

Semco

INSTRUMENTS, INC.

***ANNUAL
REPORT
2007***

SEMCO INSTRUMENTS, INC. was founded in December 1965 as an engineering based aerospace manufacturer of temperature sensors. The product line has been expanded to include speed sensors, pressure sensors, electronic devices, coaxial heaters, and specialty electrical molded cables and wiring harnesses. These products serve the requirements of the gas turbine engine manufacturers, the aircraft manufacturers, and the satellite industry. The Company is registered to the ISO9001 and AS9100 quality standards and is focused on continuous process improvement in order to achieve world-class levels of quality, delivery, and customer support.

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To Our Shareholders:

Net sales achieved by your Company in 2007 were \$34,201,540 as compared to 2006 sales of \$28,318,920. Pre-tax income in 2007 was \$3,794,659 in 2007 as compared to 2006 pre-tax income of \$2,707,650, and net income was \$2,416,542 or \$0.55 per share in 2007 as compared to a 2006 net income of \$1,690,950 or \$0.39 per share.

Sales increased 20.8% in 2007 reflecting strong demand for our products. This growth in sales was driven by robust demand from our OEM, military, industrial, and repair station customers for legacy as well as newly qualified products. The balance between commercial and military sales was approximately 60% / 40% in 2007 and we anticipate continued growth in both markets as we continue to qualify new products serving both market segments. In 2007 the Company qualified new products used on commercial and military helicopters, business jets and turboprops, and regional and long range commercial airline aircraft, as well as various industrial applications.

The level of profitability in 2007 continued to improve over previous years as the Company experienced an increase in gross profit to 21.5% from 20.3% in 2006, an increase in pre-tax profit to 11.1% from 9.6% in 2006, and an increase in net profit to 7.1% from 6.0% in 2006. This increased level of profitability is the result of a multitude of continuous improvement efforts including the elimination of non-contributing product, pursuing cost reductions from our supply chain, and continuing to seek improvement in all our processes.

The Company continues to direct resources toward growing the production capacity of our manufacturing facility in Nogales, Mexico. In 2007 the Nogales facility grew from production of approximately 3,000 units to a production level of over 10,000 units of diversified products and we are focused on continued growth of capacity in what will be a multi-year effort requiring extensive support from the Valencia facility. We are confident that the investment of resources in the Nogales facility will provide a platform that continues to increase both our competitive position and profitability in this global market.

The Atlas-Aero product line purchased in 2003 is now fully integrated into the manufacturing facilities in Valencia and Nogales and as a result we plan to close the Meriden, Connecticut facility in the middle of 2008. There will be certain one-time costs associated with this facility closure but these will be offset by cost savings that will be available immediately and on an on-going basis.

With much speculation as to the health of the economy, we believe the Company is taking the correct steps to remain lean and competitive within the aerospace and industrial markets. The Company is well positioned as a niche supplier and is postured to fully service customer requirements with engineering innovation, product quality, and the ability to consistently deliver our products and customer support in a just-in-time environment.

I am thankful for your continued interest and support.



Michael G. Moore
President

Balance Sheets

ASSETS

	December 31	
	2007	2006
Current assets		
Cash and cash equivalents	\$ 149,377	\$ 144,324
Accounts receivable	4,383,295	3,793,896
Inventories	13,110,430	11,225,051
Prepaid expenses and other current assets	235,953	64,325
Deferred income taxes	764,000	557,000
Total current assets	18,643,055	15,784,596
Property, plant and equipment		
Land and improvements	980,356	980,356
Building and improvements	2,270,770	2,263,210
Machinery and equipment	2,395,744	2,325,322
Automotive equipment	224,812	153,095
Furniture, fixtures and computers	1,049,829	1,077,334
	6,921,511	6,799,317
Less accumulated depreciation and amortization	(4,366,588)	(4,190,510)
	2,554,923	2,608,807
Deposits	17,515	17,515
	\$21,215,493	\$18,410,918

LIABILITIES AND STOCKHOLDERS' EQUITY

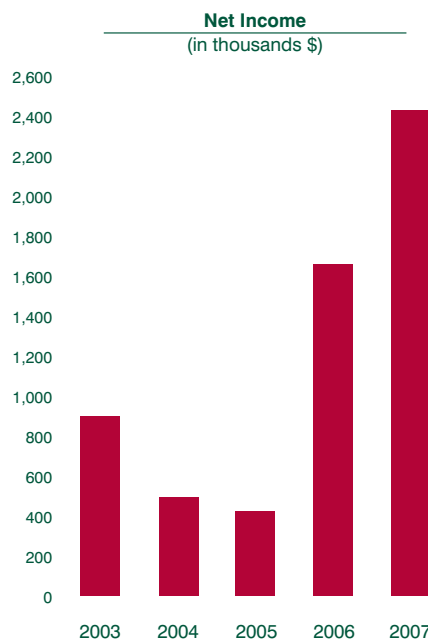
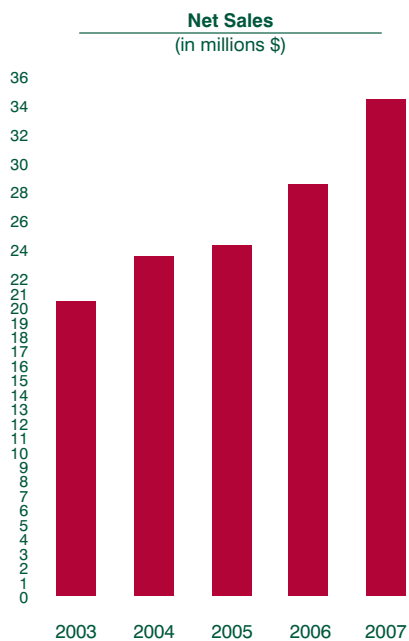
Current liabilities		
Line of credit	\$ -	\$ 3,000,000
Current maturities of long-term debt	142,776	132,483
Accounts payable and accrued expenses	3,278,262	2,804,903
Income taxes payable	\$ -	155,000
Total current liabilities	3,421,038	6,092,386
Noncurrent liabilities		
Line of credit	3,000,000	-
Long-term debt, less current maturities	3,109,226	3,252,002
Deferred compensation payable	44,660	28,889
Deferred income taxes	184,000	198,000
Total noncurrent liabilities	6,337,886	3,478,891
Commitment (Note 9)		
Stockholders' equity		
Common stock, \$0.01 par value; 6,000,000 shares authorized, 4,626,954 (2007) and 4,463,954 (2006) shares issued and outstanding	46,269	44,639
Additional paid-in-capital	1,026,088	827,332
Retained earnings	10,401,266	7,984,724
	11,473,623	8,856,695
Less treasury stock, at cost, 86,625 shares	(17,054)	(17,054)
Total stockholders' equity	11,456,569	8,839,641
	\$21,215,493	\$18,410,918

The Notes to Financial Statement are an integral part of these statements.

Statements of Income

	Years Ended December 31		
	2007	2006	2005
Net sales	\$34,201,540	\$28,318,920	\$24,448,701
Cost of sales	26,860,362	22,565,033	20,924,142
Gross profit	7,341,178	5,753,887	3,524,559
Selling, general and administrative expenses	3,123,640	2,712,465	2,386,992
income from operations	4,217,538	3,041,422	1,137,567
Other income (expense):			
Interest expense	(444,616)	(400,841)	(346,791)
Interest income	15,811	10,083	2,252
Other	5,926	56,986	(4,562)
	(422,879)	(333,772)	(349,101)
Income before provision for income taxes	3,794,659	2,707,650	788,466
Provision for income taxes	1,378,117	1,016,700	299,000
Net income	\$ 2,416,542	\$ 1,690,950	\$ 489,466
Earnings per common share:			
Basic	\$ 0.55	\$ 0.39	\$ 0.11
Diluted	\$ 0.54	\$ 0.38	\$ 0.11
Weighted average number of common shares outstanding, basic	4,421,437	4,377,329	4,377,329
Weighted average number of common shares outstanding, diluted	4,474,817	4,424,060	4,389,760

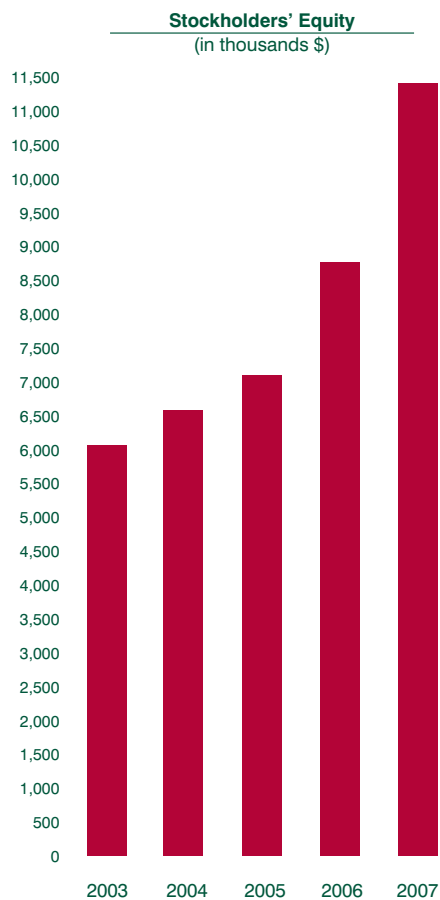
The Notes to Financial Statement are an integral part of these statements.



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, 2004	4,463,954	44,639	808,332	5,804,308	86,625	(17,054)	6,640,225
Repurchase of common stock	-	-	-	-	-	-	-
Retirement of previously repurchased treasury stock	-	-	-	-	-	-	-
Net income	-	-	-	489,466	-	-	489,466
Balance, December 31, 2005	4,463,954	44,639	808,332	6,293,774	86,625	(17,054)	7,129,691
Net income	-	-	-	1,690,950	-	-	1,690,950
Stock-based compensation	-	-	19,000	-	-	-	19,000
Balance, December 31, 2006	4,463,954	44,639	827,332	7,984,724	86,625	(17,054)	8,839,641
Net income	-	-	-	2,416,542	-	-	2,416,542
Exercise of Stock Options	163,000	1,630	155,756	-	-	-	157,386
Stock-based compensation	-	-	43,000	-	-	-	43,000
Balance, December 31, 2007	4,626,954	\$ 46,269	\$1,026,088	\$10,401,266	86,625	\$ (17,054)	\$11,456,569

See Notes to Financial Statements.



Statements of Cash Flows

	Years Ended December 31		
	2007	2006	2005
Cash Flows from Operating Activities			
Net income	\$ 2,416,542	\$ 1,690,950	\$ 489,466
Adjustments to reconcile net income to net cash provided by (used in) operating activities:			
Depreciation and amortization	341,233	381,536	432,639
Stock-based compensation	43,000	19,000	-
Gain on disposal of equipment	(33,500)	-	(2,710)
Deferred income taxes	(221,000)	(301,000)	(81,000)
Changes in operating assets and liabilities			
Increase in accounts receivables	(589,399)	(498,334)	(125,587)
Decrease (increase) in inventories	(1,885,379)	(3,371,793)	183,712
Decrease (increase) in prepaid expenses and other current assets	(171,628)	49,597	51,865
Increase (decrease) in income taxes payable	(155,000)	43,780	111,220
Increase in accounts payable and accrued expenses	489,130	715,307	332,660
Net cash provided by (used in) operating activities	233,999	(1,270,957)	1,392,265
Cash Flows from Investing Activities			
Purchase of equipment and improvements	(297,824)	(204,490)	(270,452)
Proceeds from sale of equipment	43,975	-	9,799
Net cash used in investing activities	(253,849)	(204,490)	(260,653)
Cash Flows from Financing Activities			
Net borrowings (repayments) on line of credit	-	1,600,000	(2,100,000)
Borrowings on long-term debt	-	-	2,650,000
Repayments on long-term debt	(132,483)	(122,937)	(1,748,412)
Proceeds from exercise of stock options	157,386	-	-
Net cash provided by (used in) financing activities	24,903	1,477,063	(1,198,412)
Net increase (decrease) in cash and cash equivalents	\$ 5,053	\$ 1,616	\$ (66,800)
Cash and cash equivalents			
Beginning	144,324	142,708	209,508
Ending	<u>\$ 149,377</u>	<u>\$ 144,324</u>	<u>\$ 142,708</u>
Supplemental Disclosures of Cash Flow Information			
Interest paid	<u>\$ 446,648</u>	<u>\$ 398,546</u>	<u>\$ 355,567</u>
Income taxes paid	<u>\$ 1,639,000</u>	<u>\$ 1,236,753</u>	<u>\$ 193,700</u>

See Notes to Financial Statements.

Notes to Financial Statements

1 NATURE OF BUSINESS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Business

Semco Instruments, Inc. (the Company) designs, manufactures and sells precision sensors for the measurement of temperature, pressure, and speed, as well as specialty electrical molded cables and wiring harnesses. These products are sold principally to original equipment manufacturers in aerospace and commercial industries primarily located in North America.

Use of Estimates

The preparation of the 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. Significant estimates and assumptions made by management are used for, but not limited to, inventory obsolescence reserves.

Cash and Cash Equivalents

The Company considers all highly liquid investments with a maturity of three months or less 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.

Accounts Receivables and Concentrations of Credit Risk

The Company's customers are concentrated in the commercial and military aviation industries. Accounts receivables are carried at original invoice amount less allowances provided for sales returns and doubtful accounts. The Company performs periodic credit evaluations of its customers' financial condition and generally does not require collateral. Receivables are generally due in 30 days. 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. Management determines the allowance for doubtful accounts by identifying troubled accounts and by using historical experiences. Accounts receivable are written off when deemed uncollectible. Management has determined that no allowance for doubtful accounts was necessary at December 31, 2007 and 2006.

Inventories

Inventories are stated at the lower of weighted average cost or market. The Company periodically reviews the age and turnover of its inventories 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.

Customer Concentrations

The Company derived 54% of its net sales from two customers during 2007. Individually, the two customers accounted for 32% and 22% of net sales. These two customers represented 46% of accounts receivable at December 31, 2007. The Company derived 53% of its net sales from two customers during 2006. Individually, the two customers accounted for 35% and 18% of net sales. These two customers represented 39% of accounts receivable at December 31, 2006. The Company derived 66% of its net sales from three customers during 2005. Individually, the three customers accounted for 34%, 20% and 12% of net sales.

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

Fair Value of Financial Instruments

The Company's financial instruments consist of cash, accounts receivable, accounts payable and debt. The values reported in the financial statements approximate fair value due to their short-term nature.

Property, Plant and Equipment

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

	<u>Years</u>
Building and improvements	30
Machinery and equipment	5 – 7
Automotive equipment	5
Furniture, fixtures and computers	7 – 10

Expenditures for maintenance and repairs are charged against operations. Renewals and betterments that materially extend the life of the asset are capitalized.

Impairment of Long-Lived Assets

The Company periodically reviews its property, plant, and equipment whenever events or changes in circumstances indicate the carrying amount of such assets may not be recoverable. The estimated future net undiscounted cash flows are based upon, among other things, assumptions about expected future operating performance which may differ from actual cash flows. Long-lived assets evaluated for impairment are grouped with other assets to the lowest level for which identifiable cash flows are largely dependent on the cash flows of other groups of assets and liabilities. Should the sum of the expected future net cash flows be less than the carrying value, the Company would recognize an impairment loss at that date. An impairment loss would be measured by comparing the amount by which the carrying value exceeds the fair value (estimated discounted future cash flows) of the long-lived assets. For the years ended December 31, 2007, 2006 and 2005 management has determined that no impairment of long-lived assets exists.

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 as part of accrued expenses. 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.

Employee Stock Option Plans

At December 31, 2007, The Company has a stock option plan covering the Company's common shares, which is described more fully in Note 7. The Company adopted the provisions of Statement of Financial Accounting Standards (SFAS) No. 123(R), effective January 1, 2006, using the modified prospective method, and began recording compensation expense associated with stock-based awards. SFAS 123(R) requires all share-based payments to be recognized as compensation expense through the income statement based on their fair value at issue date over the remaining vesting period. Pre-tax stock-based compensation expense amounted to \$43,000 and \$19,000 for the years ended December 31, 2007 and 2006, respectively.

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

As a result of the adoption of SFAS No. 123(R) and based on the stock-based compensation awards outstanding as of December 31, 2007, the Company expects to recognize additional pre-tax compensation cost in future years as follows:

2008	2009	2010	Total
\$43,000	\$43,000	\$20,000	\$106,000

The fair value of each option granted during 2006 was estimated at the grant date using the Black-Scholes option pricing method, with the following assumptions: estimated volatility of 22.00%, risk-free interest rate of 5.15%, the options would be exercised at the end of the exercise period and the Company would declare no dividends. No options were granted during 2007 and 2005.

In determining pro forma net income, the fair value of each option granted was estimated at the grant date using the Black-Scholes option pricing method, with the following assumptions for the options granted prior to 2006: estimated volatility of 17%, risk-free interest rate of 4.25%, the options would be exercised at the end of the exercise period of 10 years and the Company would declare no dividends.

The following table illustrates the effect on the Company's net income and earnings per share, had the Company applied the fair value recognition provision of SFAS 123(R) for the year ended December 31, 2005:

Net income		
As reported		\$ 489,466
Stock-based compensation expense determined under fair value method		<u>2,367</u>
Pro forma		<u>\$ 487,099</u>
Basic EPS:		
As reported	\$	0.11
Pro forma		0.11
Diluted EPS:		
As reported	\$	0.11
Pro forma		0.11

Revenue Recognition

Revenue is recognized as products are shipped and title and risk of loss have transferred to the customer.

Advertising Costs

The Company expenses all advertising costs as incurred.

Income Taxes

Deferred tax assets and liabilities are recognized for estimated future tax effects attributable to temporary differences between the book basis and tax basis of various assets and liabilities. Valuation allowances are established when necessary to reduce the deferred tax asset to the amount expected to be realized. The current and deferred taxes are based on the provisions of currently enacted tax laws and rates. As changes in tax laws are enacted, deferred tax assets and liabilities are adjusted accordingly through the provision for income taxes. Management has determined that no valuation allowance was necessary at December 31, 2007 and 2006.

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

Earnings Per Common Share

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.

The following table sets forth the computation of the shares outstanding for basic and fully diluted EPS as of December 31:

	2007	2006	2005
Shares outstanding, basic EPS	4,421,437	4,377,329	4,377,329
Effect of dilutive securities, employee stock options	53,380	46,731	12,431
Shares outstanding, diluted EPS	<u>4,474,817</u>	<u>4,424,060</u>	<u>4,389,760</u>

Recent Accounting Pronouncement

In June 2006, the FASB issued FASB Interpretation No. 48 (FIN 48) Accounting for Uncertainty in Income Taxes (an interpretation of FASB Statement No. 109, which is effective for fiscal years beginning after December 15, 2006. This interpretation was issued to clarify the accounting for uncertainty in income taxes recognized in the financial statements by prescribing a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. The adoption of FIN 48 did not have an impact on the Company's financial statements.

2 INVENTORIES

Inventories consist of the following at December 31:

	2007	2006
Raw materials and fabricated parts	\$ 9,805,000	\$ 8,290,811
Work in process	1,863,509	1,667,401
Finished goods	1,911,921	1,636,839
	<u>13,580,430</u>	<u>11,595,051</u>
Less reserve for obsolescence	(480,000)	(370,000)
	<u>\$ 13,110,430</u>	<u>\$ 11,225,051</u>

3 ACCOUNTS PAYABLE AND ACCRUED EXPENSES

Accounts payable and accrued expenses at December 31 consist of the following:

	2007	2006
Accounts payable	\$ 2,186,956	\$ 1,899,340
Compensation and related payroll taxes	935,159	772,765
Interest	24,322	26,354
Self-insurance liability	62,000	50,000
Other	69,825	56,444
	<u>\$ 3,278,262</u>	<u>\$ 2,804,903</u>

ACCOUNTS PAYABLE AND ACCRUED EXPENSES (continued)

The Company sponsors a self-insured group medical insurance plan. The plan is designed to provide a specified level of coverage, with stop-loss coverage provided by a commercial insurer. The Company's maximum claim exposure is limited to \$50,000 per person per policy year, with the total plan exposure capped at approximately \$800,000 per policy year. The plan provides contributory coverage for employees and their dependents. The Company's contributions totaled approximately \$570,000, \$461,000 and \$477,000 for the years ended December 31, 2007, 2006 and 2005, respectively. At December 31, 2007 and 2006, the Company recorded \$62,000 and \$50,000, respectively, of accruals based on the aggregate amount of the liability for reported claims and an estimated liability for claims incurred but not reported.

4 LINE OF CREDIT

The Company has a revolving line of credit agreement with a bank for borrowings up to a maximum of \$5,000,000. The amount outstanding under this agreement was \$3,000,000 at December 31, 2007. The agreement provides for interest, payable monthly, at the bank's prime rate (7.25% at December 31, 2007) minus 0.50%, with interest rate options based on LIBOR (5.26% at December 31, 2007) plus 1.50%. At December 31, 2007, \$1,500,000 was outstanding at 6.75% and \$1,500,000 at 6.76%. The line of credit is collateralized by all assets of the Company, including accounts receivables, inventories, equipment and fixtures. The line of credit expires June 2009. As such, the line of credit is classified as noncurrent debt on the accompanying financial statements.

At December 31, 2006 the Company's revolving line of credit called for borrowings up to a maximum of \$4,000,000. The amount outstanding under this line was \$3,000,000 at December 31, 2006. The line of credit had an expiration date of June 2007 and as such it was classified as current debt at December 31, 2006 on the accompanying financial statements.

The line of credit contains various covenants, including the maintenance of a certain minimum financial ratios related to tangible net worth, debt-to-tangible net worth, quick and cash flow ratios. In addition, the Company is subject to certain restrictions related to, but not limited to, paying dividends, purchases of treasury stock and fixed assets. At December 31, 2007, the Company was in compliance with all the covenant requirements.

5 LONG-TERM DEBT

Long-term debt at December 31 is as follows:

	<u>2007</u>	<u>2006</u>
Note payable, bank, secured by first deed of trust on real estate, payable in monthly installments of \$3,597 plus interest at the bank's prime rate plus 0.5% maturing on October 1, 2015, subject to an interest rate swap agreement, which effectively fixed the interest rate at 6.49% (see Note 10).	\$ 2,552,547	\$ 2,599,159
Note payable, former owner of Atlas, subordinated to the bank's line of credit and second security interest in all assets of the Company, payable in monthly installments of \$12,133, including interest at 8.0%, maturing in December 2014.	<u>699,455</u>	<u>785,326</u>
	3,252,002	3,384,485
Less current maturities of long-term debt	<u>(142,776)</u>	<u>(132,483)</u>
	<u>\$ 3,109,226</u>	<u>\$ 3,252,002</u>

LONG-TERM DEBT (continued)

Aggregate maturities of long-term debt as of December 31, 2007 are as follows:

Year Ending December 31,	
2008	\$ 142,776
2009	153,877
2010	165,848
2011	178,757
2012	272,680
Thereafter	<u>2,338,064</u>
	<u>\$ 3,252,002</u>

6 INCOME TAXES

Allocation of income taxes between current and deferred portions for the years ended December 31 are as follows:

	2007	2006	2005
Current:			
Federal	\$ 1,341,923	\$ 1,069,857	\$ 310,978
State	<u>257,194</u>	<u>247,843</u>	<u>69,022</u>
	<u>1,599,117</u>	<u>1,317,700</u>	<u>380,000</u>
Deferred	<u>(221,000)</u>	<u>(301,000)</u>	<u>(81,000)</u>
	<u>\$ 1,378,117</u>	<u>1,016,700</u>	<u>\$ 299,000</u>

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

	2007	2006	2005
Computed expected statutory rate	35%	35%	35%
Increase (decrease) in rate resulting from:			
State taxes, net of federal benefit	4	4	4
Other, principally benefit from reduced rate on foreign export sales	<u>(3)</u>	<u>(1)</u>	<u>(1)</u>
	<u>36%</u>	<u>38%</u>	<u>38%</u>

INCOME TAXES (continued)

Net deferred income tax assets (liabilities) as of December 31 consist of the following components:

	<u>2007</u>	<u>2006</u>
Deferred tax liabilities:		
Depreciation and amortization	\$ (83,000)	\$ (98,000)
Undistributed DISC income	(101,000)	(134,000)
	<u>(184,000)</u>	<u>(232,000)</u>
Deferred tax assets:		
Inventory reserve and capitalization	374,000	324,000
Accrued compensation	304,000	194,000
Other	86,000	73,000
	<u>764,000</u>	<u>591,000</u>
	<u>\$ 580,000</u>	<u>\$ 359,000</u>

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

	<u>2007</u>	<u>2006</u>
Current assets	\$ 764,000	\$ 557,000
Long-term liabilities	(184,000)	(198,000)
	<u>\$ 580,000</u>	<u>\$ 359,000</u>

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

7 STOCK OPTION PLAN

The Company has 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 under the plan. Qualified stock options may be issued to employees of the Company under the plan. 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 5 to 10 years from the date of grant or one month from the stock option holder's termination of employment.

STOCK OPTION PLAN (continued)

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

	2007		2006		2005	
	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
Outstanding at beginning of year:	750,000	\$1.07	150,000	\$ 0.84	150,000	\$ 0.84
Granted	-	-	600,000	1.13	-	-
Forfeited	(10,000)	1.05	-	-	-	-
Canceled	(49,500)	0.82	-	-	-	-
Exercised	(163,000)	0.97	-	-	-	-
Outstanding at end of year	<u>527,500</u>	1.13	<u>750,000</u>	1.07	<u>150,000</u>	0.84
Options exercisable, end of year	<u>85,000</u>	1.11	<u>150,000</u>	0.84	<u>112,500</u>	0.84
Options available for grant, end of year	<u>10,000</u>		<u>-</u>		<u>600,000</u>	

The following table summarizes information about stock options outstanding at December 31, 2007:

Exercise Price	Number Outstanding	Remaining Contractual Life (in Years)	Number Exercisable
\$ 1.155	397,500	8.5	52,500
1.05	<u>130,000</u>	8.5	<u>32,500</u>
	<u>527,500</u>		<u>85,000</u>

8 EMPLOYEE BENEFIT PLANS

Retirement plan

The Company has a 401(k) profit sharing plan for full-time employees who have completed 3 months of service, are at least 21 years old and are not covered by collective bargaining agreements. Eligible employees may contribute to the 401(k) plan up to 90% of their wages up to the allowable Internal Revenue Service limit. The plan allows for Company discretionary matching and profit sharing contributions. The Company made discretionary matching contributions of approximately \$92,000 and no discretionary profit sharing contributions for the year ended December 31, 2007. The Company did not make any discretionary matching or profit sharing contributions to the plan during the years ended December 31, 2006 and 2005.

EMPLOYEE BENEFIT PLANS (continued)

Deferred Compensation Agreement

The Company has established nonqualified deferred compensation agreements for six key employees. The agreements provide for a total benefit of \$116,000. The benefit under these agreements 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. At December 31, 2007 and 2006, the accrued liability related to these agreements amounted to \$44,660 and \$28,889, respectively. Deferred compensation expense amounted to approximately \$15,800 for the year ended December 31, 2007 and approximately \$7,300 for the years ended December 31, 2006 and 2005.

9 LEASE COMMITMENT

The Company has entered into a four-year non-cancelable operating lease agreement expiring September 2009 for one of its manufacturing facilities, with monthly lease payments of approximately \$9,800. The Company also leases a manufacturing facility on a month-to-month basis. The following is a schedule of future minimum rental payments under the non-cancelable lease agreement:

Year Ending December 31,	
2008	117,600
2009	<u>88,200</u>
	<u>\$ 205,800</u>

Rent expense was approximately \$224,000 for both years ended December 31, 2007 and 2006. Rent expense was approximately \$140,000 for the year ended December 31, 2005.

10 INTEREST RATE SWAP AGREEMENT

As disclosed in Note 5, the Company has entered into an interest rate swap agreement with the bank that effectively fixed the note payable in the original amount of \$2,650,000 (\$2,552,547 at December 31, 2007) at a rate of 6.49% until October 2015. The cumulative gain or loss from changes in the swap agreement's fair value will be included in other comprehensive income and will be reclassified into income or interest expense if the note is repaid at an earlier date than the full term. As of December 31, 2007 and 2006, this amount was immaterial and not recorded in other comprehensive income.

11 PLANT CLOSURE

The Company has made a decision to close down its manufacturing facility in Connecticut in 2008. As of December 31, 2007 and the date of this report the Connecticut facility is still operational, though at a reduced capacity. Management does not foresee any impact on operations as a result of the closure.

Independent Auditors' Report

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

We have audited the accompanying balance sheets of Semco Instruments, Inc. as of December 31, 2007 and 2006 and the related statements of income, stockholders' equity and cash flows for each of the years in the three year period ended December 31, 2007. 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 audits 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, 2007 and 2006, and the results of its operations and its cash flows for each of the years in the three year period ended December 31, 2007, in conformity with accounting principles generally accepted in the United States of America.

Hutchinson and Bloodgood LLP

April 16, 2008

Financial Highlights

FIVE YEAR SUMMARY	2007	2006	2005	2004	2003
Income Statement Data					
Net income	\$ 2,416,542	\$ 1,690,950	\$ 489,466	\$ 534,429	\$ 921,986
Return on sales	7.1%	6.0%	2.0%	2.2%	4.5%
Earnings per share	0.55	0.39	0.11	0.12	0.21
Weighted average # of shares outstanding	4,421,437	4,377,329	4,377,329	4,397,954	4,339,482
Net sales	34,201,540	28,318,920	24,448,701	23,772,804	20,342,240
Cost of sales	26,860,362	22,565,033	20,924,142	20,132,608	16,486,998
Gross profit margin	21.5%	20.3%	14.4%	15.3%	19.0%
Selling, general & administrative expense	3,123,640	2,712,465	2,386,992	2,497,970	2,159,137
Selling, general & administrative % of sales	9.1%	9.6%	9.8%	10.5%	10.6%
Interest expense, net	428,805	390,758	344,539	344,790	277,819
EBITDA	4,564,697	3,479,944	1,565,644	1,591,851	2,066,492
EBITDA margin	13.3%	12.3%	6.4%	6.7%	10.2%
Working Capital					
Quick ratio	1.3	0.6	0.9	0.5	0.7
Current ratio	5.4	2.6	3.1	1.7	2.4
Days sales in receivables	47	49	49	49	51
Working capital as % of sales	44.5%	34.2%	32.6%	20.5%	29.4%
Inventory turnover	2.2	2.4	2.6	2.8	3.8
Leverage and Other					
Asset turnover	1.73	1.72	1.67	1.68	1.88
Stockholder's equity	11,456,569	8,839,641	7,129,691	6,640,225	6,167,671
Return on stockholders' equity	21.1%	19.1%	6.9%	8.0%	14.9%
Liabilities and Debt/Equity	0.9	1.1	1.0	1.2	1.2
Liabilities and Debt/Assets	0.5	0.5	0.5	0.6	0.5

DIRECTORS

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

Michael G. Moore
President
Semco Instruments, Inc.

Arnold Twersky
Certified Public Accountant
Northridge, California

Daniel C. de Brauwere
President
Pacific/Southwest Division
Business Capital
Bank of America
Pasadena, California

Samuel J. Moore
Sales Manager
Semco Instruments, Inc.

OFFICERS

M.S. Moore – CEO
Michael G. Moore – President
Samuel J. Moore – Secretary/Treasurer

COUNSEL

Holland & Knight, LLP
Los Angeles, California

AUDITORS

Hutchinson and Bloodgood LLP
Glendale, California

TRANSFER AGENT AND REGISTRAR

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

