WINLAND ELECTRONICS INC
Form 10-Q
August 13, 2010

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

FORM 10-Q

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

For the Quarter Ended: June 30, 2010

OR

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

For the transition period from ____________________ to ____________________.________________

Commission File No.: 1-15637

WINLAND ELECTRONICS, INC.
(Name of registrant in its charter)

| | |
|---|---|
| Minnesota | 41-0992135 |
| (State or other jurisdiction of incorporation or organization) | (IRS Employer Identification Number) |

1950 Excel Drive, Mankato, Minnesota 56001
(Address of principal executive offices)

(507) 625-7231
(Issuer's telephone number)

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

| Title of Each Class | Name of Exchange |
|---|---|
| Common Stock, $.01 par value | American Stock Exchange |
| Preferred Stock Purchase Rights | American Stock Exchange |

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a small reporting company. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

| | | | |
|---|---|---|---|
| Large accelerated filer o | Accelerated filer o | Non-accelerated filer o | Smaller Reporting Company þ |

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
Yes o No þ

There were 3,699,230 shares of Common Stock, $.01 par value, outstanding as of August 12, 2010.

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PART I – FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

WINLAND ELECTRONICS, INC.
CONDENSED BALANCE SHEETS
(In Thousands, Except Share Data)

| ASSETS | June 30, 2010 (Unaudited) | December 31, 2009 |
|---|---|---|
| Current Assets | | |
| Cash | $ 100 | $ 55 |
| Accounts receivable, less allowance for doubtful accounts of $64 and $49, respectively | 3,597 | 2,823 |
| Refundable income taxes | 376 | 1,023 |
| Inventories, less allowance for obsolescence of $766 and $562, respectively | 3,195 | 3,039 |
| Prepaid expenses and other assets | 308 | 256 |
| Total current assets | 7,576 | 7,196 |
| | | |
| Property and equipment at cost | 11,933 | 12,266 |
| Less accumulated depreciation | (8,045) | (7,937) |
| Net property and equipment | 3,888 | 4,329 |
| Total assets | $ 11,464 | $ 11,525 |
| | | |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| | | |
| Current Liabilities | | |
| Revolving line of credit agreement | $ 1,248 | $ 367 |
| Current maturities of long-term debt | 394 | 380 |
| Accounts payable | 1,692 | 1,132 |
| Accrued expenses: | | |
| Compensation | 392 | 369 |
| Other short-term tax liabilities | 258 | - |
| Other | 53 | 49 |
| Total current liabilities | 4,037 | 2,297 |
| | | |
| Long Term Liabilities | | |
| Long-term debt, less current maturities | 498 | 699 |
| Deferred revenue | 118 | 122 |
| Other long-term tax liabilities | - | 258 |
| Total long-term liabilities | 616 | 1,079 |
| | | |
| Stockholders' Equity | | |
| Common stock, par value $0.01 per share; authorized 20,000,000 shares; issued and outstanding 3,699,230 shares as of June 30, 2010 and 3,686,435 as of December 31, 2009 | 37 | 37 |

| | | |
|---|---|---|
| Additional paid-in capital | 5,039 | 5,016 |
| Retained earnings | 1,735 | 3,096 |
| Total stockholders' equity | 6,811 | 8,149 |
| Total liabilities and stockholders' equity | $ 11,464 | $ 11,525 |

See Notes to Condensed Financial Statements

WINLAND ELECTRONICS, INC.
CONDENSED STATEMENTS OF OPERATIONS
(In Thousands, Except Share and Per Share Amounts)
(Unaudited)

| | For the Three Months Ended June 30, | | For the Six Months Ended June 30, | |
|---|---|---|---|---|
| | 2010 | 2009 | 2010 | 2009 |
| Net sales | $5,131 | $5,734 | $9,675 | $12,886 |
| Cost of sales | 4,934 | 5,246 | 9,061 | 11,322 |
| Gross profit | 197 | 488 | 614 | 1,564 |
| | | | | |
| Operating expenses | | | | |
| General and administrative | 510 | 543 | 970 | 1,169 |
| Sales and marketing | 367 | 423 | 744 | 774 |
| Research and development | 114 | 87 | 219 | 252 |
| Total operating expenses | 991 | 1,053 | 1,933 | 2,195 |
| | | | | |
| Operating loss | (794) | (565) | (1,319) | (631) |
| | | | | |
| Other income (expense) | | | | |
| Interest expense | (27) | (23) | (48) | (46) |
| Other income (expense), net | (1) | 3 | 7 | (12) |
| Total other expense | (28) | (20) | (41) | (58) |
| | | | | |
| Loss before income taxes | (822) | (585) | (1,360) | (689) |
| | | | | |
| Income tax expense | - | (129) | (2) | (150) |
| Net loss | $(822) | $(714) | $(1,362) | $(839) |
| | | | | |
| Loss per common share: | | | | |
| Basic and diluted | $(0.22) | $(0.19) | $(0.37) | $(0.23) |
| | | | | |
| Weighted-average number of common shares outstanding: | | | | |
| Basic and diluted | 3,689,930 | 3,669,148 | 3,686,683 | 3,669,148 |

See Notes to Condensed Financial Statements

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WINLAND ELECTRONICS, INC.
CONDENSED STATEMENTS OF CASH FLOWS
(In Thousands of Dollars)
(Unaudited)

| | For the Six Months Ended June 30, 2010 | 2009 |
|---|---|---|
| Cash Flows From Operating Activities | | |
| Net loss | $(1,362) | $(839) |
| Adjustments to reconcile net loss to net cash used in operating activities: | | |
| Depreciation and amortization | 397 | 412 |
| Increase in allowance for doubtful accounts | 15 | - |
| Loss on disposal of property and equipment | 47 | 20 |
| Non-cash stock based compensation | 16 | 47 |
| Changes in assets and liabilities: | | |
| Accounts receivable | (789) | 333 |
| Refundable income taxes | 647 | 204 |
| Inventories | (156) | (266) |
| Prepaid expenses | (52) | (199) |
| Accounts payable | 560 | (37) |
| Accrued expenses, including deferred revenue and other short-term tax liabilities | 27 | 26 |
| Net cash used in operating activities | (650) | (299) |
| | | |
| Cash Flows From Investing Activities | | |
| Purchases of property and equipment | (13) | (59) |
| Proceeds from sale of property and equipment | 7 | 7 |
| Net cash used in investing activities | (6) | (52) |
| | | |
| Cash flows From Financing Activities | | |
| Net borrowings on revolving line of credit | 881 | 386 |
| Payments on long-term borrowings, including capital lease obligations | (187) | (213) |
| Proceeds from issuance of common stock | 7 | 6 |
| Net cash provided by financing activities | 701 | 179 |
| | | |
| Net increase (decrease) in cash | 45 | (172) |
| | | |
| Cash | | |
| Beginning of period | 55 | 356 |
| Ending of period | $100 | $184 |
| | | |
| Supplemental information | | |
| Cash payments for: | | |
| Interest | $35 | $47 |
| Cash received for: | | |
| Income taxes | $645 | $- |
| Non-cash reclassification of other tax liability from long-term to short-term | | |

| | | |
|---|---|---|
| | $258 | $- |

See Notes to Condensed Financial Statements

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Winland Electronics, Inc.
Notes to Consolidated Financial Statements

Note 1. Basis of Presentation

The accompanying unaudited condensed financial statements have been prepared by Winland Electronics, Inc. (the "Company" or "Winland") in accordance with accounting principles generally accepted in the United States of America for the preparation of interim financial information and the instructions to Form 10-Q and Article 10 of Regulation S-X of the Securities and Exchange Commission (the "SEC"). Accordingly, they do not include all of the information and notes required by accounting principles generally accepted in the United States of America for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring adjustments) considered necessary for a fair presentation have been included. Financial results for the three and six months ended June 30, 2010 are not necessarily indicative of the results that may be expected for the year ending December 31, 2010. The footnotes are in thousands unless noted.

The condensed balance sheet at December 31, 2009 has been derived from the audited financial statements as of that date but does not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statement presentation.

This financial information should be read in conjunction with the financial statements and notes included in the Company's Annual Report on Form 10-K for the year ended December 31, 2009.

Management is required to make certain estimates and assumptions which affect the amounts of assets, liabilities, revenue and expenses reported. Actual results could differ materially from these estimates and assumptions.

The Company evaluates events through the date the financial statements are filed for events requiring adjustment to or disclosure in the financial statements.

The Company's future liquidity needs will depend on many factors, including the timing and amount of its revenues and its investment decisions, which may affect the Company's ability to generate additional cash. If cash generated from operations and financing activities, through the use of our revolving credit agreement or proposed financing as described below through at least the next twelve months, is insufficient to satisfy working capital requirements during the next twelve months, the Company may seek additional funding through bank borrowings or other means. The Company entered into a proposal for maximum borrowings of $2,200,000.00 subject to a limitation based on 75% of eligible accounts receivable on August 5, 2010. The proposal is subject to due diligence by the lender. There can be no assurance that the Company will be able to raise any such capital on acceptable terms or at all. Additionally, there can be no assurance that the Company will satisfy all the covenants in its revolving credit agreement including minimum tangible net worth in the future.

Reclassifications: Certain condensed statement of operations and segment reporting footnote disclosure amounts for the three and six months ended June 30, 2009 have been reclassified to be consistent with the classifications adopted for the same periods ended June 30, 2010. These reclassifications had no impact on operating loss, net loss or retained earnings.

Note 2. Segment Reporting

Accounting Standards Codification ("ASC") 280, Segment Reporting, requires an enterprise to report segment information in the same way that management internally organizes its business for assessing performance and making decisions regarding the allocation of resources. The Company evaluates the performance of operating segments and allocates resources based on profit and loss from operations.

The Company's EMS segment consists of the design and manufacturing of printed circuit board assemblies and higher level products sold mainly to Original Equipment Manufacturer (OEM) customers. Winland offers complete solutions to OEM customer needs by providing value-added services that complement its contract manufacturing capabilities. This is part of a "concept to product realization" strategy, the elements of which may include product concept studies, product design, printed circuit board design, design for manufacturing, higher level assembly and box build, repair service, and legacy support. These services differentiate Winland from many competitors and are intended to increase customer satisfaction, confidence, and loyalty. Winland views EMS customers as strategic partners and works to provide these partners with high level customer care and technical services.

Winland Electronics, Inc.
Notes to Consolidated Financial Statements

Note 2. Segment Reporting (Continued)

The Company's Proprietary Products segment represents an established family of environmental security products that can monitor critical environments including simple and sophisticated microprocessor and mechanically controlled sensors and alarms. These products monitor and detect critical environmental changes, such as changes in temperature or humidity, water leakage and power failures.

The Company's remaining activities are included in "Other". These are unallocated corporate level expenses, which include costs related to the administrative functions performed in a centralized manner and not attributable to particular segments (e.g., executive compensation expense, accounting, human resources and information technology support), are reported in the reconciliation of the segment totals to consolidated totals as "Other" items.

Segment assets or other balance sheet information are not presented to the Company's chief operating decision maker. Accordingly, the Company has not presented information relating to segment assets.

The following table presents nets sales and operating income (loss) by reportable segment:

WINLAND ELECTRONICS, INC.
SEGMENT REPORTING

| ($ in thousands) | EMS | Proprietary | Other | Total |
|---|---|---|---|---|
| Three months ended June 30, 2010 | | | | |
| Net sales | $4,380 | $751 | $- | $5,131 |
| Gross margin | (90) | 287 | - | 197 |
| Operating income (loss) | (205) | 35 | (624) | (794) |
| | | | | |
| Three months ended June 30, 2009 | | | | |
| Net sales | $5,005 | $729 | | $5,734 |
| Gross margin | 159 | 329 | | 488 |
| Operating income (loss) | 22 | 43 | (630) | (565) |
| | | | | |
| Six months ended June 30, 2010 | | | | |
| Net sales | $8,094 | $1,581 | $- | $9,675 |
| Gross margin | (14) | 628 | - | 614 |
| Operating income (loss) | (248) | 118 | (1,189) | (1,319) |
| | | | | |
| Six months ended June 30, 2009 | | | | |
| Net sales | $11,448 | $1,438 | | $12,886 |
| Gross margin | 875 | 689 | | 1,564 |
| Operating income (loss) | 628 | 162 | (1,421) | (631) |

Winland Electronics, Inc.
Notes to Consolidated Financial Statements

Note 3. Major Customers

The Company has various customers that accounted for 10 percent (10%) or more of net sales for the three and six months ended June 30, 2010 and 2009 as follows:

| | For the Three Months Ended June 30, | | | |
|---|---|---|---|---|
| Sales percentage: | 2010 | | 2009 | |
| Customer A | 36 | % | 41 | % |
| Customer B | 10 | % | 17 | % |
| Customer C | 7 | % | 11 | % |

| | For the Six Months Ended June 30, | | | |
|---|---|---|---|---|
| Sales percentage: | 2010 | | 2009 | |
| Customer A | 37 | % | 39 | % |
| Customer B | 14 | % | 14 | % |
| Customer C | 8 | % | 9 | % |

The Company had net receivables (as a percentage of total receivables) from the above customers at June 30, 2010 and 2009 as follows:

| Accounts receivable percentage: | 2010 | | 2009 | |
|---|---|---|---|---|
| Customer A | 43 | % | 37 | % |
| Customer B | 7 | % | 15 | % |
| Customer C | 14 | % | 11 | % |

Note 4. Loss per Common Share

Loss per common share: Basic loss per common share is computed by dividing the net loss by the weighted-average number of common shares outstanding during the period. Diluted loss per common share is computed by dividing the net loss by the weighted-average number of common shares outstanding during the period, including potentially dilutive shares such as the options and warrants to purchase shares of common stock at various amounts per share (see Note 7). For the three and six months ended June 30, 2010 and 2009, the diluted loss per share was the same as basic loss per share since the effects of options and warrants would have been anti-dilutive. The diluted share calculation excluded 368,900 weighted average shares for the three and six months ended June 30, 2010 and excluded 453,900 weighted average shares for the three and six months ended June 30, 2009.

Note 5. Inventories

The components of inventories were as follows net of reserves:

| ($ in thousands) | June 30, 2010 | December 31, 2009 |
|---|---|---|
| Raw materials | $2,534 | $2,202 |
| Work in progress | 289 | 275 |
| Finished goods | 372 | 562 |

| | | |
|---|---|---|
| Total | $3,195 | $3,039 |

Winland estimates excess, slow moving and obsolete reserves for inventory on a quarterly basis based upon order demand and production requirements for its major customers and annual reviews for other customers.  Management's estimated valuation reserve for slow moving and obsolete raw and finished goods inventories was $766,000 at June 30, 2010 and $562,000 at December 31, 2009.

Winland Electronics, Inc.
Notes to Consolidated Financial Statements

Note 6. Allowance for Rework and Warranty Costs

Winland provides a limited warranty to its OEM customers who require Winland to repair or replace product that is defective, due to Company workmanship issues, at no cost to the customer. In addition, Winland provides a limited warranty for its Proprietary Products for a period of one year, which requires Winland to repair or replace defective product at no cost to the customer or refund the purchase price. The reserve reflecting historical experience and potential warranty issues is determined based on specific customer experience factors including rate of return by item, average weeks outstanding from production to return, average cost of repair and relation of repair cost to original sales price. Any specific known warranty issues are considered individually. These are analyzed to determine the probability and the amount of financial exposure, and a specific reserve is established. The allowance for rework and warranty costs was $50,000 and $45,000 at June 30, 2010 and 2009, respectively, and is included in Accrued expenses, Other, on the balance sheet.

Changes in the Company's warranty liability were approximately as follows:

| | For the Three Months Ended June 30, | |
|---|---|---|
| ($ in thousands) | 2010 | 2009 |
| Balance, Beginning | $ 45 | $ 80 |
| Accruals for products sold | 30 | 12 |
| Expensing of specific warranty items | (30) | (15) |
| Change in estimate | 5 | (32) |
| Balance, Ending | $ 50 | $ 45 |

| | For the Six Months Ended June 30, | |
|---|---|---|
| | 2010 | 2009 |
| Balance, Beginning | $ 45 | $ 80 |
| Accruals for products sold | 53 | 50 |
| Expensing of specific warranty items | (53) | (53) |
| Change in estimate | 5 | (32) |
| Balance, Ending | $ 50 | $ 45 |

Note 7. Stock-Based Awards

For the three and six months ended June 30, 2010, the Company granted 22,000 options which had weighted average grant date fair values of $0.59. For the three and six months ended June 30, 2009, the Company granted 22,000 and 34,000 options, respectively, which had weighted average grant date fair values of $0.53 and $0.51, respectively.

For the six months ended June 30, 2010, the Company recognized expense of $16,000 related to compensation expense for stock based compensation awards compared to compensation expense of $47,000 for the six months ended June 30, 2009.

At June 30, 2010, there was $50,000 of unrecognized compensation cost related to share-based payments which is expected to be recognized over a weighted-average period of two years.

Note 8. Income Taxes

The Company calculates its income tax expense by estimating the annual effective tax rate and applying that rate to the year-to-date ordinary income (loss) at the end of the period.  The Company records a tax valuation allowance when it is more likely than not that it will not be able to recover the value of its deferred tax assets.

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Winland Electronics, Inc.
Notes to Consolidated Financial Statements

Note 8. Income Taxes (Continued)

As of June 30, 2010 and 2009, the Company calculated its estimated annualized effective tax rate at 0% and -10%, respectively. The Company recognized an income tax expense of $2,000 based on its $1,360,000 pre-tax loss for the six months ended June 30, 2010. The $2,000 tax effect was a provision to return difference identified subsequent to the filing of the 2009 Federal and state income tax returns. The Company recognized an income tax expense of $150,000 based on its $689,000 pre-tax loss for the six months ended June 30, 2009.

Winland recognizes the financial statement benefit of a tax position only after determining that the relevant tax authority would more likely than not sustain the position following an audit. For tax positions meeting the more-likely-than-not threshold, the amount recognized in the financial statements is the largest benefit that has a greater than 50% likelihood of being realized upon ultimate settlement with the relevant tax authority.

The Company files income tax returns in the U.S. federal and state jurisdictions and is currently under examination by the Internal Revenue Service (IRS) for its 2004 through 2009 tax years and the State of Minnesota for its 2003 through 2009 tax years. The Company recognized a $301,000 reduction in income tax expense as of December 31, 2007 for credits filed with the Internal Revenue Service and the State of Minnesota for tax years 2003 through 2007, net of $129,000 reserve for ASC 740, Income Taxes. An additional $129,000 of unrecognized tax benefits was recorded for the year ended December 31, 2009 for changes in opinion on positions taken in these open years. The years 2004 through 2009 remain open for examination by other state agencies.

The Company recognizes interest accrued on uncertain tax positions as well as interest received from favorable tax settlements within interest expense. The Company recognizes penalties accrued on unrecognized tax benefits within general and administrative expenses. As of June 30, 2010 and 2009, the Company recognized no interest or penalties related to uncertain tax positions due to their insignificance to its financial position and results of operations.

Given the fact that the Company is currently under audit by the IRS and the State of Minnesota, it is possible that significant changes in the gross balance of unrecognized tax benefits may occur within the next year. An estimate of the range of such gross changes cannot be made at this time. Any changes could have a significant impact on its effective tax rate and expected cash receipts for income taxes refundable within the next year.

Note 9. Financing Arrangement

On June 30, 2010, Winland and Marshall & Ilsley Bank (“M&I”) executed Amendment No. 17 to Credit Agreement, which further amended the Credit and Security Agreement dated June 30, 2003. This amendment amends the definition of borrowing base to read 70% of eligible accounts, changes the definition of maximum line to read $1,500,000 during the period from June 30, 2010 through July 31, 2010, $1,400,000 during the period from August 1, 2010 through August 31, 2010, $1,300,000 during the period from September 1, 2010 through September 29, 2010 and $1,250,000 from and after September 30, 2010 and reduced the Company's minimum tangible net worth to $6,800,000 as of the end of each fiscal quarter commencing June 30, 2010.

On July 19, 2010, Winland and M&I executed Amendment No. 18 to Credit Agreement, which further amended the Credit and Security Agreement. This amendment amends the definition of maturity date to read November 30, 2010 and increased the maximum availability to $2,000,000.

Loans under the Credit Agreement, as amended, will bear interest at either a base rate of 5.0 percent or a Eurocurrency rate equal to the London Inter-Bank Offered Rate (“LIBOR”) for the relevant term plus 3.5 percent, which ever rate is higher. The rate as of June 30, 2010 was 5.0%, the base rate. The outstanding balance under this revolving credit facility was $1,248,000 as of June 30, 2010. The amendment did not result in any debt modification.

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ITEM 2: MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

OVERVIEW

Winland Electronics, Inc. is a manufacturer providing a variety of products to customers predominantly within the transportation, industrial, instrumentation and medical market sectors primarily in North America. The Company operates in two business segments: Electronic Manufacturing Services (EMS) and Proprietary Products. EMS provides complete product realization services to OEM customers by providing value-added services which include product concept studies, product design, printed circuit board design, design for manufacturing, higher level assembly and box build, and legacy support. Proprietary Products develops and markets an established family of environmental security products that can monitor critical environments. The Company's security products include simple and sophisticated microprocessor and mechanically controlled sensors and alarms that monitor and detect critical environmental changes, such as changes in temperature or humidity, water leakage and power failures.

EXECUTIVE SUMMARY

During the second quarter, Winland continued to convert new customers' products from the qualification (new product introduction) stage to production builds, but at a slower rate than expected.

In addition, the second quarter was characterized by sales shifting from larger, long-term customers to those customers Winland acquired during the past six to twelve months. Sales to our top three customers are down $1.2 million and $2.4 million for the second quarter and the first six months of 2010, respectively. In contrast, sales from customers acquired more recently are up $1.0 million and $1.2 million for the same periods, as they move new products to Winland or transition products to us from other suppliers. These new customers' products include controls for alternative energy as well as products used in transportation safety, environmental and biotechnology research, industrial analysis, and measuring and monitoring devices.

Although the quarter-to-quarter sequential growth from new EMS customers is encouraging, during the second quarter it was not enough to offset the sales decline from our largest three customers and the absence of a large design engineering project during the second quarter last year. Instead, during the first half of 2010, design engineering sales have come primarily from a number of smaller design projects for multiple customers.

Sales of our Proprietary Products have increased over last year, due in part to investment in sales and marketing, as well as increasing demand from the food safety, medical, pharmaceutical and commercial markets Winland serves.

RESULTS OF OPERATIONS

Three and six months ended June 30, 2010 vs.
Three and six months ended June 30, 2009

The Company reported a net loss of $822,000 or $0.22 per basic and diluted share for the three months ended June 30, 2010 compared to a net loss of $714,000 or $0.19 per basic and diluted share for the same period in 2009. The Company reported a net loss of $1,362,000 or $0.37 per basic and diluted share for the six months ended June 30, 2010 compared to a net loss of $839,000 or $0.23 per basic and diluted share for the same period in 2009.

Net Sales

Net sales for the three months ended June 30, 2010 were $5,131,000, down $603,000 from the same period in 2009. EMS net sales of $4,380,000 were down $625,000 compared to the same period last year, a 13% decrease. Sales to Customer A, a Minnesota based onboard fleet management solutions provider, were down $513,000. Sales to Customer B, a Florida based medical products company, decreased $441,000. Customer C, a global leader in the manufacture of compact, professional test tools based in Washington, had sales decrease $279,000. Sales to new customers, acquired within the past twelve months, were $1,053,000 for the three months ended June 30, 2010. These sales are the culmination of a long sales cycle and qualification builds for these customers. Net sales of Proprietary Products for the three months ended June 30, 2010 were consistent with the three months ended June 30, 2009.

Net sales for the six months ended June 30, 2010 were $9,675,000, down $3,211,000 from the same period in 2009. EMS net sales of $8,094,000 were down $3,354,000 compared to the same period last year, a 29% decrease. Sales to Customer A, B and C were down $1,460,000, $535,000 and $388,000, respectively, compared to same period a year ago. Sales to new customers, acquired within the past twelve months, were $1,192,000. Net sales of Proprietary Products increased $143,000 or 10% to $1,581,000.

Operating Loss

The Company reported an operating loss of $794,000 and $565,000 for the three months ended June 30, 2010 and 2009, respectively. Gross margins decreased from 8.5% to 3.8% for the three months ended June 30, 2010 compared to the same period in 2009. The Company’s EMS segment reported an operating loss of $205,000 for the three months ended June 30, 2010 compared to operating income of $22,000 reported for the same period a year ago. EMS gross margins were -2.0% for the three months ended June 30, 2010 down from 3.2% in 2009 due to under utilization of fixed overhead expenses, higher production costs related to qualification builds, increased warranty expenses of $55,000 and increased obsolescence expenses of $147,000 which were partially offset by reduced indirect wages and benefits of $206,000. Operating expenses were also reduced $24,000 compared to last year primarily due to reductions in wages and benefits. The Company’s Proprietary Products segment operating income was $35,000 for the three months ended June 30, 2010 compared to operating income of $43,000 last year. Proprietary Products gross margins were 38.2% down from 45.1% due to under utilization of fixed overhead expenses. Reductions of wages and benefits of $25,000 partially offset the increased manufacturing costs.

The Company reported an operating loss of $1,319,000 and $631,000 for the six months ended June 30, 2010 and 2009, respectively. Gross margins decreased from 12.1% to 6.3% for the six months ended June 30, 2010 compared to the same period in 2009. The Company’s EMS segment reported an operating loss of $248,000 for the six months ended June 30, 2010 compared to operating income of $628,000 reported a year ago. EMS gross margins were down from 7.6% a year ago to 0.0% for the six months ended June 30, 2010 due to under utilization of fixed overhead expenses, higher production costs related to qualification builds, increased warranty expenses of $40,000 and increased obsolescence expenses of $160,000 which were partially offset by reduced indirect wages and benefits of $520,000. The Company’s Proprietary Products segment operating income was $118,000 for the six months ended June 30, 2010 compared to operating income of $162,000 last year. Proprietary Products gross margins were 39.7% down from 47.9% due to under utilization of fixed overhead expenses.

General and Administrative expenses were $510,000 for the three months ended June 30, 2010 compared to $543,000 for the same period a year ago, the result of reduced wages and benefits of $55,000, reduced telephone expenses of $19,000 partially offset by increased consulting fees of $64,000. General and Administrative expenses were $970,000 for the six months ended June 30, 2010 compared to $1,169,000 for the same period a year ago, the result of reduced wages and benefits of $118,000, reduced professional fees of $75,000 and reduced telephone expenses of $39,000 partially offset by increased consulting expenses of $68,000.

Research and Development expenses were $114,000 for the three months ended June 30, 2010 compared to $87,000 for the same period a year ago, the result of reduced labor and overhead expenses transferred to Engineering Cost of Goods Sold of $35,000 partially offset by reduced wages and benefits of $13,000. Research and Development expenses were $219,000 for the six months ended June 30, 2010 compared to $252,000 for the same period a year ago, the result of reduced wages and benefits of $109,000, reduced new product development expense of $11,000 partially offset by reduced labor and overhead expenses transferred to Engineering Cost of Goods Sold of $98,000.

Interest Expense and Other, Net

Interest expense and other consists primarily of interest expense and miscellaneous income and expense.  Interest expense for the three and six months ended June 30, 2010 was $27,000 and $48,000, respectively, compared to $23,000 and $46,000, respectively, during the same period a year ago.  The Company had $1,248,000 outstanding on its revolving line-of-credit as of June 30, 2010 compared to $386,000 outstanding balance at June 30, 2009.

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Income Tax

As discussed in Note 8 to the Condensed Financial Statements, income tax benefits were calculated using an estimated annual blended federal and state income tax rate of 0% and -10% for the six months ended June 30, 2010 and 2009, respectively. For the six months ended June 30, 2010, the Company recognized an income tax expense of $2,000 due to tax effect of provision to return differences identified subsequent to the filing of the 2009 Federal and state income tax returns. No income tax benefit has been provided for the three and six months ended June 30, 2010 due to a 100% valuation allowance.

LIQUIDITY AND CAPITAL RESOURCES

Operating activities used cash of $650,000 and $299,000 for the six months ended June 30, 2010 and 2009, respectively. For the six months ended June 30, 2010, the net loss of $1,362,000 was partially offset by depreciation expense of $397,000 and net changes in working capital of $249,000. For the six months ended June 30, 2009, the $839,000 net loss was partially offset by depreciation expense of $412,000 and net changes in working capital of $61,000. Cash used in investing activities was used to acquire capital equipment of $13,000 and $59,000 for the six months ended June 30, 2010 and 2009, respectively. Cash used in financing activities for the payment of long-term debt was $187,000 for the six months ended June 30, 2010 compared to $213,000 for the same period in 2009. For the six months ended June 30, 2010 and 2009 cash was provided by borrowing against the revolving line of credit in the amount of $881,000 and $386,000, respectively.

The current ratio was 1.9 to 1 at June 30, 2010 and 3.1 to 1 at December 31, 2009, respectively, with working capital equaling $3.5 million and $4.9 million at June 30, 2010 and December 31, 2009, respectively. The Company had $1,248,000 outstanding on its revolving line-of-credit with $252,000 available for borrowings as of June 30, 2010. The revolving line-of-credit expires on November 30, 2010, if not renewed prior to that date.

During and subsequent to the second quarter of 2010, Winland and M&I amended the Company's revolving credit agreement based on changes in the banking industry due to the economy and Winland's recent financial performance. Summaries of each amendment are as follows:

On June 30, 2010, Winland and M&I executed Amendment No. 17 to Credit Agreement, which further amended the Credit and Security Agreement dated June 30, 2003. This amendment amends the definition of borrowing base to read 70% of eligible accounts, changes the definition of maximum line to read $1,500,000 during the period from June 30, 2010 through July 31, 2010, $1,400,000 during the period from August 1, 2010 through August 31, 2010, $1,300,000 during the period from September 1, 2010 through September 29, 2010 and $1,250,000 from and after September 30, 2010 and reduced the Company's minimum tangible net worth to $6,800,000 as of the end of each fiscal quarter commencing June 30, 2010.

On July 19, 2010, Winland and M&I executed Amendment No. 18 to Credit Agreement, which further amended the Credit and Security Agreement. This amendment amends the definition of maturity date to be November 30, 2010 and increased the maximum availability to $2,000,000.

The Company's future liquidity needs will depend on many factors, including the timing and amount of its revenues and its investment decisions, which may affect the Company's ability to generate additional cash. If cash generated from operations and financing activities, through the use of our revolving credit agreement or proposed financing as described below, is insufficient to satisfy working capital requirements during the next twelve months, the Company may seek additional funding through bank borrowings or other means. The Company entered into a proposal for maximum borrowings of $2,200,000.00 subject to a limitation based on 75% of eligible accounts receivable on August 5, 2010.  The proposal is subject to due diligence by the lender.  There can be no assurance that the Company will be able to raise any such capital on acceptable terms or at all.  Additionally, there can be no assurance that the Company will satisfy all the covenants in its revolving credit agreement including minimum tangible net worth in the future.

FORWARD-LOOKING STATEMENTS

Certain statements contained in this Form 10-Q and other written and oral statements made from time to time by Winland do not relate strictly to historical or current facts. As such, they are considered “forward-looking statements” that provide current expectations or forecasts of future events. Such statements can be identified by the use of terminology such as “anticipate,” “believe,” “estimate,” “expect,” “intend,” “may,” “could,” “possible,” “plan,” “project,” “sho “forecast” and similar words or expressions. Winland’s forward-looking statements generally relate to its purchase order levels, building market share in the EMS market, growth strategies, financial results, product development, sales levels, sales efforts and sufficiency of capital. One must carefully consider forward-looking statements and understand that such statements involve a variety of risks and uncertainties, known and unknown, and may be affected by inaccurate assumptions. Consequently, no forward-looking statement can be guaranteed, and actual results may vary materially from results or circumstances described in such forward-looking statements. As provided for under the Private Securities Litigation Reform Act of 1995, Winland wishes to caution investors that its forward-looking statements in some cases have affected and in the future could affect Winland’s actual results of operations and cause such results to differ materially from those anticipated in forward-looking statements made in this document and elsewhere by or on behalf of Winland.

Please refer to forward-looking statements as previously disclosed in our report on Form 10-K for fiscal year ended December 31, 2009.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

None.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

As of June 30, 2010, the end of the period covered by this report, management, including the Chief Executive Officer (“CEO”) and the Chief Financial Officer (“CFO”) evaluated the effectiveness of disclosure controls and procedures (as defined in the Exchange Act Rules 13a-15(e) and 15d-15(e)) as of such date. Based on that evaluation, the CEO and CFO have concluded that the Company’s disclosure controls and procedures were effective as of June 30, 2010.

Changes in Internal Control over Financial Reporting

There were no changes in the Company’s internal control over financial reporting that occurred during the six months ended June 30, 2010 that have materially affected, or are reasonably likely to materially affect, the Company’s internal control over financial reporting.

## PART II – OTHER INFORMATION

### ITEM 1. LEGAL PROCEEDINGS

None.

### ITEM 1A. RISK FACTORS

Please refer to the risk factors as previously disclosed in our report on Form 10-K for fiscal year ended December 31, 2009.

### ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

None.

### ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

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

The Company held its Annual Meeting on May 4, 2010. Proxies for the annual meeting were solicited pursuant Regulation 14A under the Securities and Exchange Act of 1394. There was no solicitation in opposition to management's nominees as listed in the proxy statement, and all nominees were elected.

Proposal 1 for the election of directors:

| | Number of votes | |
|---|---|---|
| Nominee | For | Withheld |
| Thomas J. de Petra | 1,034,346 | 272,271 |
| Lorin E. Krueger | 1,109,637 | 196,980 |
| Richard T. Speckmann | 1,033,824 | 272,793 |
| Thomas J. Goodmanson | 1,121,775 | 184,842 |
| Thomas J. Brady | 1,116,875 | 189,742 |

Proposal 2 to set the number of directors at five: A total of 2,477,690 shares were voted in favor, 360,412 shares against and 38,746 shares abstained.

Proposal 3 to ratify the appointment of Baker Tilly Virchow Krause, LLP as the Company's independent registered public accountants for the fiscal year ending December 31, 2010. A total of 2,839,567 shares were voted in favor, 9,856 against and 27,425 abstained.

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS

See Exhibit Index following the signature page.

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SIGNATURES

Pursuant to the requirements of Section 13 of the Securities Exchange Act of 1934, the Company has caused this Report to be signed on its behalf by the undersigned, thereunto duly authorized.

| | | |
|---|---|---|
| | Winland Electronics, Inc. | |
| Date: August 13, 2010 | By: | /s/ Thomas J. de Petra<br>Thomas J. de Petra<br>President and Chief Executive Officer<br>(Principal Executive Officer) |
| | By: | /s/ Glenn A. Kermes<br>Glenn A. Kermes<br>Chief Financial Officer<br>(Principal Financial and Accounting Officer) |

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SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

EXHIBIT INDEX TO FORM 10-Q

For the fiscal quarter ended June 30, 2010 Commission File No. 1-15637

WINLAND ELECTRONICS, INC.

| Exhibit No. | Description |
| --- | --- |
| 31.1 | Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 |
| 31.2 | Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 |
| 32.1 | Certification of Chief Executive Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 |
| 32.2 | Certification of Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 |

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