ASTRO MED INC /NEW/
Form 10-K
April 13, 2009

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

x ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended January 31, 2009

OR

¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from __________ to __________

Commission file number 0-13200

Astro-Med, Inc.

(Exact name of registrant as specified in its charter)

Rhode Island	**05-0318215**
(State or other jurisdiction of	**(I.R.S. Employer Identification No.)**

incorporation or organization)

600 East Greenwich Avenue,

West Warwick, Rhode Island	**02893**
(Address of principal executive offices)	**(Zip Code)**

Registrant s telephone number, including area code: (401) 828-4000

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

Title of each class	Name of each exchange on which registered
None	**None**

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

Common Stock, $.05 Par Value

(Title of Class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ¨ No x

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ¨ No x

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

Indicate by checkmark if disclosure of delinquent filers pursuant to Item 405 of regulation S-K is not contained herein, and will not be contained. To the best of the Registrant s knowledge, in definitive proxy or information statement incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of large accelerated filer , accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer ¨	Accelerated filer ¨	Non-accelerated filer ¨ (Do not check if a smaller reporting company)	Smaller reporting company x

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

The aggregate market value of the registrant s voting common equity held by non-affiliates at August 1, 2008 was approximately $45,302,680 based on the closing price on the Nasdaq Global Market on that date.

As of April 3, 2009 there were 7,146,603 shares of Common Stock (par value $0.05 per share) of the registrant outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Company s definitive Proxy Statement for the 2009 Annual Meeting of Shareholders are incorporated by reference into Part III of this Annual Report on Form 10-K where indicated.

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ASTRO-MED, INC.

FORM 10-K ANNUAL REPORT

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ASTRO-MED, INC.

Forward-Looking Statements

Information included in this Annual Report on Form 10-K may contain forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Forward-looking statements are not statements of historical fact, but rather reflect our current expectations concerning future events and results. We generally use the words believes, expects, intends, plans, anticipates, likely, continues, may similar expressions to identify forward-looking statements. Such forward-looking statements, including those concerning our expectations, involve risks, uncertainties and other factors, some of which are beyond our control, which may cause our actual results, performance or achievements to be materially different from those expressed or implied by such forward-looking statements. These risks, uncertainties and factors include, but are not limited to, those factors set forth in this Annual Report on Form 10-K under Item 1A. Risk Factors. We undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise. The reader is cautioned not to unduly rely on such forward-looking statements when evaluating the information presented in this Annual Report on Form 10-K.

PART I

Item 1. ***Business***

General

Unless otherwise indicated, references to Astro-Med, the Company, we, our and us in this Annual Report on Form 10-K refer to Astro-Med and its consolidated subsidiaries.

Astro-Med, Inc. designs, develops, manufactures and distributes a broad range of specialty printers and data acquisition and analysis systems, including both hardware and software, which incorporate advance technologies. Target markets for products of the Company include aerospace, apparel, automotive, avionics, chemicals, computer peripherals, communications, distribution, food and beverage, general manufacturing, life sciences, packaging and transportation.

The Company s products are distributed through its own sales force in the United States and Canada and in Western Europe, and by authorized dealers elsewhere in the world. Approximately 30% of the Company s sales in fiscal 2009 were to customers located outside the United States.

We operate our business through three operating segments, Astro-Med Test & Measurement (T&M), QuickLabel Systems (QuickLabel) and Grass Technologies (GT). Financial information by business segment and geographic area appear in Note 9 to the Consolidated Financial Statements on pages 49 and 50 of this Annual Report on Form 10-K. The following description of our business should be read in conjunction with Management s Discussion and Analysis of Financial Conditions and Results of Operations on pages 16 through 24 of this Annual Report on Form 10-K.

Description of Business

Product Overview

Astro-Med develops and manufactures systems that have the ability to acquire, process, analyze, store and present electronic data in a variety of useable forms. We sell our product under brand names including Astro-Med® Test & Measurement (T&M), QuickLabel® Systems (QuickLabel) and Grass® Technologies (GT). Products sold under the Astro-Med T&M brand acquire and record data and print the output onto charts or electronic media.

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Products sold under the QuickLabel brand create product and packaging labels and tags in one or many colors. Products sold under the GT brand electronically capture and record neurological data that is used to diagnose epilepsy or to study sleep disorders. The Company supplies a range of products that include hardware, software and consumables to customers who are in a variety of industries.

Products sold under the Astro-Med T&M brand include ToughWriter printers, ToughSwitches Ethernet switches, Everest recorders and Dash series data recorders. ToughWriter ruggedized page printers are used on the flight deck and in the cabins of military and commercial aircraft to print hard copies of airport maps, flight itineraries, weather maps, gate information and ground communications. ToughSwitches Ethernet switches are used in commercial and military aircraft and military vehicles to connect multiple computers or Ethernet-compatible devices together. These products are ruggedized to comply with rigorous military and commercial flightworthiness standards for operation under extreme environmental conditions. The Company is currently furnishing ToughWriters for the Airbus A380, the Airbus A400M, Bombardier B145, the Boeing C-17, B-787, B-777, B-747, B-767, and Lockheed C-130. Other products sold under the Astro-Med brand include the Everest, used widely in the aerospace industry to monitor and track space vehicles, aircraft, missiles and other systems in flight. The Company s Dash Series product line consists of a family of portable data recorders used as maintenance and troubleshooting instruments in pulp and paper mills, metal mills, power plants, automotive R&D centers and manufacturing plants. Dash Series include the Dash 2EZ, Dash 8X, Dash 8HF, Dash 8XPM, Dash 18, Dash 20HF and the Dash 32HF. Everest recorders are used principally in the telementary sector of the aerospace industry where they are used to monitor the readiness for flight of an aircraft or space vehicle.

Products sold under the QuickLabel System brand include digital color label printers developed for short-run, in-house label printing; label substrates and thermal transfer ribbon, toner, and inkjet printing inks developed for use in label printers, and a range of labeling software, accessory products, and printing services which allow QuickLabel Systems sales and support staff to serve customers at virtually every level of their label printing needs. With its broad range of entry-level, mid-range, and high-performance digital label printers, QuickLabel Systems is able to provide its customers a continuous path to upgrade to new products. QuickLabel products are primarily sold to end-user manufacturers, processors, and retailers who package products on a Just-in-Time basis, who label products for private label, OEM, or contract packaging customers, or who label products in foreign languages for export markets. These end-users can benefit from the time savings and cost-savings of printing their own labels digitally on-demand. Industries that commonly benefit from short-run label printing include apparel, chemicals, cosmetics, electronics, foods and beverages, medical products, and pharmaceuticals, among many other manufactured goods. Current QuickLabel models include the Vivo!, a patented electrophotographic label printer developed to print on continuous rollstock for in-house label printing; the Zeo!, a lower-duty inkjet printer developed in partnership with Hewlett-Packard; and the Xe Series of color thermal transfer label printers including the QLS-4100 Xe, QLS-8100 Xe, QLS-2000 Xe and QLS-3000 Xe. The Xe Series of digital color thermal transfer label printers are unique in the industry in that they can be directly integrated with production line equipment and represent a novel, patented application of multi-color thermal transfer technology, historically only commercialized in single-color barcode label printers. QuickLabel also sells and supports its own Pronto! family of monochrome/barcode printers which utilize thermal transfer label printing technology in a single color.

Products sold under the Grass Technologies (GT) brand include electronic equipment, software and consumable products. The electronic equipment is primarily sold into the diagnostic markets of Sleep Disorders, Epilepsy Monitoring and Long-Term Monitoring (LTM). These products are sold to hospitals, free standing clinics and private physicians offices. The equipment sold to these markets detects and amplifies bio signals, for review and analysis via the special GT software programs. Customers for the secondary equipment line are typically researchers in university based research centers or companies engaged in drug research. This equipment consists of diagnostic recording systems, stimulation devices and accessories. The consumable line of products offered by GT are typically utilized with the systems described above. These products are predominantly made up of sensing devices that are used for the purpose of collecting physiological data from patients.

Technology

The core technologies of Astro-Med relate to (1) acquiring data, (2) conditioning the data, (3) displaying the data on hard copy, monitor or electronic storage media, and finally (4) analyzing the data.

We are continually improving the performance and functionality of our core technologies, enabling us to lead the competition with innovative products.

Patents and Copyrights

Astro-Med holds a number of product patents in the United States and in foreign countries. The Company copyrights its software and registers its brand trademarks. While we consider our patents to be important to the operation of our business, we do not believe that any existent patent, license, trademark or other intellectual property right is of such importance that its loss or termination would have a material adverse effect on the Company s business taken as a whole.

Manufacturing and Supplies

Astro-Med designs its products and manufactures many of the component parts. The balance of the parts are produced to our specifications by suppliers. Raw materials required for the manufacture of products, including parts produced to our specifications, are generally available from numerous suppliers. However, we do obtain certain components of our products and certain finished products from sole sources.

Product Development

Astro-Med maintains an active program of product research and development. During fiscal 2009, 2008 and 2007, we incurred costs of $4,884,767, $4,589,022 and $4,187,018, respectively, on Company-sponsored product development. We are committed to product development as a requisite to our organic growth and expect to continue our focus on research and development efforts in fiscal 2010 and beyond.

Marketing and Competition

The Company competes worldwide in many markets including clinical and research diagnostics, specialty printing systems and data acquisition and analysis. We retain a competitive position in our respective markets by virtue of proprietary technology, product reputation, delivery, technical assistance and service to customers. We market our products worldwide by advertising and promotion using major national and international trade journals, scientific meetings and trade shows, direct mailing campaigns and the internet.

Our products are sold by direct field sales persons as well as independent dealers and representatives. In the United States, the Company has factory-trained direct field sales people located in major cities from coast to coast specializing in either Astro-Med T&M products, QuickLabel products, or Grass Technologies products. Additionally, we have direct field sales and service centers in Canada, England, France, United Kingdom and staffed by our own employees. In the remaining parts of the world, Astro-Med utilizes approximately 60 independent dealers and representatives selling and marketing our products in 80 countries.

Astro-Med has a number of competitors in each of the markets that it serves. In the T&M area, we believe that we lead the field in data acquisition systems. In the digital color label printing field, we believe we lead the world in color label printing technology, and we were the first to market an electrophotographic color label printer capable of printing on continuous rollstock.

Our Grass Technologies products are devoted to clinical applications in electroncephalography (EEG), polysomnography (PSG), and Long Term Epilepsy Monitoring (LTM). There are approximately ten companies that compete in one or more of the three modalities (EEG, PSG, LTM), but none are the clear leader. We believe we offer superior products based upon our long history and pioneering efforts in the field since 1935. Unlike most of our competitors, Astro-Med designs, manufactures and produces complete systems including transducers, amplifiers, sensors, and Windows-based application software. Additionally, we produce a range of life science products for the research market many of which eventually find their way into clinical applications.

No single customer accounted for 10% or more of our net sales in any of the last three fiscal years.

International Sales

In fiscal 2009, 2008 and 2007, net sales to customers in various geographic areas outside the United States, primarily in Canada and Western Europe, amounted to $21,823,000, $21,892,000 and $18,015,000, respectively.

Order Backlog

Astro-Med s backlog fluctuates regularly. It consists of a blend of orders for end user customers as well as original equipment manufacturer customers. Manufacturing is geared to forecasted demands and applies a rapid turn cycle to meet customer expectations. Accordingly, the amount of order backlog does not indicate future sales trends. Backlog at January 31, 2009 and 2008 was $6,405,000 and $6,913,000, respectively.

Employees

As of January 31, 2009, Astro-Med employed approximately 400 people. We are generally able to satisfy our employment requirements. No employees are represented by a union. We believe that employee relations are good.

Other Information

The Company s business is not seasonal in nature. However, our sales are impacted by the size and complexity of certain individual transactions, which can cause fluctuations in sales from quarter to quarter.

Most of the Company s products are generally warranted for one year against defects in materials or workmanship. Warranty expenses have generally averaged $434,000 a year for the last five fiscal years.

Available Information

We make available free of charge on our Internet website (www. astro-medinc.com) the Company s Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and, if applicable, amendments to those reports filed or furnished pursuant to Sections 13(a) or 15(d) of the Securities Exchange Act of 1934 as soon as reasonably practicable after the Company electronically files such material with, or furnishes it to, the Securities Exchange Commission. These filings are also accessible on the SEC s website at http://www.sec.gov.

Item 1A. ***Risk Factors***

The following risk factors should be carefully considered in evaluating Astro-Med because such factors may have a significant impact on our business, operating results, liquidity and financial condition. As a result of the risk factors set forth below, actual results could differ materially from those projected in any forward-looking statements. Additional risks and uncertainties not presently known to us, or that we currently consider to be immaterial, may also impact our business, operating results, liquidity and financial condition. If any such risks occur, Astro-Med s business, operating results, liquidity and financial condition could be materially affected in an adverse manner. Under such circumstances, the trading price of our securities could decline, and you may lose all or part of your investment.

Declining general economic conditions and uncertainties in the global credit and equity markets may adversely affect Astro-Med s results of operation and financial position.

Our business is sensitive to changes in general economic conditions, both inside and outside the U.S. Worldwide financial markets have experienced extreme disruption in recent months, including, among other things, extreme volatility in security prices, severely diminished liquidity and credit availability, rating downgrades and declining valuations of investments. These disruptions are likely to have an ongoing adverse effect on the world economy. We are unable to predict how long the economic downturn will last. Continuing economic downturn and financial market disruptions may adversely impact our business resulting in:

- Reduced demand for our products realized by diminished new orders and increases in order cancellations;
- Increased risk of excess and obsolete inventories;
- Increased pressure on the prices for our products and services;
- Greater difficulty in collecting accounts receivables; and
- Greater risk of impairment to the value and liquidity of our investment portfolio.

Astro-Med faces significant competition and our failure to compete successfully could adversely affect our results of operations and financial condition.

We operate in an environment of significant competition, driven by rapid technological advances, evolving industry standards, frequent new product introductions and the demands of customers to become more efficient. Our competitors range from large international companies to relatively small firms. We compete primarily on the basis of technology, performance, price, quality, reliability, brand, distribution and customer service and support. Our success in future performance is largely dependent upon our ability to compete successfully in the markets we currently serve and to expand into additional market segments. Additionally, current competitors or new market entrants may develop new products with features that could adversely affect the competitive position of our products. To remain competitive, we must develop new products, services and applications and periodically enhance our existing offerings. If we are unable to compete successfully, we could lose market share and important customers to our competitors and that could materially adversely affect our results of operations and financial position.

Astro-Med s future revenue growth depends on our ability to introduce new products and services on a timely basis and achieve market acceptance of these new products and services.

The markets for our products are characterized by rapidly changing technology and accelerating product introduction cycles. Our future success depends largely upon our ability to address the rapidly changing needs of our customers by developing and supplying high-quality, cost-effective products, product enhancements and services on a timely basis and by keeping pace with technological developments and emerging industry standards. Astro-Med spends a significant amount of time and effort related to the development of our Ruggedized and Color Printer products. Failure to further develop these products and markets as anticipated could adversely affect our future revenue growth and operating results.

For certain components and assembled products, Astro-Med is dependent upon single or limited source suppliers. If these suppliers do not meet demand, either in volume or quality, then we could be materially harmed.

If the supply of a key component or assembled products were to be delayed or curtailed or, in the event a key manufacturing or sole vendor delays shipment of such components or completed products, our ability to ship products in desired quantities and in a timely manner would be adversely affected. Our business, results of

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operations and financial position could also be adversely affected, depending on the time required to obtain sufficient quantities from the original source or, if possible, to identify and obtain sufficient quantities from an alternative source.

Additionally, if any single or limited source supplier becomes unable or unwilling to continue to supply these components or assembled products in required volumes, we will have to identify and qualify acceptable replacements or redesign our products with different components. Alternative sources may not be available, or product redesign may not be feasible on a timely basis. Any interruption in the supply of or increase in the cost of the components and assembled products provided by single or limited source suppliers could have a material adverse effect on our business, results of operations and financial position.

Economic, political and other risks associated with international sales and operations could adversely affect Astro-Med s results of operations and financial position.

Because we sell our products worldwide, our business is subject to risks associated with doing business internationally. Revenue from international operations, which includes both direct and indirect sales to customers outside the U.S. accounted for approximately 30% of our total revenue for fiscal year 2009 and we anticipate that international sales will continue to account for a significant portion of our revenue. In addition, many of our employees, suppliers, job functions and facilities are located outside the U.S. Accordingly, our future results could be harmed by a variety of factors, including:

- Interruption to transportation flows for delivery of parts to us and finished goods to our customers;
- Customer and vendor financial stability;
- Changes in foreign currency exchange rates;
- Changes in a specific country s or region s political, economic or other conditions;
- Trade protection measures and import or export licensing requirements;
- Negative consequences from changes in tax laws;
- Difficulty in staffing and managing widespread operations;
- Differing labor regulations;
- Differing protection of intellectual property;
- Unexpected changes in regulatory requirements; and
- Geopolitical turmoil, including terrorism and war.

Astro-Med s profitability is dependent upon our ability to obtain adequate pricing for our products and to improve our cost structure.

Our success depends on our ability to obtain adequate pricing for our products and services which provides a reasonable return to our shareholders. Depending on competitive market factors, future prices we obtain for our products and services may decline from previous levels. In addition, pricing actions to offset the effect of currency devaluations may not prove sufficient to offset further devaluations or may not hold in the face of customer resistance and/or competition. If we are unable to obtain adequate pricing for our products and services, our results of operations and financial position could be materially adversely affected.

We continually review our operations with a view towards reducing our cost structure, including but not limited to downsizing our employee base, exiting certain businesses, improving process and system efficiencies and outsourcing some internal functions. We from time to time engage in restructuring actions to reduce our cost structure. If we are unable to continue to maintain our cost base at or below the current level and maintain process and systems changes resulting from prior restructuring actions, it could materially adversely affect our results of operations and financial position.

Astro-Med s results of operation may suffer if our manufacturing capacity does not match the demand for our products.

Because we cannot immediately adapt our production capacity and related cost structures to rapidly changing market conditions, when demand does not meet our expectations, our manufacturing capacity will likely exceed our production requirements. If, during a general market upturn or an upturn in one of our segments, we cannot increase our manufacturing capacity to meet product demand, we will not be able to fulfill orders in a timely manner. This inability could materially and adversely limit our ability to improve our results. By contrast, if during an economic downturn we had excess manufacturing capacity, then our fixed costs associated with excess manufacturing capacity would adversely affect our income.

Third parties may infringe our intellectual property and we may suffer competitive injury or expend significant resources enforcing our rights.

Astro-Med s success depends in part on our proprietary technology. We rely on various intellectual property rights, including patents, copyrights, trademarks and trade secrets, as well as confidentiality provisions and licensing arrangements, to establish our proprietary rights. If we do not enforce our intellectual property rights successfully our competitive position may suffer which could harm our results of operation and financial position.

Our patents, copyrights, trademarks and other intellectual property rights may not provide us a significant competitive advantage. We may need to spend significant resources monitoring our intellectual property rights and we may or may not be able to detect infringement by third parties. Our competitive position may be harmed if we cannot detect infringement and enforce our intellectual property rights quickly or at all. In some circumstances, enforcement may not be available to us because an infringer has a dominant intellectual property position or for other business reasons. In addition, competitors might avoid infringement by designing around our intellectual property rights or by developing non-infringing competing technologies. Most of our trademarks have no foreign protection since we have not registered them in foreign countries. Intellectual property rights and our ability to enforce them may be unavailable or limited in some countries which could make it easier for competitors to capture market share and could result in lost revenues.

Astro-Med could incur liabilities as a result of installed product failures due to design or manufacturing defects.

Astro-Med could incur liabilities as a result of installed product failures due to design or manufacturing defects. Our products may have defects despite testing internally or by current or potential customers. These defects could result in among other things, a delay in recognition of sales, loss of sales, loss of market share, failure to achieve market acceptance or substantial damage to our reputation. We could be subject to material claims by customers, and may need to incur substantial expenses to correct any product defects.

Astro-Med depends on the ongoing service of its senior management and ability to attract and retain other key personnel.

Our success depends to a significant degree upon the continuing contributions of key management, sales, marketing, research and development and manufacturing personnel, many of whom we would have difficulty replacing. We believe that our future success will depend in large part upon our ability to attract and retain highly skilled engineers and management, sales and marketing personnel. Failure to attract and retain key personnel could have a material adverse effect on our business, results of operations or financial position.

Astro-Med is subject to laws and regulations; failure to address or comply with these laws and regulations could harm our business and adversely affect our results of operations.

Our operations are subject to laws, rules, regulations, including environmental regulations, government policies and other requirements in each of the jurisdictions in which we conduct business. Changes in laws, rules, regulations, policies or requirements could result in the need to modify our products and could affect the demand

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for our products, which may have an adverse impact on our future operating results. In addition, we must comply with new regulations restricting our ability to include lead and certain other substances in our products. If we do not comply with applicable laws, rules and regulations we could be subject to costs and liabilities and our business may be adversely impacted.

A number of our products from our Grass Technology product group are subject to regulation by the United States Food and Drug Administration (FDA) and certain similar foreign regulatory agencies. If we or any of our suppliers or distributors fail to comply with FDA and other applicable regulatory requirements or are perceived to potentially have failed to comply, we may face, among other things, adverse publicity affecting both us and our customers; investigations or notices of non-compliance; fines, injunctions and civil penalties; partial suspensions or total shutdown of production facilities or the imposition of operating restrictions; increased difficulty in obtaining required FDA clearances or approvals; seizures or recalls of our products or those of our customers, and/or the inability to sell our products.

Astro-Med sells medical equipment to customers who rely on certain third party reimbursement rates.

We cannot be certain that third party reimbursement rates and policies will continue in the future. Any change in reimbursement rates and policies could adversely impact our profitability.

Adverse conditions in the global banking industry and credit markets may adversely impact the value of our cash investments or impair our liquidity.

At the end of fiscal 2009, we had cash and cash equivalents of approximately $11 million invested or held in a mix of money market funds, time deposit accounts and bank demand deposit accounts. The recent disruptions in the financial markets may, in some cases, result in an inability to access assets such as money market funds that traditionally have been viewed as highly liquid. Any failure of our counterparty financial institutions or funds in which we have invested may adversely impact our cash and cash equivalent positions and, in turn, our results of operations and financial position. As of January 31, 2009, we also had an approximate $10 million portfolio of securities available for sale which is primarily classified as a current asset. This portfolio consists of auction rate securities and state and municipal securities with various maturity dates. All of the securities in the portfolio are triple AAA rated at original purchase date; however, a failure of the issuer of any such commercial paper may result in an adverse impact on the portfolio.

As of January 31, 2009, we held $890,925 of auction rate securities classified as long-term investments available for sale. If the uncertainties in the credit and capital market continue, these markets continue to deteriorate or the various rating agencies downgrade any of the auction rate securities that we hold, we may be required to further write-down the value of these investments.

Astro-Med may not be able to effectively integrate businesses or assets acquired.

We may identify and pursue acquisitions of complementary companies and strategic assets, such as customer bases, products and technology. However, there can be no assurance that we will be able to identify suitable acquisition opportunities. If any such opportunity involves the acquisition of a business, we cannot be certain that:

- We will successfully integrate the operations of the acquired business with our own;
- All the benefits expected from such integration will be realized;
- Management s attention will not be diverted or divided, to the detriment of current operations;
- Amortization of acquired intangible assets will not have a negative effect on operating results or other aspects of our business;
- Delays or unexpected costs related to the acquisition will not have a detrimental effect on our business, operating results and financial condition;

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Customer dissatisfaction with, or performance problems at, an acquired company will not have an adverse effect on our reputation; and

Respective operations, management and personnel will be compatible.

In certain instances as permitted by applicable law and NASDAQ rules, acquisitions will be consummated without seeking and obtaining shareholder approval, in which case shareholders will not have an opportunity to consider and vote upon the merits of such an acquisition. Although we will endeavor to evaluate the risks inherent in a particular acquisition, there can be no assurance that we will properly ascertain or assess such risks.

Business interruptions could adversely affect Astro-Med s business.

Our operations and the operations of our suppliers, contract manufacturers and customers are vulnerable to interruptions by fire, earthquake, hurricane, power loss, telecommunications failure, terrorism and other events beyond our control. Although we carry insurance for property damage and business interruption, we do not carry insurance for interruptions or potential losses arising from terrorism. In the event that a material business interruption occurs that affects Astro-Med, its suppliers, contract manufacturers or customers, shipments could be delayed and our business and financial results could be harmed.

Item 1B. ***Unresolved Staff Comments***

None

Item 2. ***Properties***

The following table sets forth information regarding the Company s principal owned properties, all of which are included in the consolidated balance sheet appearing elsewhere in this report.

Location	Approximate Square Footage	Principal Use
West Warwick, RI	126,000	Corporate headquarters, research and development, manufacturing, sales and service
Rockland, MA	36,000	Manufacturing, sales and service
Slough, England	1,700	Sales and service

Astro-Med also leases facilities in five locations. The following information pertains to each location:

Location	Approximate Square Footage	Principal Use
Rodgau, Germany	5,435	Manufacturing, sales and service
Brossard, Quebec, Canada	3,400	Sales and service
Newport Beach, California	151	Sales and service
Trappes, France	2,164	Sales and service
Schaumburg, IL	1,131	Sales and service

We believe our facilities are well maintained, in good operating condition and generally adequate to meet our needs for the foreseeable future.

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Item 3. ***Legal Proceedings***

In April 2008, following a trial in the U.S. District Court of Rhode Island, the jury found a former employee to have violated his non-compete agreement and awarded Astro-Med damages of $375,800 against both the former employee and the former employee s new employer. Astro-Med was also awarded exemplary damages and attorneys fees (all of which have been previously expensed), resulting in a total award of over $1.1 million. The defendants have appealed the judgment to the United States Court of Appeals for the First Circuit and have posted a bond for approximately $1.3 million as a security for payment of the judgment during the appeal process. Currently the appeal is pending. The Company has not recognized any income through January 31, 2009 on this contingency.

There are no pending or threatened legal proceedings against Astro-Med believed to be material to our financial position or results of operations.

Item 4. ***Submission of Matters to a Vote of Security Holders***

No matters were submitted to a vote of the Company s security holders, through solicitation of proxies or otherwise, during the last quarter of the period covered by this report.

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PART II

Item 5. ***Market for the Registrant s Common Stock, Related Stockholder Matters and Issuer Purchases of Equity Securities***

Astro-Med s common stock trades on The NASDAQ Global Market under the symbol ALOT. The following table sets forth dividend data and the range of high and low closing prices, as furnished by NASDAQ, for the years ended January 31:

	High	Low	Dividends Per Share
2009			
First Quarter	$ 10.00	$ 8.34	$ 0.06
Second Quarter	$ 10.38	$ 8.25	$ 0.06
Third Quarter	$ 10.00	$ 6.00	$ 0.06
Fourth Quarter	$ 7.39	$ 5.55	$ 0.06
2008			
First Quarter	$ 11.94	$ 10.48	$ 0.05
Second Quarter	$ 12.08	$ 9.11	$ 0.05
Third Quarter	$ 10.68	$ 8.38	$ 0.05
Fourth Quarter	$ 10.29	$ 8.40	$ 0.05

Astro-Med had approximately 315 shareholders of record as of April 3, 2009, which does not reflect shareholders with beneficial ownership in shares held in nominee name.

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The line graph below shows a comparison of the cumulative total return on the Company s common stock against the cumulative total return of a NASDAQ market index and a peer index for the period of five fiscal years ended January 31, 2009. The University of Chicago s Center for Research in Security Pricing (CRSP) total return index is calculated using all companies trading on the NASDAQ Global Select, NASDAQ Global Market and the NASDAQ Capital Market listing through January 31, 2009. It includes both domestic and foreign companies. The index is weighted by the current shares outstanding and assumes dividends reinvested. The return is calculated on a monthly basis. The peer group index, the CRSP Index for NASDAQ Electronic Components Stock designated below as the industry index, is comprised of companies classified as electronic equipment manufacturers. The total returns assume $100 invested on February 1, 2004 with reinvestment of dividends.

	2004	2005	2006	2007	2008	2009
Astro-Med, Inc.	$ 100.00	$ 71.57	$ 79.07	$ 102.20	$ 97.21	$ 71.76
Nasdaq Electronic Components	$ 100.00	$ 72.01	$ 79.86	$ 83.47	$ 79.03	$ 47.24
Nasdaq US and foreign index	$ 100.00	$ 99.91	$ 112.72	$ 121.28	$ 118.40	$ 59.00

Dividend Policy

Astro-Med began a program of paying quarterly cash dividends in fiscal 1992 and has paid a dividend for 70 consecutive quarters. During fiscal 2009, we paid a quarterly dividend of $0.06 per share. We anticipate that we will continue to pay comparable cash dividends on a quarterly basis.

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Stock Repurchases

On August 16, 2004, Astro-Med announced that its Board of Directors had approved the repurchase of 600,000 shares of common stock. This is an ongoing authorization without any expiration date.

During the fourth quarter of fiscal 2009, the Company made the following repurchases of its common stock:

	Total Number of Shares Repurchased	Average Price paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number of Shares That May Be Purchased Under The Plans or Programs
November 2 November 29		$		392,289
November 30 December 27		$		392,289
December 28 January 31		$		392,289

Item 6. ***Selected Financial Data***

The following financial data with respect to our results of operations, per share and financial condition data for each of the five fiscal years in the period ended January 31, 2009 set forth below has been derived from our audited consolidated financial statements. The selected financial information presented below should be read in conjunctions with the Consolidated Financial Statements and related notes thereto and Item 7-Management s Discussion and Analysis of Financial Condition and Results of Operations included in this Annual Report on Form 10-K.

(Dollars in Thousands, Except Per Share Amounts)

	2009	2008	2007	2006	2005
Results of Operations:					
Net Sales	$ 71,783	$ 72,371	$ 65,519	$ 59,301	$ 55,975
Cost of Sales	40,715	41,260	38,521	34,643	32,929
Gross Profit	31,068	31,111	26,998	24,658	23,046
Selling and Marketing	16,942	17,126	15,437	14,143	13,360
General and Administrative	4,615	4,682	3,884	3,317	3,070
Research & Development	4,885	4,589	4,187	4,043	4,046
Restructuring Charge		515			
Operating Expenses	26,442	26,912	23,508	21,503	20,476
Gain on Sale of Real Estate, Net of Related Costs			5,252		
Operating Income	4,626	4,199	8,742	3,155	2,570
Investment Income	489	611	649	337	416
Other, Net	(538)	244	234	(90)	(219)
Income Before Income Taxes	4,577	5,054	9,625	3,402	2,767
Income Tax Provision	1,613	744	3,566	851	57
Net Income	$ 2,964	$ 4,310	$ 6,059	$ 2,551	$ 2,710

Per Share:					
Net Income per Common Share Basic	$ 0.42	$ 0.63	$ 0.90	$ 0.39	$ 0.41
Net Income per Common Share Diluted	$ 0.40	$ 0.57	$ 0.82	$ 0.35	$ 0.37
Dividends Declared per Common Share	$ 0.24	$ 0.20	$ 0.20	$ 0.13	$ 0.13
Financial Condition:					
Working Capital	$ 40,119	$ 39,411	$ 34,294	$ 31,222	$ 29,268
Total Assets	$ 62,155	$ 61,699	$ 58,001	$ 49,647	$ 47,039
Long-Term Debt	$	$	$	$	$
Shareholders Equity	$ 51,471	$ 49,355	$ 45,958	$ 40,301	$ 38,408

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Item 7. ***Management s Discussion and Analysis of Financial Condition and Results of Operations***

Overview

Astro-Med is a multi-national enterprise, which designs, develops, manufactures, distributes and services a broad range of products that acquire, store, analyze and present data in multiple formats. The Company organizes its structure around a core set of competencies, including research and development, manufacturing, service, marketing and distribution. It markets and sells its products and services through the following three sales product groups:

Test and Measurement Product Group (T&M) represents a suite of telemetry recorder products sold to the aerospace and defense industries, as well as portable data acquisition recorders, which offer diagnostic and test functions to a wide range of manufacturers including paper, energy, automotive and steel fabrication. In addition, T&M also includes a suite of ruggedized printer products designed for military and commercial applications to be used in the avionics industry to print weather maps, communications and other flight critical information.

QuickLabel Systems Product Group (QuickLabel) offers hardware, software and media products that create on demand color labels, store the images and produce the images in color or non-color formats on a broad range of media substrates.

Grass Technologies Product Group (GT) centers on diagnostic and monitoring products that serve the clinical neurophysiology markets, as well as a range of biomedical instrumentation products and supplies focused on the life sciences markets.

Astro-Med markets and sells its products and services globally through a diverse distribution structure of sales personnel, manufacturing representatives and dealers that deliver a full complement of branded products and services to customers in our respective markets.

Our strategic growth strategy centers on organic growth through product innovation made possible by research and development initiatives, as well as acquisitions that fit into existing core businesses. Research and development activities are funded and expensed by the Company at approximately 6.8% of annual sales for fiscal 2009.

Our continued success in increasing our product revenues will be dependent on our ability to introduce new and/or enhanced product lines each year. We target approximately 45% of annual hardware sales to be generated by products developed or acquired within the past three years.

In 2009, Astro-Med experienced a slowdown in customer demand during the latter months of the fiscal year, especially the fourth quarter. The effects of the worldwide recession were evident as customers deferred capital expenditures and curtailed consumable purchases. In order to respond to the current uncertainty in the global economy and to mitigate the effects of the related business slowdown, Astro-Med has adopted a Company-wide cost reduction initiative involving instituting wage and salary freezes, layoffs and a general reduction in hours worked by production staff. Additionally, all non-essential capital expenditures have been temporarily deferred. These cost-reduction initiatives are being implemented in the first quarter of fiscal 2010 and will remain in effect until the Company determines otherwise. Astro-Med will, however, continue all Research and Development activities as planned, as we believe that the development of new products and the enhancement of existing products will promote growth and profitability of the Company going forward.

Results of Operations

($ in thousands)	2009			2008			2007	
	Net Sales	**As a % of Total Net Sales**	**% Change Over Prior Year**	**Net Sales**	**As a % of Total Net Sales**	**% Change Over Prior Year**	**Net Sales**	**As a % of Total Net Sales**
T&M	$ 15,796	22.0%	(4.3)%	$ 16,505	22.8%	5.2%	$ 15,695	23.9%
QuickLabel	37,398	52.1%	(2.0)%	38,144	52.7%	22.6%	31,121	47.5%
GT	18,589	25.9%	4.9%	17,722	24.5%	(5.2)%	18,703	28.6%
Total	$ 71,783	100.0%	(0.8)%	$ 72,371	100.0%	10.5%	$ 65,519	100.0%

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Fiscal 2009 compared to Fiscal 2008

Astro-Med s sales in fiscal 2009 were $71,783,000, down 0.8% from the prior year s sales of $72,371,000. Domestic sales of $49,960,000 decreased 1.0% from the prior year sales of $50,479,000. The lower revenue was driven by T&M domestic sales which declined 6.5% from the prior year, primarily due to lower sales of Ruggedized products, partially offset by an increase in shipments of Everest and Dash products. The decrease in domestic sales in fiscal 2009 was tempered by an increase in both QuickLabel and GT domestic sales. International shipments of $21,823,000 were flat over previous year s sales of $21,892,000, as increases in T&M and GT sales of 6.0% and 14.1%, respectively, were tempered by an 8.0% decline in QuickLabel sales. The impact of foreign exchange rate changes added approximately $272,000 or 1.2% in sales through the international channel when compared to the prior year.

Hardware sales in fiscal 2009 were $34,521,000, down 1.7% from the prior year sales of $35,128,000. The decrease from prior year was driven by lower sales of T&M s Ruggedized products, QuickLabel s color printer systems and GT s EEG systems. Increased hardware sales for fiscal 2009 as compared to prior year were attributable to T&M s Dash and Everest and GT s diagnostic sleep product lines.

Consumable sales in fiscal 2009 were $32,027,000, relatively flat compared to prior year sales of $31,986,000, as the increase in GT s product lines was offset by lower sales of consumable products in T&M s and QuickLabel s product lines.

Service and related products in fiscal 2009 were $5,235,000, flat compared to prior year sales of $5,257,000, as the increase in repair revenues was offset by the lower service and freight revenue.

Current year gross profit was $31,068,000, comparable to the prior year s gross profit of $31,111,000. Astro-Med realized a gross profit margin of 43.3% as compared to prior year s gross margin of 43.0%. The Company was able improve its gross profit margin for fiscal 2009 as compared to the prior year due to sales mix and manufacturing cost reductions, especially freight and warranty expense.

Operating expenses for the current year were $26,442,000, approximately flat with the prior year s operating expenses of $26,397,000 (excluding the prior year $515,000 restructuring charge related to the closure of the sales and service centers located in Italy and the Netherlands). Specifically, selling and marketing expenses decreased 1.0% to $16,942,000 in fiscal 2009, representing 23.6% of sales, relatively flat from the prior year s 23.7% of sales. The decrease in selling and marketing was primarily the result of lower benefits, as well as lower commissions and travel spending. General and administrative (G&A) expenses decreased 1.4% to $4,615,000 in fiscal 2009. The decrease in G&A was primarily due to a decrease in benefits as compared to prior year. Spending on research & development (R&D) in fiscal 2009 increased 6.5% to $4,885,000. This level represents 6.8% of sales, higher than the prior year s level of 6.3%. The increase in R&D during the current year is primarily due to purchases of outside software engineering services.

Investment income in fiscal 2009 was $489,000, down from $611,000 in fiscal 2008. The decrease in investment income during fiscal year 2009 was due to lower overall interest rates, as well as the Company investing in tax-exempt municipal bonds. Other expense was $538,000 in fiscal 2009 as compared to other income of $244,000 in fiscal 2008. The decrease is primarily attributable to foreign exchange losses due to the strengthening of the US dollar during the second half of the year.

As a result of the adoption of SFAS No. 123(R), Astro-Med s fiscal 2009 pretax income was reduced by approximately $472,000 in stock-based compensation expense. During fiscal 2008, Astro-Med s pretax income was reduced by approximately $585,000 in stock-based compensation expense.

During fiscal 2009 the Company incurred an income tax expense of $1,613,000 and had an effective tax rate of 35.2%. The current year s income tax expense includes 1) an expense of $1,692,000 on the current year s pre-tax income, 2) expense of $59,000 related to a discrete payment of additional state franchise tax, 3) a benefit of $111,000 related to the recently passed extension of the R&D tax credit and 4) a benefit of $27,000 related to differences between the prior year tax provision and the actual return as filed. This compares to an income tax expense of $744,000 and an effective tax rate of 14.7% in the prior year which includes 1) an expense of $2,128,000 on the current year s pre-tax income, 2) a benefit of $167,000 related to the completion of an IRS exam, 3) a benefit of $319,000 related to changes in uncertain R&D and foreign tax credit positions, 4) an expense of $40,000 related to differences between the prior year tax provision and the actual return as filed and 5) tax benefits of $938,000 related to the restructuring and closing of the sales and service centers located in Italy and the Netherlands.

Net income for fiscal year 2009 was $2,964,000 reflecting a return on sales of 4.1% and generating an EPS of $0.40 per diluted share. On a comparative basis, prior year s net income was $4,310,000 providing a return of 6.0% on sales and an EPS of $.57 per diluted share which includes $.06 of favorable tax benefits and $.05 of favorable adjustments related to the restructuring of the sales and service centers located in Italy and the Netherlands.

Fiscal 2008 compared to Fiscal 2007

Astro-Med sales in fiscal 2008 were $72,371,000, up 10.5% from the prior year s sales of $65,519,000. Domestic sales of $50,479,000 increased 6.3% from the prior year sales of $47,504,000. The increase was driven by growth in the T&M and QuickLabel product groups. T&M domestic sales increased 12.7% on strong growth from the Dash and Ruggedized products. QuickLabel System domestic sales increased 13.7% over the prior year sales as demand for color printer systems and consumables remained strong. GT domestic sales decreased 11.5% as a result of lower sleep systems and research product sales. Sales through the Company s international channels were $21,892,000, representing a 21.5% increase from the prior year sales of $18,016,000. The increase was driven by growth in the QuickLabel and GT product groups. QuickLabel international sales increased 43.9% on strong demand for color printer systems and consumable sales while GT international sales increased 11.0% on strong demand for sleep systems and electrode consumables. T&M international sales declined 19.9% due to lower Everest product sales. The impact of foreign exchange rate changes added approximately $1,271,000 in sales through the international channel when compared to the prior year.

Hardware sales were $35,128,000, up 7.2% from the prior year sales of $32,779,000. The increase was driven by the T&M Ruggedized and Dash products, the QuickLabel printer systems and the GT LTM systems. Lower hardware sales were experienced in the T&M Everest and GT Sleep and Research product lines.

Consumable sales were $31,986,000, up 14.3% from the prior year sales of $27,991,000. This increase was driven by QuickLabel consumable sales and GT electrode product lines which increased 17.8% and 4.0%, respectively.

Service and related products were $5,257,000, up 10.7% from the prior year sales of $4,749,000 as a result of higher revenue from parts and repairs invoicing.

Gross profit was $31,111,000, an increase of 15.2% over the prior year s gross profit of $26,998,000. This year s gross profit margin of 43.0% was higher than the prior year s gross margin of 41.2%. The increase in gross profit margin was the result of an improvement in absorption driven by the higher volume of sales. The impact of product mix on gross margin during the year was nominal.

Operating expenses grew 14.5% to $26,912,000. Specifically, selling and marketing expenses increased 10.9% to $17,126,000, representing 23.7% of sales, flat compared to the prior year s 23.6% of sales. The increased selling and marketing spending was the result of higher personnel costs, commissions and travel expenses. General and administrative (G&A) expenses increased 20.5% to $4,682,000 in fiscal 2008. The increase in G&A was primarily due to higher personnel cost and legal and other professional fees. During fiscal

2008, the Company spent approximately $362,000 in connection with preparations related to Sarbanes-Oxley Section 404 requirements. Research & Development (R&D) expenses increased 9.6% to $4,589,000. This level of spending represents 6.3% of sales which was nominally lower than the prior year s level of 6.4%. Also included in operating expenses is approximately $515,000 of restructuring charges related to the decision to reorganize and close the sales and service centers located in Italy and the Netherlands.

Investment income in fiscal 2008 was $611,000, down from $649,000 in fiscal 2007. The decrease in investment income during fiscal year 2008 was attributable to lower average cash balances during the year and lower pretax investment yields associated with the Company s move towards tax exempt investments. Other income was $244,000 in fiscal 2008 as compared to other income of $235,000 in fiscal 2007.

As a result of the adoption of SFAS No. 123(R), during fiscal 2008 the Company s pretax income was reduced by approximately $585,327 in stock-based compensation expense. The composition included $97,378 recorded in cost of sales, $390,816 recorded in SG&A and $97,378 recorded within R&D. During fiscal 2007, the Company s pretax income was reduced by $412,693 in stock-based compensation expense. The composition included $78,085 recorded in cost of sales, $261,169 recorded in SG&A and $73,439 recorded within R&D.

During fiscal 2008 the Company incurred an income tax expense of $744,000. The current year s income tax expense includes 1) an expense of $2,128,000 on the current year s pre-tax income, 2) a benefit of $167,000 related to the completion of an IRS exam, 3) a benefit of $319,000 related to changes in uncertain R&D and foreign tax credit positions, 4) an expense of $40,000 related to differences between the prior year tax provision and the actual return as filed and 5) tax benefits of $938,000 related to the restructuring and closing of the sales and service centers located in Italy and the Netherlands. This compares to an income tax expense of $3,566,000 in the prior year which includes 1) an expense of $1,671,000 on the current year s pre-tax income, excluding the gain on sale of real estate, 2) a benefit of $232,000 related to differences between the prior year tax provision and the actual return as filed primarily due to additional tax credits, R&D credits and lower state income taxes and 3) an expense of $2,127,000 related to the net gain on the sale of the Company s former Braintree property.

Included in the fiscal 2008 net income per common share-diluted of $.57 is $.06 of favorable tax benefits and $.05 of favorable adjustments related to the restructuring of the sales and service centers located in Italy and the Netherlands. Included in fiscal 2007 net income per common share-diluted of $.82 is $.03 of favorable tax adjustments and $.42 for the gain on the sale of the Company s former Braintree property.

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Segment Analysis

Astro-Med reports three segments consistent with its sales product groups: Test & Measurement (T&M), QuickLabel Systems (QuickLabel) and Grass Technologies (GT). Segment performance is evaluated based on the operating segment s profit before corporate and financial administration expenses.

The following table summarizes selected financial information by segment:

(Dollars in thousands)	Net Sales			Segment Operating Profit			Segment Operating Profit as a % of Net Sales		
	2009	2008	2007	2009	2008	2007	2009	2008	2007
T&M	$ 15,796	$ 16,505	$ 15,695	$ 2,463	$ 3,056	$ 2,592	15.6%	18.5%	16.5%
QuickLabel	37,398	38,144	31,121	3,664	4,222	1,248	9.8%	11.1%	4.0%
GT	18,589	17,722	18,703	2,553	1,583	3,109	13.7%	8.9%	16.6%
Total	$ 71,783	$ 72,371	$ 65,519	8,680	8,861	6,949	12.1%	12.2%	10.6%
Corporate Expenses				4,054	4,147	3,460			
Restructuring Charges					515				
Gain on Sale of Real Estate, Net						5,252			
Operating Income				4,626	4,199	8,741			
Other Income (Expense), Net				(49)	855	884			
Income Before Income Taxes				4,577	5,054	9,625			
Income Tax Provision				1,613	744	3,566			
Net Income				$ 2,964	$ 4,310	$ 6,059			

Test & Measurement

T&M s sales decreased 4.3% in fiscal 2009 to $15,796,000 from $16,505,000 in the prior year. Within the product group, the Ruggedized product sales were down 21.3% from the prior year due to delays in the deployment of the new Airbus A380 and the Boeing 787 commercial aircraft. However, current year sales from the Everest and Dash product line grew 30.9% and 2.3%, respectively from the prior year. Selling and marketing expenses as a percent of sales were up slightly from the prior year. T&M s segment operating profit was $2,463,000 in fiscal 2009, as compared to prior year s segment operating profit of $3,056,000. The decrease in fiscal 2009 segment operating profit resulted in operating profit margin of 15.6% as compared to fiscal 2008 operating profit margin of 18.5%. The current year s decline in operating profits is an outgrowth of lower sales volume, especially Ruggedized products, and reduced standard margins.

T&M s sales increased 5.2% in fiscal 2008 to $16,505,000 from $15,695,000 in the prior year. The increase is traceable to sales growth within the Dash products which were up 9.8% and the Ruggedized products which were up 41.7%. These increases were tempered by lower volume from the Everest product line. T&M s segment operating profit was $3,056,000 in fiscal 2008. This result compares favorably to the prior year s segment operating income of $2,592,000. The current year s improvement is due to higher sales volume from the Ruggedized product line, better manufacturing absorption and lower R&D and selling expenses.

QuickLabel Systems

QuickLabel Systems sales decreased 2.0% in fiscal 2009 to $37,398,000 from sales of $38,144,000 in the prior year. This year s sales decline was primarily due to a 6.3% decrease in printer systems and a 1.7% decrease in service and other sales. Media sales within the product group for fiscal 2009 were flat as compared to the prior year. Selling and marketing expenses as a percent of sales were up slightly from the prior year. The QuickLabel

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Product Group segment operating profit was $3,664,000 during fiscal 2009 compared to the prior year s segment operating profit of $4,222,000. The decrease in fiscal 2009 segment operating profit resulted in operating profit margin of 9.8% as compared to fiscal 2008 operating profit margin of 11.1%. The 13.2% decrease in segment operating profit for fiscal 2009 as compared to the prior year was driven by lower printer sales and increased selling and R&D spending.

QuickLabel Systems sales increased 22.6% in fiscal 2008 to $38,144,000 from $31,121,000 in the prior year. This year s sales growth was driven by a 42.2% increase in printer systems and a 17.8% increase in consumable products. The QuickLabel Product Group segment operating profit was $4,222,000 during fiscal 2008. This amount is an increase from the prior year s segment operating profit of $1,248,000. The improved segment operating profit was driven by gross profit improvement from volume growth in color printers and related consumables, as well as lower manufacturing cost from increased absorption. Selling and marketing expenses as a percent of sales were consistent with the prior year.

Grass Technologies

GT s sales increased 4.9% in fiscal 2009 to $18,589,000 from $17,722,000 in the prior year. The product group s increase in sales for the current year was achieved through growth of the clinical products (EEG, sleep and long term monitoring diagnostic products) of 10% and the consumable products of creams and electrodes of 7.3%, partially offset by a decrease in the service and other product lines of 10.2%. The GT product Group segment operating profit was $2,553,000 during fiscal 2009. The increase in fiscal 2009 segment operating profit resulted in operating profit margin of 13.7% as compared to fiscal 2008 operating profit margin of 8.9%. The 61.3% improvement from the prior year s segment operating profit was due to the 10% sales increase in the clinical diagnostic systems, especially sleep applications, lower manufacturing costs, better production absorption and lower field selling and customer service expenses. The improved operating profits were tempered somewhat from higher R&D spending.

GT s sales decreased 5.2% in fiscal 2008 to $17,722,000 from $18,703,000 in the prior year. The product group s lower sales were due to decreases within Sleep systems which were down 18.6% and research products which were down 11.6%. EEG systems were essentially flat while LTM systems were up 15.1%. The GT product group s consumable sales were essentially flat with the prior year. The GT Product Group segment operating profit was $1,583,000 during fiscal 2008. The decrease from the prior year s segment operating profit of $3,109,000 was traceable to lower gross profits stemming from reduced sales of clinical and research products compounded by higher spending on R&D projects and additional personnel in the field selling organization.

Liquidity and Capital Resources

The Company expects to finance its future working capital needs, capital expenditures and acquisition requirements through internal funds. To the extent the Company s capital and liquidity requirements are not satisfied internally, the Company may utilize a $3,500,000 unsecured bank line of credit, all of which is currently available. Borrowing under this line of credit bears interest at the bank s prime rate. The expiration date of this line of credit is July 31, 2009, at which time we plan to review our line of credit options.

Astro-Med s Statements of Cash Flows for the three years ended January 31, 2009, 2008 and 2007 are included on page 36. Net cash flow provided by operating activities in fiscal year 2009 was $6,955,000. The net cash flow provided by operations is attributed to the positive cash flow generated from net income and from the reductions in accounts receivable and inventory balances of $3,515,000 and $1,224,000, respectively. Cash flow from operating activities was lowered by funding accounts payable and accrued expenses of $1,906,000. The increase in working capital is in support of the Company s growth.

Net cash flow used in investing activities was $973,000 which was mostly the result of capital expenditures of approximately $1,665,000 for machinery and equipment of $903,000, information technology of $218,000, tools and dies of $59,000 and building improvements of $485,000.

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Net cash flow used by financing activities was $752,000 in fiscal 2009. During the year the Company paid dividends of $1,678,000. Also during the current year, the Company generated $793,000 in cash through the exercise of employee stock options and Employee Stock Purchase Plan transactions and $134,000 in excess tax benefits resulting from share-based compensation.

Dividends paid for fiscal 2009, 2008, and 2007 were $ 1,678,000, $1,380,000 and $1,274,000, respectively. The Company s annual dividend per share was $0.24 in fiscal 2009 and $0.20 in fiscal 2008 and 2007. Since the inception of the common stock buy back program in fiscal 1997, the Company has repurchased 1,149,335 shares of its common stock. At January 31, 2009, the Company has the Board of Directors authorization to purchase an additional 392,289 shares of the Company s common stock in the future.

Contractual Obligations, Commitments and Contingencies

Astro-Med is subject to contingencies, including legal proceedings and claims arising out of its businesses that cover a wide range of matters, including, among others, contract and employment claims, workers compensation claims, product liability, warranty and modification, adjustment or replacement of component parts of units sold. While it is impossible to ascertain the ultimate legal and financial liability with respect to contingent liabilities, including lawsuits, we believe that the aggregate amount of such liabilities, if any, in excess of amounts provided or covered by insurance, will not have a material adverse effect on our consolidated financial position or results of operations. It is possible, however, that future results of operations for any particular future period could be materially affected by changes in our assumptions or strategies related to these contingencies or changes out of the Company s control.

Critical Accounting Policies and Estimates

Astro-Med s discussion and analysis of our financial condition and results of operations are based upon the Company s Consolidated Financial Statements, which have been prepared in accordance with accounting principles generally accepted in the United States. Certain of our accounting policies require the application of judgment in selecting the appropriate assumptions for calculating financial estimates. By their nature, these judgments are subject to an inherent degree of uncertainty. We periodically evaluate the judgments and estimates used for our critical accounting policies to ensure that such judgments and estimates are reasonable for our interim and year-end reporting requirements. These judgments and estimates are based on the Company s historical experience, current trends and information available from other sources, as appropriate. If different conditions result from those assumptions used in our judgments, the results could be materially different from our estimates. We believe the following are our most critical accounting policies as they require significant judgments and estimates in the preparation of our financial statements:

Revenue Recognition: The majority of our product sales are recorded at the time of shipment, when legal title has transferred and risk of loss passes to the customer, when persuasive evidence of an arrangement exists, the seller s price to the buyer is fixed or determinable and collectibility is reasonably assured in accordance with the requirements in Staff Accounting Bulletin (SAB) 104, Revenue Recognition in Financial Statements. When a sale arrangement involves training or installation, the deliverables in the arrangement are evaluated to determine whether they represent separate units of accounting in accordance with SAB 104 and EITF 00-21, Revenue Arrangements With Multiple Deliverables. This evaluation occurs at inception of the arrangement and as each item in the arrangement is delivered. The total fee from the arrangement is allocated to each unit of accounting based on its relative fair value. Fair value for each element is established generally based on the sales price charged when the same or similar element is sold separately.

Revenue is recognized when revenue recognition criteria for each unit of accounting are met. When other significant obligations remain after products are delivered, revenue is recognized only after such obligations are fulfilled. All of the Company s equipment contains embedded operating systems and data management software which is included in the purchase price of the equipment. The software is deemed incidental to the systems as a whole as it is not sold separately or marketed separately and its production costs are minor as compared to those of the hardware system. Returns and customer credits are infrequent and are recorded as a reduction to sales. Rights of return are not included in sales arrangements. Revenue associated with products that contain specific customer acceptance criteria is not recognized before the customer acceptance criteria are satisfied.

Infrequently, Astro-Med recognizes revenue for non-recurring engineering (NRE) fees for product modification orders upon completion of agreed-upon milestones. Revenue is deferred for any amounts received prior to completion of milestones. Certain of our NRE arrangements include formal customer acceptance provisions. In such cases, we determine whether we have obtained customer acceptance for the specific milestone before recognizing revenue.

Infrequently, the Company receives requests from customers to hold product being purchased from us for the customers convenience. We recognize revenue for such bill and hold arrangements in accordance with the requirements of SAB No. 104 which requires, among other things, the existence of a valid business purpose for the arrangement; the transfer of ownership of the purchased product; a fixed delivery date that is reasonable and consistent with the buyer s business purpose; the readiness of the product for shipment; the use of customary payment terms; no continuing performance obligation by Astro-Med and segregation of the product from the Company s inventories.

Warranty Claims and Bad Debts: Provisions for the estimated costs for future product warranty claims and bad debts are recorded in cost of sales and general and administrative expense, respectively, at the time a sale is recorded. The amounts recorded are generally based upon historically derived percentages while also factoring in any new business conditions that might impact the historical analysis such as new product introduction for warranty and bankruptcies of particular customers for bad debts. We also periodically evaluate the adequacy of our reserves for warranty and bad debts recorded in its consolidated balance sheet as a further test to ensure the adequacy of the recorded provisions. Warranty and bad debt analysis often involves subjective analysis of a particular customer s ability to pay. As a result, significant judgment is required in determining the appropriate amounts to record and such judgments may prove to be incorrect in the future. We believe that our procedures for estimating such amounts are reasonable and historically have not resulted in material adjustments in subsequent periods when the estimates are adjusted to the actual amounts.

Inventories: Inventories are stated at the lower of cost (first-in, first-out) or market. The Company records provisions to write-down obsolete and excess inventory to its estimated net realizable value. The process for evaluating obsolete and excess inventory consists of analyzing the inventory supply on hand and estimating the net realizable value of the inventory based on historical experience, current business conditions and anticipated future sales. We believe that our procedures for estimating such amounts are reasonable and historically have not resulted in material adjustments in subsequent periods when the estimates are adjusted to actual experience.

Income Taxes: Astro-Med accounts for income taxes in accordance with Statement of Financial Accounting Standards (SFAS) No. 109, Accounting for Income Taxes. SFAS 109 requires that a valuation allowance be established when it is more likely than not that all or a portion of deferred tax assets will not be realized. A review of all available positive and negative evidence must be considered, including the Company s performance, the market environment in which the Company operates, length of carryforward periods, existing sales backlog and future sales projections. At January 31, 2009, the Company has provided valuation allowances for future tax benefits resulting from certain R&D tax credits which could expire unused.

Long-Lived Assets and Goodwill: The impairment of long-lived assets to be held and used are reviewed for impairment in accordance with SFAS No. 144 Accounting for the Impairment or Disposal of Long-Lived Assets whenever events or changes in circumstances indicate that the carrying amount of such assets may not be recoverable. Determination of recoverability is based on an estimate of undiscounted future cash flows resulting from the use of the asset and its eventual disposition. Measurement of an impairment loss for long-lived assets that management expects to hold and use is based on the fair value of the asset.

Goodwill impairment reviews are performed in accordance with the provisions of SFAS No. 142, Goodwill and Other Intangible Assets. Management evaluates the recoverability of goodwill annually or more frequently if events or changes in circumstances, such as declines in sales, earnings or cash flows, or material adverse changes in the business climate, indicate that the carrying value of an asset might be impaired. Goodwill is considered to be impaired when the net book value of a segment exceeds its estimated fair value. Fair values are established using a discounted cash flow methodology based on the long-range planning forecast.

Share-Based Compensation: Effective as of February 1, 2006, the Company adopted the provisions of SFAS No. 123(R), Share-Based Payment, under the modified prospective transition method outlined in the statement. A modified prospective transition method is one in which compensation expense is recognized beginning with the effective date (a) based on the requirements of SFAS No. 123(R) for all share-based payments granted after the effective date and (b) based on the requirements of SFAS No. 123 for all awards granted to employees prior to the effective date of SFAS No. 123(R) that remain unvested on the date of adoption.

The Company has estimated the fair value of each option grant on the date of grant using the Black-Scholes option-pricing model. The volatility assumption is based on the historical weekly price data of the Company s common stock over a period equivalent to the weighted average expected life of the Company s options. Management evaluated whether there were factors during that period which were unusual and would distort the volatility figure if used to estimate future volatility and concluded that there were no such factors. In determining the expected life of the option grants, the Company has observed the actual terms of prior grants with similar characteristics and the actual vesting schedule of the grant and has assessed the expected risk tolerance of different option groups. The risk-free interest rate is based on the actual U.S. Treasury zero coupon rates for bonds matching the expected term of the option as of the option grant date. The dividend assumption is based upon the prior year s average dividend yield.

Recent Accounting Pronouncements

Reference is made to Note 1 of our Consolidated Financial Statements included herein.

Item 7A. ***Quantitative and Qualitative Disclosures about Market Risk***

The registrant is a smaller reporting company and is not required to provide this information.

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Item 8. ***Financial Statements and Supplementary Data***

The consolidated financial statements required under this item are submitted as a separate section of this report on the pages indicated at Item 15(a)(1). The supplementary data regarding quarterly results of operations is set forth in the following table.

QUARTERLY FINANCIAL DATA (Unaudited)

(Dollars in Thousands, Except Per Share Amounts)

	2009

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IC products

The Company sells products both directly to customers, as well as through distributors. Revenue from sales directly to customers is generally recognized at the time of shipment. The Company records an estimated allowance, at the time of shipment, for future returns and other charges against revenue consistent with the terms of sale. IC product revenue and costs relating to sales made through distributors with rights of return or stock rotation are deferred until the distributors sell the product to end customers due to the Company s inability to estimate future returns and credits to be issued. Distributors are generally able to return up to 10% of their purchases for slow, non-moving or obsolete inventory for credit every six months. At the time of shipment to distributors, an accounts receivable for the selling price is recorded, as there is a legally enforceable right to receive payment, and inventory is relieved, as legal title to the inventory is transferred upon shipment. Revenues are recognized upon receiving notification from the distributors that products have been sold to end customers. Distributors provide information regarding products and quantity, end customer shipments and remaining inventory on hand. The associated deferred margin is included in the deferred revenues line item in the condensed consolidated balance sheets.

Licensing

Licensing revenue consists of fees earned from license agreements, development services and support and maintenance. For stand-alone license agreements or license deliverables in multi-deliverable arrangements that do not require significant development, modification or customization, revenues are recognized when all revenue recognition criteria have been met. Delivery of the licensed technology is typically the final revenue recognition criterion met, at which time revenue is recognized. If any of the criteria are not met, revenue recognition is deferred until such time as all criteria have been met. Support and maintenance revenue is recognized ratably over the period during which the obligation exists, typically 12 months. Licensing revenue was $7,000 and $52,000 for the three months ended September 30, 2014 and 2013, respectively, and $54,000 and $340,000 for the nine months ended September 30, 2014 and 2013, respectively.

Cost of Net Revenue

Cost of net revenue consists primarily of direct and indirect costs of IC product sales and engineering personnel costs directly related to maintenance and support services specified in licensing agreements. Maintenance and support typically includes engineering support to assist in the commencement of production of a licensee s products.

Goodwill

The Company reviews goodwill for impairment on an annual basis or whenever events or changes in circumstances indicate the carrying value of an asset may not be recoverable. The Company first assesses qualitative factors to determine whether it is more-likely-than-not that the fair value of the reporting unit is less than the carrying amount as a basis for determining whether it is necessary to perform the two-step impairment test. If the qualitative assessment warrants further analysis, the Company compares the fair value of the reporting unit to its carrying value. The fair value of the reporting unit is determined using the market approach. If the fair value of the reporting unit exceeds the carrying value of net assets of the reporting unit, goodwill is not impaired, and the Company is not required to perform further testing. If the carrying value of the reporting unit s goodwill exceeds its implied fair value, then the Company must record an impairment charge equal to the difference. The Company has determined that it has a single reporting unit for purposes of performing its goodwill impairment test. As the Company uses the market approach to assess impairment in the second step of the analysis, the price of its common stock is an important component of the fair value calculation. If the Company s stock price continues to experience significant price and volume fluctuations, this will impact the fair value of the reporting unit, which can lead to potential impairment in future periods. The Company performed step one of the annual impairment test in September 2014, and concluded no factors indicated impairment of goodwill.

Per Share Amounts

Basic net loss per share is computed by dividing net loss for the period by the weighted-average number of shares of common stock outstanding during the period. Diluted net loss per share gives effect to all potentially dilutive common shares outstanding during the period. Potentially dilutive common shares consist of incremental shares of common stock issuable upon the exercise of stock options, vesting of stock awards and purchases under the employee stock purchase plan. As of September 30, 2014 and 2013, stock awards to purchase approximately 10,190,000 and 10,662,000 shares, respectively, were excluded from the computation of diluted net loss per share as their inclusion would be anti-dilutive.

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Comprehensive Loss

Comprehensive loss includes unrealized gains and losses on available-for-sale securities. Realized gains and losses on available-for-sale securities are reclassified from accumulated other comprehensive loss and included in other income, net in the condensed consolidated statements of operations and comprehensive loss. All amounts recorded in the three and nine months ended September 30, 2014 and 2013 are not considered significant.

Recent Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standard Update No. 2014-09 (ASU 2014-09), *Revenue from Contracts with Customers*, which requires an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods and services to customers. ASU 2014-09 will replace most existing revenue recognition guidance in U.S. GAAP when it becomes effective. The new standard will be effective for the Company on January 1, 2017. Early application is not permitted. ASU 2014-09 permits the use of either the retrospective or cumulative effect transition method. The Company has not yet selected a transition method nor has it determined the potential effect that ASU 2014-09 will have on its consolidated financial statements and related disclosures.

In August 2014, the FASB Accounting Standards Update No. 2014-15 (ASU 2014-15), *Presentation of Financial Statements-Going Concern (Subtopic 205-40): Disclosure of Uncertainties about an Entity s Ability to Continue as a Going Concern*. ASU 2014-15 requires management to evaluate, at each annual and interim reporting period, whether there are conditions or events that raise substantial doubt about the entity s ability to continue as a going concern within one year after the date the financial statements are issued and provide related disclosures. ASU 2014-15 is effective for annual and interim reporting periods ending after December 15, 2016, with early adoption permitted. The Company is currently evaluating the impact the adoption of ASU 2014-15 will have on its consolidated statements and related disclosures.

Note 2. Fair Value of Financial Instruments

The estimated fair values of financial instruments outstanding were as follows (in thousands):

	September 30, 2014			
	Cost	Unrealized Gains	Unrealized Losses	Fair Value
Cash and cash equivalents	$ 4,685	$	$	$ 4,685
Short-term investments:				
U.S. government-sponsored enterprise bonds	$ 2,252	$ 1	$	$ 2,253
Municipal bonds	3,424	1		3,425

Corporate notes		12,609		10		(5)		12,614
Certificates of deposit		3,624		1				3,625
Total short-term investments	$	21,909	$	13	$	(5)	$	21,917
Long-term investments:								
U.S. government-sponsored enterprise bonds	$	1,000	$		$	(5)	$	995
Corporate notes		6,070				(10)		6,060
Total long-term investments	$	7,070	$		$	(15)	$	7,055

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	December 31, 2013			
	Cost	Unrealized Gains	Unrealized Losses	Fair Value
Cash and cash equivalents	$ 4,364	$	$	$ 4,364
Short-term investments:				
U.S. government-sponsored enterprise bonds	$ 6,543	$	$ (1)	$ 6,542
Municipal bonds	13,401	11		13,412
Corporate notes	7,245	2	(2)	7,245
Certificates of deposit	4,994	1	(2)	4,993
Total short-term investments	$ 32,183	$ 14	$ (5)	$ 32,192
Long-term investments:				
U.S. government-sponsored enterprise bonds	$ 2,752	$	$	$ 2,752
Municipal bonds	264			264
Corporate notes	9,466	9	(1)	9,474
Certificates of deposit	1,440		(4)	1,436
Total long-term investments	$ 13,922	$ 9	$ (5)	$ 13,926

The estimated fair values of available-for-sale securities with unrealized losses were as follows (in thousands):

	September 30, 2014		
	Cost	Unrealized Losses	Fair Value
Short-term investments:			
Corporate notes	$ 2,188	$ (5)	$ 2,183
Total short-term investments	$ 2,188	$ (5)	$ 2,183
Long-term investments:			
U.S. government-sponsored enterprise bonds	$ 1,000	$ (5)	$ 995
Corporate notes	6,070	(10)	6,060
Total long-term investments	$ 7,070	$ (15)	$ 7,055

	December 31, 2013		
	Cost	Unrealized Losses	Fair Value
Short-term investments:			
U.S. government-sponsored enterprise and municipal bonds	$ 5,289	$ (1)	$ 5,288
Corporate notes	3,844	(2)	3,842
Certificates of deposit	3,080	(2)	3,078
Total short-term investments	$ 12,213	$ (5)	$ 12,208
Long-term investments:			
U.S. government-sponsored enterprise bonds	$ 1,253	$	$ 1,253
Corporate notes	1,001	(1)	1,000
Certificates of deposit	1,440	(4)	1,436
Total short-term investments	$ 3,694	$ (5)	$ 3,689

As of September 30, 2014 and December 31, 2013, all of the available-for-sale securities with unrealized losses had been in a loss position for less than 12 months.

Cost and fair value of investments based on two maturity groups were as follows (in thousands):

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	September 30, 2014			
	Cost	Unrealized Gains	Unrealized Losses	Fair Value
Due within 1 year	$ 21,909	$ 13	$ (5)	$ 21,917
Due in 1-2 years	7,070		(15)	7,055
Total	$ 28,979	$ 13	$ (20)	$ 28,972

	December 31, 2013			
	Cost	Unrealized Gains	Unrealized Losses	Fair Value
Due within 1 year	$ 32,183	$ 14	$ (5)	$ 32,192
Due in 1-2 years	13,922	9	(5)	13,926
Total	$ 46,105	$ 23	$ (10)	$ 46,118

The following table represents the Company s fair value hierarchy for its financial assets (cash equivalents and investments) as of September 30, 2014 and December 31, 2013 (in thousands):

	September 30, 2014			
	Fair Value	Level 1	Level 2	Level 3
Money market funds	$ 3,661	$ 3,661	$	$
Certificates of deposit	3,625		3,625	
Corporate notes	18,674		18,674	
U.S. government-sponsored enterprise bonds	3,248		3,248	
Municipal bonds	3,425		3,425	
Total assets	$ 32,633	$ 3,661	$ 28,972	$

	December 31, 2013			
	Fair Value	Level 1	Level 2	Level 3
Money market funds	$ 3,012	$ 3,012	$	$
Certificates of deposit	6,429		6,429	
Corporate notes	16,719		16,719	
U.S. government-sponsored enterprise bonds	9,295		9,295	
Municipal bonds	13,675		13,675	
Total assets	$ 49,130	$ 3,012	$ 46,118	$

There were no transfers in or out of Level 1 and Level 2 securities during the three and nine months ended September 30, 2014 and 2013.

Note 3: Balance Sheet Detail

	September 30, 2014	December 31, 2013
	(in thousands)	

Inventories:				
Work-in-process	$	676	$	542
Finished goods		170		25
	$	846	$	567

Identifiable intangible assets relating to business combinations and the patent license were as follows (dollar amounts in thousands):

	September 30, 2014						
	Life (years)		**Gross Carrying Amount**		**Accumulated Amortization**		**Net Carrying Value**
Developed technology	3-5	$	9,240	$	8,809	$	431
Patent license	7		780		306		474
Total		$	10,020	$	9,115	$	905

	December 31, 2013						
	Life (years)		**Gross Carrying Amount**		**Accumulated Amortization**		**Net Carrying Value**
Developed technology	3-5	$	9,240	$	8,142	$	1,098
Patent license	7		780		223		557
Total		$	10,020	$	8,365	$	1,655

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Intangible assets acquired in business combinations, referred to as purchased intangible assets, are accounted for based on the fair value of assets purchased and are amortized over the period in which economic benefit is estimated to be received. Amortization expense has been included in research and development expense in the condensed consolidated statements of operations and comprehensive loss. The estimated aggregate amortization expense to be recognized in future years is approximately $0.3 million for the remainder of 2014, $0.3 million for 2015 and $0.1 million annually for each of 2016, 2017 and 2018.

Note 4. Commitments and Contingencies

Indemnifications

In the ordinary course of business, the Company enters into contractual arrangements under which it may agree to indemnify the counterparties from any losses incurred relating to breach of representations and warranties, failure to perform certain covenants, or claims and losses arising from certain events as outlined within the particular contract, which may include, for example, losses arising from litigation or claims relating to past performance. Such indemnification clauses may not be subject to maximum loss clauses. The Company has also entered into indemnification agreements with its officers and directors. No material amounts were reflected in the Company s condensed consolidated financial statements for the three and nine months ended September 30, 2014 or 2013 related to these indemnifications.

The Company has not estimated the maximum potential amount of indemnification liability under these agreements due to the limited history of prior claims and the unique facts and circumstances applicable to each particular agreement. To date, the Company has not made any material payments related to these indemnification agreements.

Legal Matters

The Company is not a party to any material legal proceeding that the Company believes is likely to have a material adverse effect on its condensed consolidated financial position or results of operations. From time to time, the Company may be subject to legal proceedings and claims in the ordinary course of business. These claims, even if not meritorious, could result in the expenditure of significant financial resources and diversion of management efforts.

Note 5. Business Segments and Significant Customers

The Company operates in one business segment and uses one measurement of profitability for its business. Net revenue attributed to the United States and to all foreign countries is based on the geographical location of the customer.

The Company recognized revenue from licensing of its technologies and shipment of ICs to customers in North America, Asia and Europe as follows (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Taiwan	$ 485	$ 375	$ 1,358	$ 1,422
Japan	356	217	1,755	956
North America	311	349	1,094	1,007
Rest of Asia	1	16	16	27
Europe			11	
Total net revenue	$ 1,153	$ 957	$ 4,234	$ 3,412

Customers who accounted for at least 10% of total net revenues were as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Customer A	40%	39%	31%	41%
Customer B	27%	*	37%	*
Customer C	10%	13%	11%	12%
Customer D	*	11%	*	*

*Represents percentages less than 10%

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Four customers accounted for 99% of net accounts receivable at September 30, 2014. Two customers accounted for 96% of net accounts receivable at December 31, 2013.

Note 6. Income Tax Provision

The Company determines deferred tax assets and liabilities based upon the differences between the financial statement and tax bases of the Company s assets and liabilities using tax rates in effect for the year in which the Company expects the differences to affect taxable income. A valuation allowance is established for any deferred tax assets for which it is more likely than not that all or a portion of the deferred tax assets will not be realized.

The Company files U.S. federal and state and foreign income tax returns in jurisdictions with varying statutes of limitations. The Company is currently under tax examination in India. The 2003 through 2013 tax years generally remain subject to examination by federal, state and foreign tax authorities. As of September 30, 2014, the Company has not recorded any liability for unrecognized tax benefits related to uncertain tax positions.

Note 7. Stock-Based Compensation

The Company recorded $1.1 million and $1.0 million of stock-based compensation expense for the three months ended September 30, 2014 and 2013, respectively. The Company recorded $3.6 million and $2.8 million of stock-based compensation expense for the nine months ended September 30, 2014 and 2013, respectively. The expense relating to stock-based awards is recognized on a straight-line basis over the requisite service period, usually the vesting period, based on the grant-date fair value. The unamortized compensation cost, net of expected forfeitures, as of September 30, 2014 was $4.1 million related to stock options and is expected to be recognized as expense over a weighted average period of approximately 2.13 years. The expense related to restricted stock units is recognized over a three-to-five year vesting period and is based on the fair value of the underlying stock on the dates of grant. The unamortized compensation cost, net of expected forfeitures, as of September 30, 2014 was $1.2 million related to restricted stock units and is expected to be recognized as expense over a weighted average period of approximately 2.49 years.

The Company presents the tax benefits resulting from tax deductions in excess of the compensation cost recognized from the exercise of stock options as financing cash flows in the condensed consolidated statements of cash flows. For the three and nine months ended September 30, 2014 and 2013, there were no such tax benefits associated with the exercise of stock options due to the Company s loss position.

Common Stock Options and Restricted Stock

A summary of the option activity under the Company s Amended and Restated 2000 Stock Option and Equity Incentive Plan and Amended and Restated 2010 Equity Incentive Plan (Amended 2010 Plan), referred to collectively as the Plans, is presented below (in thousands, except exercise price):

		Options Outstanding	
	Available for Grant	Number of Shares	Weighted Average Exercise Prices
Balance at December 31, 2013	422	6,727	$ 3.86
Additional shares authorized under the Amended 2010 Plan	500		
Restricted stock units granted	(499)		
Options granted	(49)	49	$ 4.69
Options cancelled	60	(60)	$ 3.42
Options exercised		(300)	$ 3.58
Options expired	(60)		3.42
Balance at March 31, 2014	374	6,416	$ 3.89
Additional shares authorized under the Amended 2010 Plan	1,500		
Restricted stock units granted	(9)		
Options cancelled	4	(4)	$ 5.21
Options exercised		(52)	$ 1.61
Options expired	(4)		$ 5.21
Balance at June 30, 2014	1,865	6,360	$ 3.91
Options granted	(120)	120	$ 3.10
Options cancelled	257	(257)	$ 4.55
Options exercised		(48)	$ 1.72
Options expired	(257)		$ 4.55
Balance at September 30, 2014	1,745	6,175	$ 3.88

At the Company s 2014 Annual Meeting of Stockholders held on June 3, 2014, the Company s stockholders approved an increase of 1,500,000 shares reserved for issuance under the Amended 2010 Plan.

The Company also has awarded options to new employees outside of the Plans and may continue to do so, as material inducements to the acceptance of employment with the Company, as permitted under the Listing Rules of the Nasdaq Stock Market. These grants must be approved by the compensation committee of the board of directors, a majority of the independent directors or, below a specified share level, by an authorized executive officer.

A summary of the inducement grant option activity is presented below (in thousands, except exercise price):

	Options Outstanding		
	Number of Shares		**Weighted Average Exercise Prices**
Balance at December 31, 2013	3,178	$	4.42
Granted	118	$	5.22
Cancelled	(40)	$	4.47
Exercised	(32)	$	3.88
Balance at March 31, 2014	3,224	$	4.46
Granted	125	$	3.87
Exercised	(20)	$	1.55
Balance at June 30, 2014	3,329	$	4.45
Granted	95	$	3.11
Exercised	(5)	$	1.55
Balance at September 30, 2014	3,419	$	4.42

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A summary of restricted stock unit activity under the Plans is presented below (in thousands, except fair value):

	Number of Shares		Weighted Average Grant-Date Fair Value
Non-vested shares at December 31, 2013	27	$	4.46
Granted	499	$	4.62
Vested	(122)	$	4.62
Non-vested shares at March 31, 2014	404	$	4.61
Granted	9	$	4.62
Vested	(5)	$	4.62
Non-vested shares at June 30, 2014	408	$	4.61
Vested	(9)	$	4.46
Non-vested shares at September 30, 2014	399	$	4.61

The following table summarizes significant ranges of outstanding and exercisable options as of September 30, 2014 (in thousands, except contractual life and exercise price):

	Options Outstanding						Options Exercisable				
Range of Exercise Price	Number Outstanding	Weighted Average Remaining Contractual Life (in Years)		Weighted Average Exercise Price		Aggregate Intrinsic value	Number Exercisable	Weighted Average Remaining Contractual Life (in Years)		Weighted Average Exercise Price	Aggregate Intrinsic value
$1.50 - $3.23	2,845	3.05	$	2.68	$	574	1,904	2.24	$	2.47	$ 574
$3.24 - $4.25	2,512	4.11	$	3.82			1,706	3.57	$	3.83	
$4.26 - $5.61	3,377	3.75	$	4.94			2,473	2.09	$	5.09	
$5.62 - $7.00	860	2.56	$	6.00			730	2.34	$	6.00	
	9,594	3.53	$	4.07	$	574	6,813	2.53	$	4.14	$ 574

As of September 30, 2014, the Company had 9.3 million shares subject to outstanding options fully vested and expected to vest, after estimated forfeitures, with a remaining contractual life of 3.43 years, weighted average exercise price of $4.08 and aggregate intrinsic value of $0.6 million.

The total fair value of shares subject to outstanding options vested during the nine months ended September 30, 2014 and 2013 calculated using the Black-Scholes valuation method was $2.6 million and $2.5 million, respectively. The total intrinsic value of employee stock options exercised during the nine months ended September 30, 2014 and 2013 was $0.7 million and $0.8 million, respectively.

Valuation Assumptions and Expense Information

The fair value of the Company s share-based payment awards for the three and nine months ended September 30, 2014 and 2013 was estimated on the grant date using a Black-Scholes valuation option-pricing model with the following assumptions:

	Three Months Ended September 30,		Nine Months Ended September 30,	
Employee stock options:	**2014**	**2013**	**2014**	**2013**
Risk-free interest rate	1.3% - 1.7%	1.0% - 1.7%	1.3% 1.7%	0.5% 1.7%
Volatility	53.7% 55.6%	57.7% 62.9%	53.7% 57.5%	57.7% 62.9%
Expected life (years)	4.0-5.0	4.0-5.0	4.0-5.0	4.0-5.0
Dividend yield	0%	0%	0%	0%

The risk-free interest rate was derived from the Daily Treasury Yield Curve Rates as published by the U.S. Department of the Treasury as of the grant date for terms equal to the expected terms of the options. The expected volatility was based on the historical volatility of the Company s stock price over the expected term of the options. The expected term of options granted was derived from historical data based on employee exercises and post-vesting employment termination behavior. A dividend yield of zero is applied because the Company has never paid dividends and has no intention to pay dividends in the near future.

The stock-based compensation expense recorded is adjusted based on estimated forfeiture rates. An annualized forfeiture rate has been used as a best estimate of future forfeitures based on the Company s historical forfeiture experience. The stock-based compensation expense will be adjusted in later periods if the actual forfeiture rate is different from the estimate.

Employee Stock Purchase Plan

In June 2010, the Company s stockholders approved the 2010 Employee Stock Purchase Plan (ESPP). A total of 2,000,000 shares of common stock have been reserved for issuance under the ESPP. The ESPP, which is intended to qualify under Section 423 of the Internal Revenue Code, is administered by the board of directors or the compensation committee of the board of directors. The ESPP provides that eligible employees may purchase up to $25,000 worth of the Company s common stock annually over the course of two six-month offering periods. The purchase price to be paid by participants is 85% of the price per share of the Company s common stock either at the beginning or the end of each six-month offering period, whichever is less. On September 1, 2010, the Company commenced the first offering period under the ESPP. On February 28, 2014, approximately 140,000 shares of common stock were issued at an aggregate purchase price of $434,000 under the ESPP. On August 29, 2014, approximately 154,000 shares of common stock were issued at an aggregate purchase price of $422,000 under the ESPP. As of September 30, 2014, there were approximately 766,000 shares authorized and unissued under the ESPP.

Note 8. Related Party Transactions

In February 2012, the Company entered into a strategic development and marketing agreement with Credo Semiconductor (Hong Kong) Ltd. (Credo), a privately-funded, fabless semiconductor company, to develop, market and sell integrated circuits. Two of the Company s executive officers between them loaned a total of $250,000 to Credo for a portion of the seed funding needed by Credo to commence its integrated circuit design efforts. These loans may be converted into minority equity interests in Credo. The strategic development and marketing agreement, as amended, calls for the Company to make payments to Credo upon Credo achieving certain development and verification milestones towards the development of IC products and provides the Company with exclusive sales and marketing rights for such IC products. To date, the Company has paid Credo $2.9 million for achievement of additional development milestones, as well as for mask costs and wafer purchases from third-party vendors. All amounts incurred have been recorded as research and development expenses. Currently, under the strategic development and marketing agreement, the Company is entitled to reimbursement of $2.6 million of development costs based on payments made to Credo to date. This amount is subject to increase as additional payments are made to Credo. The reimbursement will be funded by the gross profits earned by the Company and Credo from the sale of the products, with the initial gross profits being primarily applied to reimbursing the Company for these development payments. Once the full amount has been reimbursed, the gross profits will be shared equally by the Company and Credo.

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

This Management s Discussion and Analysis of Financial Condition and Results of Operations should be read in conjunction with the accompanying condensed consolidated financial statements and notes included in this report. This Form 10-Q contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934, which include, without limitation, statements about the market for our technology, our strategy, competition, expected financial performance, all information disclosed under Item 3 of this Part I, and other aspects of our business identified in our most recent annual report on Form 10-K filed with the Securities and Exchange Commission (SEC) on March 14, 2014 and in other reports that we file from time to time with the Securities and Exchange Commission. Any statements about our business, financial results, financial condition and operations contained in this Form 10-Q that are not statements of historical fact may be deemed to be forward-looking statements. Without limiting the foregoing, the words believes, anticipates, expects, intends, plans, projects, or similar expressions are intended to identify forward-looking statements. Our actual results could differ materially from those expressed or implied by these forward-looking statements as a result of various factors, including the risk factors described below in Risk Factors and elsewhere in this report and under Item 1A of our annual report on Form 10-K for the year ended December 31, 2013. We undertake no obligation to update publicly any forward-looking statements for any reason, except as required by law, even as new information becomes available or events occur in the future.

Company Overview

Our strategy and primary business objective is to be an IP-rich fabless semiconductor company focused on the development and sale of integrated circuits, or ICs, for the high-speed networking, communications, storage and computing markets. Prior to 2011, our primary business activities were designing, developing, marketing and licensing high-performance semiconductor memory and high-speed parallel and serial interface, or SerDes I/O, intellectual property (IP) used by semiconductor industry and communications, networking and storage equipment manufacturers. Since 2011, we have developed two IC product lines under the Bandwidth Engine® and LineSpeed product names. Bandwidth Engine ICs combine our proprietary 1T-SRAM® high-density embedded memory and high-speed serial interface with our intelligent access technology and a highly efficient interface protocol. The LineSpeed IC product line is comprised of non-memory, high-speed SerDes I/O devices with gearbox and retimer functionality, which convert lanes of data received on line cards or by optical modules into different configurations and/or ensure signal integrity. Certain SerDes products have been developed under a strategic development and marketing agreement with Credo Semiconductor Ltd., or Credo. We have paid a total of $2.9 million for the development of these new products. The initial gross profits earned by us from the sale of Credo developed products will be primarily applied to reimbursing us for these development payments. Once $2.6 million of this amount has been reimbursed, all gross profits from the sale of the Credo-developed products worldwide will be shared equally by Credo and us.

Revenue from sales of our IC products is increasing, as we continue to support existing design-win customers and actively pursue additional design wins for the use of our ICs in networking and communication equipment. We have established initial pricing of our IC products ordered to date, but longer-term volume prices will be subject to negotiations with our customers and may vary substantially from the initial prices. Our future success and ability to achieve and maintain profitability depend on the manufacturing, marketing and sales of our IC products into networking, communications and other end- customer applications markets requiring the type of high performance provided by our products.

Sources of Revenue

Product. Product revenue is generally recognized at the time of shipment to our customers. An estimated allowance is recorded, at the time of shipment, for future returns and other charges against revenue consistent with the terms of sale. IC product revenue and costs relating to sales made through distributors with rights of return and stock rotation are deferred until the distributors sell the product to end customers due to our inability to estimate future returns and credits to be issued. At the time of shipment to distributors, an accounts receivable for the selling price is recorded, as there is a legally enforceable right to receive payment, inventory is relieved, as legal title to the inventory is transferred upon shipment, and the associated deferred margin is recorded as deferred revenues in the condensed consolidated balance sheets. Revenues are recognized upon receiving notification from the distributors that products have been sold to end customers.

Royalty. Royalty revenue represents amounts earned under provisions in our memory licensing contracts that require our licensees to report royalties and make payments at a stated rate based on actual units manufactured or sold by licensees for products that include our memory IP. Our license agreements require the licensee to report the manufacture or sale of products that include our technology after the end of the quarter in which the sale or manufacture occurs, and we recognize royalties in the quarter in which we receive the licensee s report. The timing and level of royalties are difficult to predict. They depend on the licensee s ability to market, produce and sell products incorporating our technology.

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Licensing. Licensing revenue, which is included in royalty and other revenue, consists of fees earned from license agreements, development services, and support and maintenance. Our licensing revenue consists primarily of fees for providing circuit design, layout and design verification and granting licenses to customers that embed our technology into their products. The vast majority of our contracts allow for milestone billing based on work performed. Fees billed prior to revenue recognition are recorded as deferred revenue.

Critical Accounting Policies and Estimates

The discussion and analysis of our financial condition and results of operations are based upon our condensed consolidated financial statements, which have been prepared in accordance with GAAP. The preparation of these financial statements requires us to make certain estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses. On an ongoing basis we make these estimates based on our historical experience and on assumptions that we consider reasonable under the circumstances. Actual results may differ from these estimates, and reported results could differ under different assumptions or conditions. Our significant accounting policies and estimates are disclosed in Note 1 of the Notes to Consolidated Financial Statements in our Annual Report on Form 10-K for the year ended December 31, 2013. As of September 30, 2014, there have been no material changes to our significant accounting policies and estimates.

Results of Operations

Net Revenue.

	September 30, 2014	2013	Change 2013 to 2014	
	(dollar amounts in thousands)			
Product three months ended	$ 437	$ 90	$ 347	386%
Percentage of total net revenue	38%	9%		
Product nine months ended	$ 1,993	$ 211	$ 1,782	845%
Percentage of total net revenue	47%	6%		

Product revenue increased due to increased volume of shipments for our Bandwidth Engine ICs as we have more customers. In the first six months of 2014, we realized $0.4 million of revenue recognition from the reversal of sales return reserves recorded in prior periods. We expect product revenue to fluctuate for the remainder of 2014, as our customers have not yet commenced full production of their systems that utilize our ICs.

	September 30, 2014	2013	Change 2013 to 2014	
	(dollar amounts in thousands)			
Royalty and other three months ended	$ 716	$ 867	$ (151)	(17)%
Percentage of total net revenue	62%	91%		

Royalty and other	nine months ended	$	2,241	$	3,201	$	(960)	(30)%
Percentage of total net revenue			53%		94%			

Royalty and other revenue include revenues generated from licensing agreements. Royalty and other revenue decreased primarily due to a decrease in shipment volumes by licensees whose products incorporate our licensed IP.

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Cost of Net Revenue and Gross Profit.

	September 30, 2014	2013	Change 2013 to 2014	
	(dollar amounts in thousands)			
Cost of net revenue three months ended	$ 447	$ 158	$ 289	183%
Percentage of total net revenue	39%	17%		
Cost of net revenue nine months ended	$ 2,046	$ 254	$ 1,792	706%
Percentage of total net revenue	48%	7%		

	September 30, 2014	2013	Change 2013 to 2014	
	(dollar amounts in thousands)			
Gross profit three months ended	$ 706	$ 799	$ (93)	(12)%
Percentage of total net revenue	61%	83%		
Gross profit nine months ended	$ 2,188	$ 3,158	$ (970)	(31)%
Percentage of total net revenue	52%	93%		

Cost of net revenue is primarily comprised of direct and indirect costs related to the sale of IC products.

Cost of net revenue increased for the three and nine months ended September 30, 2014, compared with the same periods of 2013, primarily due to the increase in product material and testing costs related to IC shipments.

Gross profit decreased for the three and nine months ended September 30, 2014, compared with the same periods of 2013, primarily due to the decrease in our royalty revenue, which has no associated costs, coupled with the increase in IC shipments. The deferred margin recognized from the reversal of sales return reserves in the first six months 2014 was not material. Gross margin percentage decreased for the three and nine months ended September 30, 2014, compared with the same periods of 2013, primarily due to the shift in revenue mix from royalty revenue, which has no associated costs, to product revenue.

Research and Development.

	September 30, 2014	2013	Change 2013 to 2014	
	(dollar amounts in thousands)			
Research and development three months ended	$ 7,507	$ 6,243	$ 1,264	20%
Percentage of total net revenue	651%	652%		
Research and development nine months ended	$ 20,993	$ 17,546	$ 3,447	20%
Percentage of total net revenue	496%	514%		

Our research and development expenses include costs related to the development of our IC products and amortization of intangible assets. We expense research and development costs as they are incurred.

The $1.3 million and $3.4 million increases for the three and nine months ended September 30, 2014, respectively, compared with the same periods a year ago, were primarily due to higher personnel costs resulting from higher headcount, product development, computer-aided design software tools, consulting, and stock-based compensation charges, partially offset by decreased tape-out costs related to our LineSpeed IC products.

R&D expense is expected to increase in absolute dollars in the fourth quarter of 2014 primarily due to the timing of masks and test chip expenditures related to tape-outs of new IC products. Tape-outs of new products also drive higher computer-aided design and consulting costs in the quarters preceding the tape-out.

Research and development expenses included stock-based compensation expense of $0.8 million and $0.6 million for the three months ended September 30, 2014 and 2013, respectively. Research and development expenses included stock-based compensation expense of $2.7 million and $1.9 million for the nine months ended September 30, 2014 and 2013, respectively.

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Selling, General and Administrative (SG&A).

	September 30, 2014	2013	Change 2013 to 2014	
	(dollar amounts in thousands)			
SG&A three months ended	$ 1,689	$ 1,595	$ 94	6%
Percentage of total net revenue	146%	167%		
SG&A nine months ended	$ 4,976	$ 4,678	$ 298	6%
Percentage of total net revenue	118%	137%		

Selling, general and administrative expenses consist primarily of personnel and related overhead costs for sales, marketing, finance, human resources and general management.

Selling, general and administrative expenses increased $0.1 million for the three months ended September 30, 2014, compared with the same period a year ago, as a result of higher consulting costs.

The $0.3 million increase for the nine months ended September 30, 2014 was primarily due to higher personnel and consulting costs.

Selling, general and administrative expenses included stock-based compensation expense of $0.3 million for each of the three months ended September 30, 2014 and 2013. Selling, general and administrative expenses included stock-based compensation expense of $0.9 million for each of the nine months ended September 30, 2014 and 2013.

We expect total selling, general and administrative expenses to remain consistent in the fourth quarter compared with the third quarter.

Other Income, net.

	September 30, 2014	2013	Change 2013 to 2014	
	(dollar amounts in thousands)			
Other income, net three months ended	$ 30	$ 122	$ (92)	(75)%
Percentage of total net revenue	3%	13%		
Other income, net nine months ended	$ 115	$ 166	$ (51)	(31)%

Percentage of total net revenue	3%	5%	

Other income, net primarily consisted of interest income on our investments, partially offset by other non-operating items.

Income Tax Provision.

	September 30, 2014	2013	Change 2013 to 2014	
	(dollar amounts in thousands)			
Income tax provision three months ended	$ 23	$ 28	$ (5)	(18)%
Percentage of total net revenue	2%	3%		
Income tax provision nine months ended	$ 65	$ 68	$ (3)	(4)%
Percentage of total net revenue	2%	2%		

The provision for the three and nine months ended September 30, 2014 and 2013 was primarily attributable to taxes on earnings of our foreign subsidiary and branches. We believe that, based on the history of our operating losses and other factors, the weight of available evidence indicates that it is more likely than not that we will not be able to realize the benefit of our net operating losses, which are primarily generated in the United States. Accordingly, a full valuation reserve has been recorded against our net deferred tax assets.

Liquidity and Capital Resources; Changes in Financial Condition

Cash Flows

As of September 30, 2014, we had cash, cash equivalents and short and long-term investments of $33.7 million and had total working capital of $25.4 million. Our primary capital requirements are to fund working capital, including development of our IC products, and any acquisitions that we may make that require cash considerations or expenditures.

Net cash used in operating activities was $18.7 million for the first nine months of 2014, which primarily resulted from our net loss of $23.7 million, partially offset by non-cash charges, including stock-based compensation expense of $3.6 million, depreciation and amortization expenses of $1.1 million and $0.3 million in a net increase due to the changes in assets and liabilities primarily related to the timing of the payments to vendors.

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Net cash used in operating activities was $17.7 million for the first nine months of 2013, which primarily resulted from the net loss of $18.3 million, a gain on sale of assets of $0.6 million and $2.9 million in the net reduction of assets and liabilities, partially offset by non-cash charges, including stock-based compensation expense of $2.8 million and depreciation and amortization expenses of $1.3 million. The changes in assets and liabilities primarily related to the timing of payments to vendors.

Net cash provided by investing activities was $16.8 million for the first nine months of 2014, and included net amounts transferred to cash and cash equivalents from investments of $17.1 million, which did not impact our liquidity, partially offset by $0.3 million for purchases of fixed assets.

Net cash used in investing activities was $12.4 million for the first nine months of 2013, and included net amounts transferred from cash and cash equivalents to investments of $12.9 million, which did not impact our liquidity, and $0.1 million for purchases of fixed assets, partially offset by $0.6 million in proceeds from the sale of assets.

Our financing activities for the first nine months of 2014 primarily consisted of proceeds from the exercise of stock options and our employee stock purchase plan. Our proceeds from financing activities for the first nine months of 2013 of $29.8 million consisted of net proceeds received from the sale of common stock though a public offering and proceeds from the exercise of stock options and purchases of common stock under our employee stock purchase plan.

Our future liquidity and capital requirements are expected to vary from quarter to quarter, depending on numerous factors, including:

- level of revenue;
- cost, timing and success of technology development efforts;
- inventory levels, timing of product shipments and length of billing and collection cycles;
- fabrication costs, including mask costs, of our ICs, currently under development;
- variations in manufacturing yields, materials costs and other manufacturing risks;

- costs of acquiring other businesses and integrating the acquired operations; and

- profitability of our business.

We expect our cash expenditures to continue to exceed receipts for the foreseeable future as our revenues will not be sufficient to offset our operating expenses, which include significant research and development expenditures for the expansion and fabrication of our IC products. We believe our existing cash, cash equivalents and investments, along with our existing capital and cash generated from operations, if any, to be sufficient to meet our capital requirements for at least the next twelve months. However, there can be no assurance that our capital is sufficient to fund operations until such time as we begin to achieve positive cash flows. We might decide to raise additional capital, and there can be no assurance that such funding will be available to us on favorable terms, if at all. We have an effective shelf registration statement on file with the SEC to allow us to sell up to approximately $50 million of our securities from time to time prior to September 2017.

If we were to raise additional capital through sales of our equity securities, our stockholders would suffer dilution of their equity ownership. If we engage in debt financing, we may be required to accept terms that restrict our ability to incur additional indebtedness, prohibit us from paying dividends, repurchasing our stock or making investments, and force us to maintain specified liquidity or other ratios, any of which could harm our business, operating results and financial condition. If we need additional capital and cannot raise it on acceptable terms, we may not be able to, among other things:

- develop or enhance our products;

- continue to expand our product development and sales and marketing organizations;

- acquire complementary technologies, products or businesses;

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- expand operations, in the United States or internationally;
- hire, train and retain employees; or
- respond to competitive pressures or unanticipated working capital requirements.

Our failure to do any of these things could seriously harm our ability to execute our business strategy and may force us to curtail our research and development plans or existing operations.

Contractual Obligations

The impact that our contractual obligations as of September 30, 2014 are expected to have on our liquidity and cash flow in future periods is as follows (in thousands):

	Payment Due by Period				
	Total	Less than 1 year	1-3 years	3-5 years	More than 5 years
Operating leases	$ 4,432	$ 749	$ 1,488	$ 1,489	$ 706
Software licenses	3,980	3,095	885		
Wafer purchase obligations	360	360			
	$ 8,772	$ 4,204	$ 2,373	$ 1,489	$ 706

As of September 30, 2014, our software licenses related to computer-aided design software.

ITEM 3. Qualitative and Quantitative Disclosures about Market Risk

Our investment portfolio consists of money market accounts, certificates of deposit, corporate debt, government agency and municipal debt securities. The portfolio dollar-weighted average maturity of these investments is within 12 months. Our primary objective with this investment portfolio is to invest available cash while preserving principal and meeting liquidity needs. No single security should exceed 5% of the portfolio or $2.0 million at the time of purchase. In accordance with our investment policy, we place investments with high credit quality issuers and limit the amount of credit exposure to any one issuer. These securities, which approximated $32.6 million as of September 30, 2014 and earned an average annual interest rate of approximately 0.3% during the first nine months of 2014, are subject to interest rate and credit risks. We do not have any investments denominated in foreign currencies, and, therefore, are not subject to foreign currency risk on such investments.

ITEM 4. Controls and Procedures

Disclosure Controls and Procedures. Our management is responsible for establishing and maintaining adequate internal control over our financial reporting. Because of inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, we conducted an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934. Based on this evaluation, our management concluded that as of September 30, 2014, our disclosure controls and procedures were effective.

Changes in Internal Control over Financial Reporting. During the third quarter of 2014, there was no change in our internal control over financial reporting that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II OTHER INFORMATION

ITEM 1. Legal Proceedings

The discussion of legal matters in Note 4 of the Notes to Condensed Consolidated Financial Statements included in Part I, Item 1 of this report under the heading Legal Matters is incorporated by reference in response to this Part II, Item 1.

ITEM 1A. Risk Factors

We face many significant risks in our business, some of which are unknown to us and not presently foreseen. These risks could have a material adverse impact on our business, financial condition and results of operations in the future. We have disclosed a number of material risks under Item 1A of our annual report on Form 10-K for the year ended December 31, 2013, which we filed with the Securities and Exchange Commission on March 14, 2014.

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ITEM 6. Exhibits

(a) Exhibits

31.1	Rule 13a-14 certification
31.2	Rule 13a-14 certification
32.1	Section 1350 certification
101	The following financial information from MoSys, Inc. s Quarterly Report on Form 10-Q for the period ended September 30, 2014, filed with the SEC on November 7, 2014, formatted in Extensible Business Reporting Language (XBRL): (i) the Condensed Consolidated Statements of Operations and Comprehensive Loss for the three and nine months ended September 30, 2014 and 2013, (ii) the Condensed Consolidated Balance Sheets as of September 30, 2014 and December 31, 2013, (iii) the Condensed Consolidated Statements of Cash Flows for the nine months ended September 30, 2014 and 2013, and (iv) Notes to Condensed Consolidated Financial Statements.

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Signatures

Pursuant to the requirements of the Securities Exchange Act of 1934, as amended, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Dated: November 7, 2014	MOSYS, INC.
	By: /s/ Leonard Perham Leonard Perham President and Chief Executive Officer
	By: /s/ James W. Sullivan James W. Sullivan Vice President of Finance and Chief Financial Officer (Principal Financial Officer)

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