		2001		2000	
	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
Outstanding at beginning of year:	150,000	\$0.19	450,000	\$ 0.19	900,000	\$ 0.23
Granted	150,000	0.84	—	—	—	—
Canceled	—	—	—	—	450,000	0.27
Exercised—	—	—	<u>300,000</u>	0.19	—	—
Outstanding at end of year	<u>300,000</u>	0.52	<u>150,000</u>	0.19	<u>450,000</u>	0.19
Options exercisable, end of year	<u>150,000</u>	0.19	<u>37,500</u>	0.19	<u>225,000</u>	0.19
Options available for grant, end of year	<u>—</u>		<u>150,000</u>		<u>150,000</u>	
Weighted average fair value of options granted during the year, per share	<u>\$ 0.10</u>		<u>\$ —</u>		<u>\$ —</u>	

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## STOCK OPTION PLAN (continued)

The following table summarizes information about stock options outstanding at December 31, 2002:

Exercise Price	Number Outstanding	Remaining Contractual Life (in Years)	Number Exercisable
\$ 0.19	125,000	1	125,000
0.20	25,000	1	25,000
0.82	116,000	5	—
0.90	<u>34,000</u>	5	<u>—</u>
	<u>300,000</u>		<u>150,000</u>

## 9 EMPLOYEE BENEFIT PLANS

### *Profit sharing plan*

The Company has a 401(k) profit sharing plan for full-time employees who have completed 12 months of service and reached age 21. Eligible employees may contribute from 2% to 20% of their wages up to the allowable Internal Revenue Service limit. The plan allows for a discretionary matching contribution up to 5% of each employee's contributed salary deferral. The Company has made no matching contributions to the plan since its inception.

### *Deferred compensation plan*

The Company established nonqualified deferred compensation plans for four key employees on December 31, 2002. The total benefit under these plans amounts to approximately \$65,000 as of December 31, 2002. The benefit under these plans vests at the earlier of the participant's death or retirement at age 65 or the later of nine years of employee service or the employee's voluntary termination thereafter. The Company will expense the benefits provided under the deferred compensation agreements over the employee service period. No plan expenses or accruals have been recorded as of December 31, 2002.

## 10 DIVIDENDS PAID AND DECLARED

The Company declared and paid dividends of \$213,187 (\$.05 per share) to stockholders of record on May 25, 2001. On November 13, 2001, the Company declared dividends of \$260,352 (\$.06 per share) for stockholders of record on January 4, 2002, which were paid in 2002.

## 11 SUBSEQUENT EVENT

### *Atlas-Aero Corporation acquisition*

On February 17, 2003, the Company acquired all of the operating assets and assumed operating liabilities of the Atlas-Aero Corporation (Atlas) for a purchase price of \$5.5 million. The Company is in the process of finalizing the purchase price allocation. Atlas is based in Meriden, Connecticut, and designs and manufactures cable and wire harness assemblies and electronic and electromechanical assemblies for aircraft, helicopters and missiles. Atlas reported sales of approximately \$12.1 million for the year ended December 31, 2002. The acquisition was financed by the Company through \$1.45 million of cash, \$750,000 from the Company and \$700,000 from Atlas; \$3.05 million of borrowings under a revised line of credit with its current bank, discussed in Note 4; and a 10-year, 8%, \$1 million secured seller note with principal payments beginning March 1, 2004. In conjunction with the acquisition of Atlas, the Company incurred transaction costs of \$129,349 during 2002, which are included in the accompanying balance sheet as other noncurrent assets. The Company incurred additional transaction costs during 2003.

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## SUBSEQUENT EVENT (continued)

Condensed unaudited balance sheet information for the Company, including the effects of the Atlas acquisition, as of March 31, 2003 and income statement information for the three months ended March 31, 2003 (including the operations of Atlas from February 17, 2003 to March 31, 2003) is as follows:

### Balance Sheet

	Unaudited March 31, 2003
<b>Assets</b>	
Current assets	\$ 10,398,000
Property, plant and equipment	2,705,000
Other assets	2,251,000
	<u>\$ 13,354,000</u>
<b>Liabilities and Stockholders' Equity</b>	
Current liabilities	\$ 4,823,000
Long-term debt and other long-term liabilities	3,137,000
Stockholders' equity	5,394,000
	<u>\$ 13,354,000</u>

### Statement of Income

	Unaudited Three Months Ended March 31, 2003
Net sales	\$ 3,847,000
Cost of sales	2,968,000
Gross profit	<u>2,879,000</u>
Selling, general and administrative expenses	2,373,000
Operating income	<u>2,506,000</u>
Interest expense	2,057,000
Federal and state income taxes	2,162,000
Net income	<u>\$ 2,287,000</u>

## INDEPENDENT AUDITOR'S REPORT

To the Board of Directors and Stockholders  
Semco Instruments, Inc.  
Valencia, California

We have audited the accompanying balance sheets of Semco Instruments, Inc. as of December 31, 2002 and 2001, and the related statements of income, stockholders' equity and cash flows for each of the three years in the period ended December 31, 2002. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Semco Instruments, Inc. as of December 31, 2002 and 2001, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2002, in conformity with accounting principles generally accepted in the United States of America.

*McGladrey & Pullen, LLP*

Pasadena, California  
April 25, 2003

# Financial Highlights

<b>FIVE YEAR SUMMARY</b>	<b>2002</b>	<b>2001</b>	<b>2000</b>	<b>1999</b>	<b>1998</b>
<b>Income Statement Data</b>					
Net income	\$ 4,730,687	\$ 4,569,736	\$ 4,610,687	\$ 4,269,193	\$ 4,285,262
Return on sales	8.3%	6.5%	7.6%	4.2%	4.2%
Earnings per share	\$ 4.0.17	\$ 4.0.14	\$ 4.0.15	\$ 4.0.06	\$ 4.0.06
Weighted average # of shares outstanding	4,339,204	4,182,969	4,110,510	4,322,386	4,406,549
Net sales	\$ 8,850,951	\$ 8,710,586	\$ 8,053,746	\$ 6,376,818	\$ 6,791,165
Cost of sales	\$ 6,272,577	\$ 6,285,290	\$ 5,671,844	\$ 4,720,789	\$ 5,107,063
Gross profit margin	29.1%	27.8%	29.6%	26.0%	24.8%
Selling, general & administrative expense	\$ 1,320,634	\$ 1,224,764	\$ 1,261,513	\$ 1,101,273	\$ 1,021,394
Selling, general & administrative % of sales	14.9%	14.1%	15.7%	17.3%	15.0%
Interest expense, net	\$2 107,837	\$2 113,733	\$2 119,328	\$2 142,009	\$2 232,446
EBITDA	\$ 1,494,884	\$ 1,429,637	\$ 1,396,648	\$2 814,649	\$2 892,676
EBITDA margin	16.8%	16.4%	17.3%	12.8%	13.1%
<b>Working Capital</b>					
Quick ratio	3.3	1.8	2.4	2.0	1.9
Current ratio	6.2	3.8	4.7	5.3	5.3
Liabilities and Debt/Equity	0.6	0.8	0.7	0.7	0.8
Liabilities/Assets	0.4	0.4	0.4	0.4	0.4
Days sales in receivables	65	53	53	59	51
Working capital as % of sales	51.0%	40.3%	46.3%	48.7%	45.2%
Inventory turnover	2.8	2.9	2.7	2.1	2.2
<b>Leverage and Other</b>					
Asset turnover	1.10	1.14	1.15	0.98	1.09
Stockholder's equity	\$ 5,208,723	\$ 4,478,036	\$ 4,317,298	\$ 3,782,413	\$ 3,537,085
Return on stockholders' equity	14.0%	12.7%	14.1%	7.1%	8.1%
Liabilities and Debt/Equity	0.6	0.8	0.7	0.7	0.8
Liabilities/Assets	0.4	0.4	0.4	0.4	0.4

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## DIRECTORS

M. S. Moore  
Chairman/CEO  
Semco Instruments, Inc.

Arnold Twersky  
Certified Public Accountant  
Northridge, California

Edwin H. Boyer  
Private Investor  
Westlake Village, California

Daniel C. de Brauwere  
Senior Vice President  
BankAmerica Business Credit, Inc.  
Pasadena, California

Michael G. Moore  
President  
Semco Instruments, Inc.

## OFFICERS

M.S. Moore – CEO  
Michael G. Moore – President  
Edwin H. Boyer – Secretary/Treasurer

## COUNSEL

Holland & Knight, LLP  
Los Angeles, California

## AUDITORS

McGladrey & Pullen, LLP  
Pasadena, California

## TRANSFER AGENT AND REGISTRAR

Registrar and Transfer Company  
10 Commerce Drive  
Cranford, New Jersey 07016

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25700 Rye Canyon Road, Valencia, California 91355

Telephone 661 257 2000  
Facsimile 661 295 0044