

CPS TECHNOLOGIES CORP/DE/  
Form 10-K  
March 27, 2009

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

**FORM 10-K**

(Mark One)

**Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934** for the fiscal year ended December 27, 2008

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: 0-16088

CPS TECHNOLOGIES CORPORATION

(Exact Name of Registrant as Specified in its Charter)

Delaware  
(State or Other Jurisdiction  
of Incorporation or Organization)

04-2832509

(I.R.S. Employer  
Identification No.)

111 South Worcester Street  
Norton, MA  
(Address of principal executive offices)

02712-0338  
(Zip Code)

Registrant's telephone no., including area code: 508-222-0614

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

Common Stock, par value, \$0.01 per share

(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

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

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 than the registrant was required to file such reports), and (2) has been subject to the filing requirements for the past 90 days.

Yes  No

Indicate by check mark 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 statements incorporated by reference in Part III of this Form 10-K or any amendment to the 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 definitions of "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer  Accelerated filer

Non-accelerated filer  Smaller reporting company

(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act)

Yes  No

The aggregate market value of the voting Common Stock held by non-affiliates of the Registrant was \$15,079,534 based on the average of the reported closing bid and asked prices for the Common Stock as of the last business day of the registrant's most recently completed second fiscal quarter as reported on the OTC Bulletin Board.

Number of shares of Common Stock outstanding as of March 20, 2009: 12,624,959 shares.

Documents incorporated by reference.

## Part I

### Item 1. Business.

CPS Technologies Corporation (the "Company" or "CPS") (formerly Ceramics Process Systems Corporation) provides advanced material solutions to the electronics, power generation, automotive and other industries. In 2008 the Company also entered into a cooperative agreement with the U.S. Army to further develop its composite technology to produce armor.

The Company's products are generally used in high-power, high-reliability applications. These applications always involve energy use or energy generation and the Company's products allow higher performance and improved energy efficiency. The Company is an important participant in the growing movement towards alternative energy and "green" lifestyles. For example, the Company's products are used in mass transit, hybrid and electric cars, wind-turbines for electricity generation as well as routers and switches for the internet which in turn allows telecommuting.

Our primary advanced material solution is metal matrix composites (MMCs), a new class of materials which are a combination of metal and ceramic. CPS has a leading, proprietary position in metal matrix composites. Metal matrix composites have several superior properties compared to conventional materials including improved thermal conductivity, thermal expansion matching, stiffness and light weight which enable higher performance and higher reliability in our customers' products.

Like plastics several decades ago, we believe metal-matrix composites will penetrate many end markets over many years. CPS management believes our business model of providing advanced material solutions to a portfolio of high growth end markets which are, at any point in time, in various stages of the technology adoption lifecycle, provides CPS with the opportunity for sustained growth and a diversified customer base. We believe we have validated this model as we are now supplying customers at all stages of the technology adoption lifecycle.

CPS is the leader in supplying metal matrix composites to certain high growth electronics end markets which are well along in the adoption lifecycle and therefore generating significant demand. These end markets include high-performance integrated circuits and circuit boards used in internet switches and routers, as well as motor controllers used in high-speed electric trains, subway cars and wind turbines. CPS supplies heat spreaders, lids and baseplates to customers in these end markets. CPS is a fully qualified manufacturer for many of the world's largest electronics OEMs.

CPS also assembles housings and packages for hybrid circuits. These housings and packages may include components made of metal-matrix composites; they may include components made of more traditional materials such as aluminum, copper-tungsten, etc.

Concurrently, CPS is participating in certain end markets that are at an earlier stage of the adoption lifecycle. Management believes these end markets will generate additional growth longer-term. An example of such an end market is motor controllers for hybrid automobiles and trucks.

We are also actively working with customers in end markets at the beginning stages of the adoption lifecycle. An example of such a market is the market for armor. In 2008 the Company entered into a cooperative agreement with the Army Research Laboratory to further develop large hybrid metal matrix composite modules which integrally combine metal matrix composites and ceramics by enveloping ceramic tiles with MMCs. This system offers a lighter weight, durable, multi-hit capable and cost competitive alternative to conventional steel, aluminum and ceramic based armor systems. CPS hybrid hard face armor modules are comprised of multiple materials completely enveloped within and mechanically and chemically bonded to lightweight and stiff aluminum metal matrix composites.

The Company believes that its hybrid hard face armor tiles will find application in many military vehicles as well as armored commercial vehicles.

Our products are manufactured by proprietary processes we have developed including the Quickset™ Injection Molding Process ("Quickset Process") and the QuickCast™ Pressure Infiltration Process ("QuickCast Process").

CPS was incorporated in Massachusetts in 1984 as Ceramics Process Systems Corporation and reincorporated in Delaware in April 1987 through a merger into a wholly-owned Delaware subsidiary organized for purposes of the reincorporation. In July 1987, CPS completed our initial public offering of 1.5 million shares of our Common Stock. In March 2007, we changed our name from Ceramics Process Systems Corporation to CPS Technologies Corporation.

## Overview of Markets and Products

### Electronics Markets Overview

Consumer demand continues to motivate the electronics industry to produce products which:

- operate at higher speeds;
- are smaller in size; and
- operate with higher reliability.

While these three requirements result in products of ever-increasing performance, these requirements also create a fundamental challenge for the designer to manage the heat generated by the system moving at higher speeds and/or higher power. Smaller assemblies further concentrate the heat and increase the difficulty of removing it.

This challenge is found at each level in an electronic assembly: at the integrated circuit level speeds are increasing and line widths are decreasing; at the circuit board level higher density devices are placed closer together on circuit boards; and at the system level higher density circuit boards are being assembled closer together.

The designer must resolve the thermal management issues or the system will fail. For every 10 degree Celsius rise in temperature above a threshold level, the reliability of a circuit is decreased by approximately half. In addition, heat usually causes changes in parameters which degrade the performance of both active and passive electronic components.

To resolve thermal management issues the designer is primarily concerned with two properties of the materials which comprise the system: 1) thermal conductivity, which is the rate at which heat moves through materials, and 2) thermal expansion rate (Coefficient of Thermal Expansion or CTE) which is the rate at which materials expand or contract as temperature changes. The designer must ensure that the temperature of an electronic assembly stays within a range in which the differences in the expansion rates of the materials in the assembly do not cause a failure from breaking, delaminating, etc.

CPS combines at the microstructural level a ceramic with a metal to produce a metal matrix composite which has the thermal conductivity needed to remove heat, and a thermal expansion rate which is sufficiently close to other components in the assembly to ensure the assembly is reliable. The ceramic is silicon carbide (SiC), the metal is aluminum (Al), and the composite is aluminum silicon carbide (AlSiC), a metal-matrix composite. CPS can adjust the thermal expansion rate of AlSiC components to match the specific application by modifying the amount of SiC compared to the amount of Al in the component.

CPS produces products made of AlSiC in the shapes and configurations required for each application, for example, in the form of lids, substrates, housings, etc. Every product is made to a customer's blueprint. The CPS process technology allows most products to be made to net shape, requiring no or little final machining.

Although our focus today is on AlSiC components, we believe our proprietary Quickset- Quickcast process technology can be used to produce other metal-matrix composites which may meet future market needs.

Today, the problem of thermal management is most acute in high-performance, high-density applications such as cellular basestations, high-performance microprocessors, application-specific integrated circuits for internet routers and switches, motor controllers and components for satellite communications. However, as the trends towards faster speeds, reduced size and increased reliability continue, and as high-density circuitry is used in a larger number of applications, we believe our products will be used in an increasing number of applications across many end markets.

### Structural Markets Overview

Structural applications perform primarily a mechanical rather than electrical function. In any mechanical assembly with moving parts the stiffness and weight of moving parts can have a significant impact on the performance and energy efficiency of the assembly. In particular, in equipment with reciprocating components increasing the stiffness and reducing the weight of reciprocating components improves the performance and energy efficiency of the

equipment.

Today many mechanical components are made of steel because steel has the stiffness required for the particular application. AlSiC has approximately the same stiffness as steel, but is only one-third the weight of steel. AlSiC is, however, higher cost than steel. However, we believe there are many mechanical applications where the customer will pay the higher cost for AlSiC because of significant improvements in performance resulting from the superior stiffness-to-weight ratio of AlSiC.

Examples of structural applications for which we are developing and supplying components include robotic arms for semiconductor manufacturing equipment, certain components for specialty internal combustion engines, and hybrid armor.

#### Specific Markets and Products

##### Lids and Heat Spreaders for High-Performance Microprocessors, Application-Specific Integrated Circuits and Other Integrated Circuits ("Flip-chip Applications")

Increases in speed, circuit density, and the number of connections in microprocessor chips (CPUs) and application-specific integrated circuits (ASICs) are accelerating a transition in the way in which these circuits are packaged. Packages provide mechanical protection to the integrated circuit (IC), enable the IC to be connected to other circuits via pins, solder bumps or other connectors, and allow attachment of a heat sink or fan to ensure the IC does not overheat. In the past most high-performance ICs were electrically connected to the package by fine wires in a process known as wire bonding. Increasingly high-performance semiconductors are connected to the package by placing metal bumps on the connection points of the die, turning the die upside down in the package, and directly connecting the bumps on the die with corresponding bumps on the package base by reflowing the bumps. This is referred to as a "flip-chip package". Flip chip packages allow for connection of a larger number of leads in a smaller space, and can provide other electrical performance advantages compared to wire bonded packages.

In many flip chip configurations a lid or heat spreader is placed over the die to protect the die from mechanical damage and to facilitate the removal of heat from the die. Often a heat sink or fan is then attached to the lid. For a high-density die the package designer must ensure that the lid has sufficient thermal conductivity to remove heat from the die and that all components of the package assembly - the die itself, the package base, and the package lid - are made from materials with sufficiently similar thermal expansion rates to ensure the assembly will not break itself apart over time as it thermally cycles.

Our composite material, AlSiC, has been developed to meet these two needs: it is engineered to have sufficient thermal conductivity to allow the heat generated by the die to be removed through the lid, and it is engineered to expand upon heating at a rate similar to other materials used in the package assembly in order to ensure reliability of the package over time as it thermally cycles. We produce lids made of AlSiC for high performance microprocessors and application-specific integrated circuits used in servers, internet switches and other applications.

Most participants in the semiconductor industry believe the densities of ICs will continue to increase following the well-known "Moore's Law". As IC densities increase, generally so does the IC size, and the amount of heat generated by the IC. We believe the need for thermal management will continue to grow rapidly.

##### Wireless Communications Infrastructure Applications ("Cellular Basestation Applications")

The demand for wireless telecommunications services such as cellular telephone service has grown significantly during the past decade, driven by reduced costs for wireless handsets, a more favorable regulatory environment, increasing competition among service providers and a greater availability of services and microwave spectrum.

We manufacture substrates and heat spreaders on which high-performance and high power circuits such as power amplifiers and power supplies are mounted in wireless basestations. Use of our products allows the basestation manufacturer to reduce overall basestation size, increase the number of calls a basestation can handle, and to improve reliability.

#### Motor Controller Applications (Insulated Gate Bipolar Transistor ("IGBT") Applications)

The use of power modules to control electric motors of all sizes is growing. This growth is the result of several factors including emerging high-power applications which demand power controllers such as trains, subways and certain industrial equipment, and cost declines in power modules which increasingly make variable speed drives cost effective. Power semiconductors are a very significant portion of the cost of variable speed drives, and the cost of the module housing and thermal management system are also significant; declines in the costs of all these components is driving increased use of variable speed drives.

We provide substrates, baseplates and heat spreaders on which power semiconductors are mounted to produce modules for motor control. The power semiconductors are typically insulated gate bipolar transistors and these applications are often referred to as IGBT applications. Our AlSiC baseplates have sufficient thermal conductivity to allow for removal of heat through the baseplate, and have a thermal expansion rate sufficiently similar to the other components in the assembly to ensure reliability over time as the assembly thermally cycles. We believe this market will continue to grow as the use of power modules penetrates additional motor applications, and as electric motors themselves penetrate new applications such as the hybrid electric vehicle.

Today our primary products for IGBT applications are used in electric trains, subway cars, wind-generating turbines and hybrid and electric vehicles.

Major automobile companies around the world are introducing hybrid electric vehicles (HEVs) and electric vehicle (EVs) at an increasing rate. This focus on more energy efficient vehicles is being driven by increases in energy costs and concerns about climate change. There are many varieties of HEVs and EVs, but all HEVs and EVs contain an electric motor and contain one or more motor controller modules. The Company provides baseplates on which motor controller modules are assembled; these baseplates are lighter weight and provide greater reliability than baseplates made from more conventional materials.

In 2008, the first two commercial hybrid automobile models containing motor controller modules using the Company's baseplates entered production. The Company is working with multiple tier one and tier two suppliers to the automobile industry on several new designs for future introduction. The Company believes the HEV and EV markets will be the source of significant and long-term growth for the Company.

#### Customers

We sell primarily to major microelectronics systems houses in the United States, Europe and Asia. Our customers typically purchase prototype and evaluation quantities of our products over a one to three year period before purchasing production volumes.

In 2008, our four largest customers accounted for 35%, 28%, 8% and 5% of revenues, respectively. In 2008, 91% of our revenues were derived from commercial applications and 9% from defense-related applications.

#### Research and Development

In 2008, research and development costs were incurred related to the Cooperative Agreement with the US Army. These costs consist of labor, including applicable overhead expenses, materials and other costs associated with our Cooperative Agreement. Total expenditures incurred in 2008 under this Cooperative Agreement amounted to \$376

thousand of which \$310 thousand is included in cost of research and development under cooperative agreement in the Statement of Income. \$357 thousand of these costs were funded by the US Army in 2008 and is classified as research and development cooperative agreement revenues in the Statement of Income. The \$19 thousand funded by CPS consists of \$16 thousand of direct and indirect costs in connection with the contract included in costs of research and development under cooperative agreements and the Company's allocated portion of general and administrative expenses allowed under the contract included in selling, general and administrative expenses of \$2 thousand.

Unfunded research and development costs, if any, are charged to expense as incurred and were \$0 in 2008, 2007 and 2006.

#### Availability of Raw Materials

We use a variety of raw materials from numerous domestic and foreign suppliers. These materials are primarily aluminum ingots, ceramic powders and chemicals. The raw materials we use are available from domestic and foreign sources and none is believed to be scarce or restricted for national security reasons.

#### Patents and Trade Secrets

As of December 27, 2008, we had 13 United States patents and one United States patent pending. We also have several international patents covering the same subject matter as the U.S. patents. Our licensees have rights to use certain patents as defined in their respective license agreements. As of December 27, 2008, none of our licensees are producing products under license agreements signed previously, and we do not expect the license agreements in place to generate additional license revenues in the future.

We intend to continue to apply for domestic and foreign patent protection in appropriate cases. In other cases, we believe we are better served by reliance on trade secret protection. In all cases, we seek protection for our technological developments to preserve our competitive position.

#### Backlog and Contracts

As of December 27, 2008, we had a total backlog of approximately \$8.6 million consisting of product backlog of \$7.9 million, and backlog remaining on the first-year funding under the Cooperative Agreement with the US Army of \$691 thousand.

The product backlog as of December 29, 2007 was approximately \$6.4 million. We shipped 100% of the year-end 2007 product backlog in 2008.

#### Competition

We have developed and expect to continue to develop products for a number of different end markets and we will encounter competition from different producers of metal-matrix composites and other competing materials.

We believe that the principal competitive factors in our end markets today include technical competence, product performance, quality, reliability, price, corporate reputation, and strength of sales and marketing resources. We believe our proprietary processes, reputation, and the price at which we can offer products for sale will enable us to compete successfully in the many electronics end markets. However, many of the American and foreign companies now producing or developing metal-matrix composites have far greater financial and sales and marketing resources than we do which may enable them to develop and market products which would compete against those developed by us.

#### Government Regulation

We produce non-nuclear, non-medical hazardous waste in our development and manufacturing operations. The disposal of such waste is governed by state and federal regulations. Various customers, vendors, and collaborative development agreement partners of CPS may reside abroad, thereby possibly requiring export and import of raw materials, intermediate products, and finished products, as well as potential technology transfer abroad under collaborative development agreements. These types of activities are regulated by bureaus within the Departments of Commerce, State and Treasury.

In 2008, the Company entered into a cooperative agreement with the US Army Research Laboratory to perform research and development concerning hybrid metal matrix composite encapsulated ceramic armor technology. The Cooperative Agreement is a four-year agreement which is 95% funded by the US Department of Defense and 5% funded by CPS.

Revenues from this Cooperative Agreement are recognized proportionally as costs are incurred. We are reimbursed for reasonable and allocable costs up to the reimbursement limits set by the Cooperative Agreement. All payments to the Company for work performed on this Cooperative Agreement are subject to audit and adjustment by the Defense Contract Audit Agency. Adjustments are recognized in the period made.

### Employees

As of December 27, 2008, we had 130 full-time employees and 3 part-time employees, of whom 120 were engaged in manufacturing and engineering and 13 in sales and administration. We also employ temporary employees as needed to support production and program requirements.

None of our employees is covered by a collective bargaining agreement. We consider our relations with our employees to be excellent.

### Item 1A. Risk Factors.

#### **We are heavily dependent on the electronics industry and changes in the industry could harm our business and operating results.**

The electronics industry is subject to economic cycles and is currently experiencing recessionary pressures, and is likely in the future to experience recessionary periods. A protracted general recession in the electronics industry could have a material adverse effect on our business, financial condition and results of operations.

Our operating results may fluctuate substantially, which may cause our stock price to fall.

Our quarterly and annual results of operations have varied in the past, and our operating results may vary significantly in the future due to a number of factors including, but not limited to, the following: timing of orders from major customers; mix of products and services; pricing and other competitive pressures; delays in prototype shipments, economic conditions in the electronics industry, raw material costs, and our ability to time expenditures in anticipation of future revenues.

Some executive officers and key personnel are critical to our business and these key personnel may not remain with the Company in the future.

Our success depends upon the continued service of some executive officers and other key personnel. Our employees are not bound by employment agreements, and there can be no assurance that the Company will retain its officers and key employees.



We may need additional capital in the future, which may not be available.

If our capital resources are insufficient to meet future capital requirements, we will have to raise additional funds. The sale of equity or convertible debt securities in the future may be dilutive to our shareholders. If we are unable to obtain adequate funds on reasonable terms, we may be required to curtail operations significantly or to obtain funds by entering into financing agreements on unattractive terms.

The trading price of our common stock may be volatile.

The trading prices of our common stock has been and could in the future be subject to significant fluctuations in response to variations in quarterly operating results, developments in the electronics industry, changes in general economic conditions and economic conditions in the electronics industry, and other factors. In addition, the stock market in recent years has experienced significant price and volume fluctuations which have affected the market prices of technology companies and which have been unrelated to or disproportionately impacted by the operating performance of those companies. These broad market fluctuations may cause the market price of our common stock to decline.

#### Item 1B. Unresolved Staff Comments

None.

#### Item 2. Properties.

All of our manufacturing, engineering, sales and administrative operations are located in a leased facility in Norton, Massachusetts. The Company entered into a 10-year lease for the Norton facilities effective on March 1, 2006. The leased facilities comprise approximately 38 thousand square feet. Prior to entering into this lease, the Company was renting a portion of the facilities as a tenant-at-will.

#### Item 3. Legal Proceedings.

We are not a party to any litigation which could have a material adverse effect on us or on our business and we are not aware of any pending or threatened material litigation against us.

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

No matters were submitted to a vote of security holders during the fourth quarter of the year ended December 27, 2008.

#### Part II

#### Item 5. Market for Registrant's Common Stock and Related Stockholder Matters.

On December 27, 2008, we had approximately 850 shareholders. The high and low closing bid prices of our common stock for each quarter during the years ended December 27, 2008 and December 29, 2007 are shown below.

|             | <u>2008</u> |            | <u>2007</u> |            |
|-------------|-------------|------------|-------------|------------|
|             | <u>High</u> | <u>Low</u> | <u>High</u> | <u>Low</u> |
| 1st Quarter | \$ 2.60     | \$ 2.05    | \$ 2.95     | \$ 1.45    |

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|             |         |         |         |         |
|-------------|---------|---------|---------|---------|
| 2nd Quarter | \$ 2.20 | \$ 1.75 | \$ 4.00 | \$ 2.30 |
| 3rd Quarter | \$ 2.10 | \$ 1.55 | \$ 3.75 | \$ 2.30 |
| 4th Quarter | \$ 2.01 | \$ 1.10 | \$ 2.90 | \$ 2.05 |

CPS has never paid cash dividends on our Common Stock. We currently plan to reinvest our earnings, if any, for use in the business and do not intend to pay cash dividends in the foreseeable future. Future dividend policy will depend, among other factors, upon our earnings and financial condition.

Our Common Stock is traded on NASD's Over-the-Counter Bulletin Board (OTCBB) under the symbol CPSH.OB

Item 6. Selected Financial Data

The following selected financial data of CPS should be read in conjunction with the financial statements and related notes filed as part of this Annual Report on Form 10-K. Amounts are in thousands except per share amounts.

SELECTED FINANCIAL DATA (\$000)

| For the Fiscal Year:   | <u>2008</u> | <u>2007</u> | <u>2006</u> | <u>2005</u> | <u>2004</u> |
|--|-------------|-------------|-------------|-------------|-------------|
| Summary of Operations  |             |             |             |             |             |
| Product Revenue  | \$14,456    | \$12,447    | \$11,908    | \$7,019     | \$6,835     |
| License and Royalty Revenue                                  | --          | --          | --          | 137         | 8           |
| Cooperative Agreement Revenue                                | 357         | --          | --          | --          | --          |
| Operating Expenses   | 13,429      | 11,496      | 10,387      | 6,834       | 5,775       |
| Operating Income (Loss)                                      | 1,384       | 950         | 1,520       | 322         | 1,068       |
| Other Income (Expense), Net                                  | (44)        | (60)        | (30)        | (25)        | (28)        |
| Net Income (Loss) Before Taxes                               | 1,340       | 890         | 1,490       | 297         | 1,040       |
| Provision (Benefit) for Income Taxes                         | (134)       | (58)        | (288)       | 10          | --          |
| Net Income (Loss)  | 1,474       | 949         | 1,778       | 287         | 1,040       |
| Net Income (Loss) Per Basic Common Share                     | \$0.12      | \$0.08      | \$0.14      | \$0.02      | \$0.08      |
| Weighted Average Basic Number of Common Shares Outstanding   | 12,613      | 12,543      | 12,473      | 12,308      | 12,293      |
| Net Income (Loss) Per Diluted Common Share                   | \$0.11      | \$0.07      | \$0.14      | \$0.02      | \$0.08      |
| Weighted Average Diluted Number of Common Shares Outstanding | 13,243      | 13,299      | 13,067      | 12,832      | 12,761      |

## Year-End Position

|                       |         |         |         |         |         |
|-----------------------|---------|---------|---------|---------|---------|
| Working Capital       | 4,663   | 3,549   | \$2,971 | \$1,972 | \$1,660 |
| Total Assets          | 8,367   | 7,007   | 6,389   | 3,670   | 3,246   |
| Long-term Obligations | 152     | 274     | 246     | 312     | 243     |
| Stockholders Equity   | \$6,981 | \$5,406 | \$4,381 | \$2,551 | \$2,242 |

SELECTED QUARTERLY FINANCIAL DATA

|  | First<br>Fiscal<br><u>Quarter</u> | Second<br>Fiscal<br><u>Quarter</u> | Third<br>Fiscal<br><u>Quarter</u> | Fourth<br>Fiscal<br><u>Quarter</u> |
|--|-----------------------------------|------------------------------------|-----------------------------------|------------------------------------|
| 2008   |                                   |                                    |                                   |                                    |
| Total Revenues                                   | \$3,415                           | \$4,472                            | \$3,581                           | \$3,346                            |
| Gross Margin                                     | \$1,062                           | \$1,370                            | \$793                             | \$759                              |
| Net Income                                       | \$423                             | \$567                              | \$165                             | \$320                              |
| Net Income Per Basic Share                       | \$0.03                            | \$0.05                             | \$0.01                            | \$0.03                             |
| Net Income Per Diluted Common<br>Share           | \$0.03                            | \$0.04                             | \$0.01                            | \$0.02                             |
| 2007   |                                   |                                    |                                   |                                    |
| Total Revenues                                   | \$3,140                           | \$3,067                            | \$3,082                           | \$3,157                            |
| Gross Margin                                     | \$888                             | \$643                              | \$803                             | \$766                              |
| Net Income                                       | \$340                             | \$132                              | \$225                             | \$252                              |
| Net Income Per Basic and Diluted<br>Common Share | \$0.03                            | \$0.01                             | \$0.02                            | \$0.02                             |

Our results of operations fluctuate from quarter to quarter. The fluctuations are caused by various factors, primarily fluctuations in the timing of customer demand for our products. Quarterly data may not sum to annual data due to rounding.

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

This document contains forward-looking statements, based on numerous assumptions, subject to risks and uncertainties. Although we believe that the forward-looking statements are reasonable, we do not and cannot give any assurance that our beliefs and expectations will prove to be correct. Many factors could significantly affect our operations and cause our actual results to be substantially different from our expectations. Those factors include, but are not limited to: (i) general economic and business conditions; (ii) customer acceptance of our products; (iii) materials and manufacturing costs; (iv) the financial condition of customers, competitors and suppliers; (v) technological developments; (vi) increased competition; (vii) changes in capital market conditions; (viii) governmental and business conditions in countries where our products are manufactured and sold; (ix) changes in trade regulations; (x) the effect of acquisition activity; (xi) changes in our plans, strategies, objectives, expectations or intentions; and (xii) other risks and uncertainties indicated from time to time in our filings with the Securities and

Exchange Commission. Actual results might differ materially from results suggested by any forward-looking statements in this report. We do not have an obligation to publicly update any forward-looking statements, whether as a result of the receipt of new information, the occurrence of future events or otherwise.

### Overview

We provide advanced material solutions to the electronics, robotics, automotive, defense and other industries.

Our primary advanced material solution is metal matrix composites, a new class of materials which are a combination of metal and ceramic. CPS has a leading, proprietary position in metal matrix composites. Metal matrix composites have several superior properties compared to conventional materials including improved thermal conductivity, thermal expansion matching, stiffness and light weight, which enable higher performance and higher reliability in our customers' products.

The end markets which account for a majority of our sales today are all electronics markets: the high-performance microprocessor and application-specific integrated circuits market, the motor controller market and the cellular basestation market. Our products are typically in the form of housings, packages, lids, substrates, thermal planes, heat spreaders or baseplates, and are used in applications where thermal management and/or weight are important considerations.

In addition to electronics end markets, we are developing, manufacturing and marketing metal-matrix composite components for some structural end-markets including armor.

The objective of the Cooperative Agreement is to further develop large hybrid metal matrix composite modules which integrally combine metal matrix composites and ceramics by enveloping ceramic tiles with MMCs. This system offers a lighter weight, durable, multi-hit capable and cost competitive alternative to conventional steel, aluminum and ceramic based armor systems. CPS hybrid hard face armor modules are comprised of multiple materials completely enveloped within and mechanically and chemically bonded to lightweight and stiff aluminum metal matrix composites. The Company believes that its hybrid hard face armor tiles will find application in many military vehicles as well as armored commercial vehicles.

Our products are custom rather than catalog items. They are made to customers' blueprints and are used as components in systems built and sold by our customers. At any point in time our product mix will consist of some products with on-going production demand, and some products which are in the prototyping or evaluation stages at our customers. We seek to have a portfolio of products which include products in every stage of the technology adoption lifecycle at our customers. Our growth is dependent upon the level of demand for those products already in production, as well as our success in achieving new "design wins" for future products.

As a manufacturer of highly technical and custom products, we incur fixed costs needed to support the business, but which do not vary significantly with changes in sales volume. These costs include the fixed costs of applications engineering, tooling design and fabrication, process engineering, etc. Accordingly, particularly given our current size, changes in sales volume generally result in even greater changes in financial performance on a percentage basis as fixed costs are spread over a larger or smaller base. Sales volume is therefore a key financial metric used by management.

We believe the underlying demand for metal matrix composites is growing as the electronics and other industries desire higher performance, higher reliability, and reduced costs. We believe that we are well positioned to offer our solutions to current and new customers as these demands grow. In 2008 our top four customers accounted for 76% of revenue and the remaining 24% of revenue was derived from approximately 51 customers. In 2007, our top four customers accounted for 66% of revenue, and the remaining 34% of revenue was derived from approximately 45 other

customers.

### Application of Critical Accounting Policies

Management prepares our financial statements in conformity with accounting principles generally accepted in the United States of America. As such, we are required to make certain estimates, judgments and assumptions that we believe are reasonable based upon the information available. These estimates and assumptions affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the periods presented. Our significant accounting policies are presented within Note 2 to the financial statements; the significant accounting policies which management believes are most critical to aid in fully understanding and evaluating our reported financial results include the following:

#### Revenue Recognition

We recognize revenue in accordance with the provisions of the Securities and Exchange Commission Staff Accounting Bulletin ("SAB") No. 104 which establishes guidance in applying generally accepted accounting principles to revenue recognition in financial statements. SAB No. 104 requires that four basic criteria must be met before revenue can be recognized: (1) persuasive evidence of an arrangement exists; (2) delivery has occurred or services rendered; (3) the price to the buyer is fixed or determinable; and (4) collectibility is reasonably assured.

Our shipping terms are customarily FOB shipping point. Revenues for products sold in the normal course of business are recognized upon shipment when delivery terms are FOB shipping point and all other revenue recognition criteria have been met.

We have entered into consigned inventory agreements with several customers. For product shipped under consigned inventory agreements, we recognize revenue when the customer notifies us that they have picked the product from the consigned inventory. Of the total finished goods inventory of \$943,122 at December 27, 2008, \$629,736 was located at the Company's facility in Norton, Massachusetts and \$313,386 was located at customers' locations pursuant to consigned inventory agreements. Of the total finished goods inventory of \$885,680 at December 29, 2007, \$370,883 was located at the Company's facility in Norton, Massachusetts and \$514,797 was located at customers' locations pursuant to consigned inventory agreements.

Advance payments in excess of revenue recognized are recorded as deferred revenue.

In 2008, we entered into a cooperative agreement with the US Army Research Laboratory to perform research and development concerning hybrid metal matrix composite encapsulated ceramic armor technology. The Cooperative Agreement is a four-year agreement which is 95% funded by the US Department of Defense and 5% funded by CPS.

Revenues on this Cooperative Agreement are recognized proportionally as costs are incurred. We are reimbursed for reasonable and allocable costs up to the reimbursement limits set by the Cooperative Agreement. All payments to the Company for work performed on this Cooperative Agreement are subject to audit and adjustment by the Defense Contract Audit Agency. Adjustments are recognized in the period made.

While this Cooperative Agreement extends for four years, funding is provided incrementally on a year-to-year basis if contract terms are met and Congress has authorized the funds. As of December 27, 2008, the Company has recognized \$357,213 of revenue on the Cooperative Agreement. The total estimated funding to be received over the four year term is \$8.34M. The Company's cost share amounts to \$439,000 over the term of the Cooperative Agreement. Should funding be tentatively delayed or if business initiatives change, we may choose to devote resources to other activities, including internally funded research and development. The Company was approved for \$1.048M in funding of which \$357K was invoiced in 2008.

## Accounts Receivable

We perform ongoing monitoring of the status of our receivables based on the payment history and the credit worthiness of our customers, as determined by a review of their current credit information. Management continuously monitors collections and payments from customers and maintains a provision for estimated credit losses based upon historical experience and any specific customer collection issues that have been identified. While such credit losses have historically been low and within expectations, there is no guarantee that we will continue to experience the same credit loss rates as in the past. A significant change in the liquidity or financial position of one of our major customers could have a material adverse impact on the collectibility of accounts receivable and future operating results.

## Inventory

We value our inventory at the lower of cost to manufacture or current estimated market value, whichever is less.

We follow a build to order business model; we manufacture product to ship against specific purchase orders, only rarely do we manufacture product in advance of anticipated purchase orders. In addition, 100% of our products are custom, meaning they are produced to a customer's blueprint and generally cannot be used for any other purpose. Purchase orders generally have cancellation provisions which vary from customer to customer, but which can result occasionally in CPS producing product which the customer is not obligated to purchase. However, once a product has gone into production most customer orders are recurring and order cancellations are very rare therefore no reserve is needed for obsolete inventory.

The level of inventory fluctuates for several reasons. Some customers place a blanket purchase order and then request that we maintain certain inventory levels so we can ship immediately upon receiving a shipment release from them. In other cases we may deliberately produce product for which the customer's shipment dates are in the future to more efficiently schedule production resources. Many customers provide us with forecasts and our inventory levels may fluctuate as we adjust production schedules to changes in customer forecasts.

In determining inventory value we use the first-in, first-out method and state inventory at the lower of cost or market. As a result of the fact that our inventory is customer specific, if a customer order is cancelled it is likely that we would be unable to sell inventory manufactured to meet that order to another customer. Likewise, if we did manufacture product in advance of anticipated purchase orders and those orders did not materialize, it is likely that we would be unable to sell that inventory to another customer. The value of our work in process and finished goods is based on the assumption that specific customers will take delivery of specific items of inventory. We have experienced no losses to date as a result of customer cancellations and we have no reserves against such cancellations.

## Property and Equipment

Property and equipment are stated at cost. Depreciation of equipment is calculated on a straight-line basis over the estimated useful life, generally five years for production equipment and three to five years for furniture and office equipment. Amortization of equipment under capital leases is calculated on a straight-line basis over the life of the lease. Maintenance and repairs are charged to expense as incurred. Upon retirement or sale, the cost and related accumulated depreciation or amortization are removed from their respective accounts. Any gains or losses on the disposition of property and equipment are included in the results of operations in the period in which they occur.

## Income Taxes

We record deferred tax assets and liabilities based on the net tax effects of tax credits, operating loss carryforwards and temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. We assess the likelihood that our deferred tax assets will be recovered from future taxable income and we establish a valuation allowance to reduce deferred tax assets to an amount which

we believe to be more likely than not realizable. The valuation allowance is based on our estimates of taxable income by jurisdiction in which we operate and the period over which our deferred tax assets will be recoverable.

### Results of Operations

Revenue in 2008 of \$14.8 million was 19% higher than 2007 revenue of \$12.4 million. The increase in revenue in 2008 came from higher demand for heat sinks for integrated circuits particularly in the first half of the year, higher demand for baseplates for motor controllers throughout the year, and from revenue in the fourth quarter from the Cooperative Agreement the Company entered into with the Army Research Laboratory in September.

The Cooperative Agreement is a four-year agreement which is 95% funded by the US Department of Defense and 5% funded by CPS. The Department of Defense funding is in support of the Future Combat System and is Manufacturing Technology ("ManTech") funding. The total estimated amount of the Cooperative Agreement is \$8.8 million, of which the total estimated Government funding is \$8.3 and the total estimated CPS funding is \$439 thousand. The funding is authorized on a yearly basis, and the first year government funding is \$1 million. The Cooperative Agreement became effective on September 2, 2008.

In 2008, research and development costs were incurred related to the Cooperative Agreement with the US Army. These costs consist of labor, including applicable overhead expenses, materials and other costs associated with our Cooperative Agreement. Total expenditures incurred in 2008 under this Cooperative Agreement amounted to \$376,014 of which \$310,451 is included in cost of research and development under cooperative agreement in the Statement of Income. \$357,213 of these costs were funded by the US Army in 2008 and is classified as research and development cooperative agreement revenues in the Statement of Income. The \$18,801 funded by CPS consists of \$16,340 of direct and indirect costs in connection with the contract included in costs of research and development under cooperative agreements and the Company's allocated portion of general and administrative expenses allowed under the contract included in selling, general and administrative expenses of \$2,461.

Revenue in 2007 of \$12.4 million increased by 5% from revenue in 2006 of \$11.9 million. The increase in demand in 2007 was the net effect of increases in demand for baseplates for motor controllers and certain heat sinks for integrated circuits in the first half of their life cycle, offset by lower demand for certain heat sinks for integrated circuits and baseplates for cellular telephone applications which are in the last half of their life cycle.

### Operating Costs

Total operating costs were \$13.4 million, \$11.5 million and \$10.4 million for the fiscal years 2008, 2007 and 2006, respectively.

Operating costs increased in 2008 compared to 2007 by \$1.9 million or 17% due to higher labor and material costs related to the higher shipment levels, costs incurred in connection with the Cooperative Agreement and to higher sales commissions paid to manufacturers representatives due to changes in product mix.

Operating costs increased in 2007 compared to 2006 by \$1.1 million or 11% due to changes in product mix, higher employment levels maintained in anticipation of growth, and slightly higher shipments.

Cost of sales for 2008, 2007 and 2006 were \$10.8 million, \$9.3 million and \$8.6 million respectively. In 2008, cost of sales for the Cooperative Agreement of \$310 thousand includes a portion of the 5% cost share from CPS of \$16 thousand. The increase in cost of sales in 2008 compared to 2007 was primarily the result of increases in labor and materials associated with increased shipments as well as the costs resulting from the Cooperative Agreement.

The increase in cost of sales in 2007 compared to 2006 was primarily the result of increases in labor and materials associated with increased shipments and changes in product mix.

Gross margins on product revenue for 2008, 2007 and 2006 were 27.2%, 24.9% and 27.5% respectively. The increase in gross margin on product revenue in 2008 was primarily the result of fixed costs being spread over a larger revenue base.

The decrease in gross margin in 2007 was primarily the result of changes in product mix.

Selling, general and administrative (SG&A) expenses for 2008, 2007 and 2006 were \$2.6 million, \$2.2 million and \$1.8 million, respectively. The increase in SG&A expense in 2008 compared to 2007 is primarily the result of increased sales compensation related to increased headcount in sales as well as increased sales commissions paid to manufacturers representatives.

The increase in SG&A expense in 2007 compared to 2006 is primarily the result of increased sales commissions (which in turn resulted from changes in product mix), increased sales compensation, and increased sales promotion.

#### Other Income and Expense, Net

The Company had net other expense of \$44 thousand, \$60 thousand and \$30 thousand for 2008, 2007 and 2006, respectively. These amounts were primarily interest expense for production equipment on capital leases, offset partially by interest income on cash balances.

#### Income Taxes

The Company recorded an income tax benefit of \$134 thousand in 2008 consisting of a deferred tax benefit of \$299 thousand resulting from most significantly the reduction in the valuation allowance provided on our net operating loss carryforwards based on our estimate of future taxable income offset by \$165 thousand of current federal and state tax expense. The current federal tax expense of \$27 thousand relates to alternative minimum tax. The Company incurred \$137 thousand of current state tax expense in 2008.

The Company recorded an income tax benefit of \$58 thousand in 2007 consisting of a deferred tax benefit of \$144 thousand resulting from most significantly the reduction in the valuation allowance provided on our net operating loss carryforwards based on our estimate of future taxable income offset by \$86 thousand of current federal and state tax expense. The current federal tax expense of \$22 thousand relates to alternative minimum tax. The Company incurred \$64 thousand of current state tax expense in 2007.

The Company recorded an income tax benefit of \$288 thousand in 2006 consisting of a deferred tax benefit of \$400 thousand resulting from the reduction in the valuation allowance provided on our net operating loss carryforwards based on our estimate of future taxable income offset by \$112 thousand of current federal and state tax expense. The current federal tax expense of \$29 thousand relates to alternative minimum tax.

Certain provisions of the Internal Revenue Code limit the annual utilization of net operating loss carryforwards if a change in ownership as defined, occurs. The Company believes that it did not have an ownership change as defined through the year ending December 27, 2008; therefore, at December 27, 2008 all net operating loss carryforwards are available to offset future taxable income.



Liquidity and Capital Resources

Cash on hand at year-end 2008 of \$1.16 million reflects a 145% increase from cash on hand at year-end 2007 of \$472 thousand. The increased cash is a result of higher revenues in 2008, particularly in the second quarter of 2008 compared to the same period a year ago, as well as cash conservation measures implemented by management in the third and fourth quarters of 2008 as world-wide macro economic conditions worsened. In 2008, the Company generated cash of \$1.7 million from operations and \$74 thousand from the issuance of common stock, but consumed \$742 thousand in purchases of property and equipment and made principal payments of \$353 thousand on its lease obligations.

Cash on hand at year-end 2007 of \$472 thousand reflects a 9% decrease from cash on hand at year-end 2006 of \$518 thousand. Management considers this difference in cash balances to be well within the range of normal business fluctuations. The Company has identified potential capital equipment purchases to effect process improvements and/or cost reductions, and management funds these projects as the cash balance allows. In 2007 the Company generated \$803 thousand from operations and \$21 thousand from the issuance of common stock, but consumed \$537 thousand in purchases of property and equipment and made principal payments of \$332 thousand on its lease obligations.

In May 2008, the Company renewed its \$1 million revolving line of credit and its \$1.5million lease line with Sovereign Bank. The line of credit is secured by the accounts receivable and other assets of the Company. The revolving line of credit has a one-year term although management believes it is likely that Sovereign Bank and the Company will renew the line at the end of the term. In 2008 there were no borrowings under this line of credit.

The \$1.5 million lease line with Sovereign Bank calls for a separate schedule for each item placed on the lease line. As of year-end 2008, the Company had \$653 thousand net carrying value of capital equipment financed by the Sovereign lease line, each schedule with a three-year term and a one-dollar buyout at the end of the term. As of year-end 2008 the Company had \$1.08 million available remaining on the Sovereign lease line.

Management believes that cash flows from operations, existing cash balances and the leasing and credit line in place with Sovereign Bank will be sufficient to fund our cash requirements for the foreseeable future. However, there is no assurance that we will be able to generate sufficient revenues or reduce certain discretionary spending in the event that planned operational goals are not met such that we will be able to meet our obligations as they become due.

Contractual Obligations

Our contractual obligations at year-end 2008 consist of the following:

Payments Due by Period

|   | <u>Total</u> | <u>Less than<br/>one year</u> | <u>1-3 years</u> | <u>4-5 years</u> | <u>More than<br/>5 years</u> |
|---|--------------|-------------------------------|------------------|------------------|------------------------------|
| Capital lease obligations, including interest | \$ 446,768   | \$ 287,619                    | \$ 159,149       | None             | None                         |
| Operating lease obligations                   | \$ 982,000   | \$ 118,750                    | \$ 386,000       | \$ 288,000       | \$ 189,250                   |

Off-Balance Sheet Arrangements

We have no off-balance sheet arrangements.

Recent Accounting Pronouncements

A summary of recent accounting standards is included in Note 2 to the financial statements.

Inflation

Inflation had no material effect on the results of operations or financial condition during 2008, 2007 or 2006. There can be no assurance however, that inflation will not affect our operations or business in the future.

Item 7A. Quantitative and Qualitative Disclosure about Market Risk

We are not significantly exposed to the impact of interest rate changes and foreign currency fluctuations. We have not used derivative financial instruments.

Item 8. Financial Statements and Supplementary Data

See Index to the Company's Financial Statements and the accompanying notes which are filed as part of this Annual Report on Form 10-K.

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

None.

Item 9A. Controls and Procedures

*Evaluation of Disclosure Controls and Procedures*

The Company maintains disclosure controls and procedures that are designed to ensure that information required to be disclosed in Securities and Exchange Commission reports is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms, and that such information is accumulated and communicated to the Company's management, including the Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

Under the direction of our Chief Executive Officer and Chief Financial Officer, management has carried out an evaluation of the effectiveness of the Company's disclosure controls and procedures as such item is defined in Rule 13a-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act"). Based on that evaluation, the Chief Executive Officer and Chief Financial Officer have concluded that these disclosure controls and procedures were effective as of December 27, 2008.

Changes in Internal Control over Financial Reporting

There were no changes in the Company's internal control over financial reporting in the fourth quarter of fiscal 2008 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

Item 9A(T) Controls and Procedures

Management's Report on Internal Control over Financial Reporting

Management is responsible for establishing and maintaining adequate internal control over financial reporting for the Company, as such term is defined in Rule 13a-15(f) of the Exchange Act. Internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with accounting principles generally accepted in the United States and includes those policies and procedures that (i) pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the Company's assets; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with accounting principles generally accepted in the United States, and that receipts and expenditures of the Company are being made only in accordance with authorizations of the Company's management and directors; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of the Company's assets that could have a material effect on the financial statements.

Because of its 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 direction of our Chief Executive Officer and Chief Financial Officer, management has assessed the effectiveness of the Company's internal control over financial reporting as of December 27, 2008. In making this assessment, management used the criteria set forth in the "Internal Control Integrated Framework" issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Based on this assessment, management concluded that the Company's internal control over financial reporting was effective as of December 27, 2008.

This annual report does not include an attestation report of the company's registered public accounting firm regarding internal control over financial reporting. Management's report was not subject to attestation by the company's registered public accounting firm pursuant to temporary rules of the Securities and Exchange Commission that permit the company to provide only management's report in this annual report.

#### Item 9B. Other Information

The Company had no information required to be disclosed in a report on Form 8-K during the fourth quarter of the year covered by this Form 10-K that has not been so reported.

### Part III

#### Item 10. Directors, Executive Officers and Corporate Governance

##### Board Members and Executive Officers

Directors of the Company are elected annually and hold office until the next annual meeting of stockholders and until their respective successors are duly elected and qualified. The executive officers of the Company are appointed by the Board of Directors and hold office until their respective successors are duly elected and qualified.

The names of the directors and executive officers of the Company and certain information about them as of December 29, 2007 are listed below.

| <u>Name</u>      | <u>Age</u> | <u>Position</u> |
|------------------|------------|-----------------|
| Grant C. Bennett | 54         |                 |

President, Chief Executive Officer, Treasurer and  
Director

Francis J. Hughes, Jr. 58 Director

Daniel Snow 37 Director

Mr. Grant C. Bennett has held the positions of President, Chief Executive Officer and Director and Treasurer of the Company since September, 1992. Prior to that time, he served as Vice President, Sales and Marketing of the Company from November, 1985 to September, 1992. Before joining CPS, Mr. Bennett was a consultant at Bain & Company, a Boston-based management consulting firm. Mr. Bennett has an MS degree from MIT.

Mr. Francis J. Hughes, Jr. has served as President of American Research and Development Corporation ("ARD"), a venture capital firm, since 1992. Mr. Hughes joined ARD's predecessor organization in 1982, and became Chief Operating Officer in 1990. Mr. Hughes has co-founded and served as a General Partner of the following venture capital funds: ARD I, L.P., ARD II, L.P. (July, 1985), ARD III, L.P. (April, 1988), Hospitality Technology Fund, L.P. (June, 1991) and Egan-Managed Capital, L.P. (February, 1997). Mr. Hughes has served as a Director of the Company since 1993. Mr. Hughes has an MS degree from MIT and an MBA from the Harvard Business School.

Dr. Daniel C. Snow has served on the faculty of the Harvard Business School since 2004, where he teaches a course on Operations Strategy. His research focuses on technological innovation, specifically furthering the understanding of the complex interplay between old and new technologies. Professor Snow holds an MBA from Brigham Young University's Marriott School of Management, and a PhD from the University of California, Berkeley. Professor Snow previously worked for Ford Motor Company as a financial analyst.

There are no family relationships between or among any executive officers or directors of the Company.

#### Board Independence

The Board has determined that Messrs. Hughes and Snow are independent as defined in Rule 4200(a)(15) of the National Association of Securities Dealers' listing standards.

#### Board Meetings and Attendance

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The Board held six meetings during the fiscal year ended December 27, 2008. Each Board member attended more than 75% of the meetings of the Board and of the committees on which he served which were held during the period for which he was a director or committee member.

#### Committees

The Board has an Audit Committee and a Compensation Committee, but not a Nominating Committee.

#### Audit Committee

The Company has a separately designated standing Audit Committee established in accordance with Section 3(a)(58)(A) of the Exchange Act. The members of the Audit Committee are Francis J. Hughes, Jr. and Daniel C. Snow. The Audit Committee met four times in fiscal 2008.

The Board of Directors has determined that Francis J. Hughes, Jr. and Daniel C. Snow are both audit committee financial experts as defined by Item 401(h) of Regulations S-K of the Securities Exchange Act of 1934, as amended (the "Exchange Act") and is independent within the meaning of Item 7(d)(3)(iv) of Schedule 14A of the Exchange Act.

#### Compensation Committee

Each member of the Compensation Committee is independent as defined in Rule 4200(a)(15) of the National Association of Securities Dealers' listing standards. The Compensation Committee makes recommendations concerning salaries and incentive compensation, awards equity compensation to employees and consultants under our equity incentive plans and otherwise determines compensation levels and performs other functions regarding compensation that are delegated by the Board. The members of the Compensation Committee are Daniel C. Snow and Francis J. Hughes, Jr. The Compensation Committee met two times in fiscal 2008.

#### *Selection of New Directors*

The Board does not have a nominating committee. The Board itself is responsible for selecting its own members and recommending them for election by the shareholders.

#### Shareholder Communication with the Board of Directors

Any shareholder who desires to communicate with the Board, non-management directors as a group, or any individual director, may send a letter addressed to the same, c/o VP Administration, CPS Technologies Corporation, 111 South Worcester Street, Norton, MA 02766. The VP Administration has been instructed by the Board to forward such communication directly to the addressee(s) unopened.

#### Directors' Compensation

The Company adopted the 1999 Stock Incentive Plan ("1999 Plan") on January 22, 1999. Under the terms of the 1999 Plan, all of the Company's employees, officers, directors, consultants and advisors are eligible to be granted options, restricted stock awards, or other stock-based awards. In 2008, upon his election to the Board of Directors, Dr. Snow was granted options to purchase 8,000 shares of the Company's common stock. The options granted are nonstatutory stock options exercisable at the fair market value of the stock on the date of grant one year from the date of grant, and expire ten years from the date of grant. The 1999 Plan includes provisions for the acceleration of vesting in the event of a change in control of the Company. The Company measures the fair value of the stock awards on the date of grant and the cost is recognized over the requisite service period.

Outside directors may receive expense reimbursements for attending board and committee meetings. Directors who are officers or employees of the Company do not receive any additional compensation for their services as directors.

#### Code of Ethics

We have adopted a code of business conduct and ethics for directors, officers, (including the principal executive officer, principal financial officer and treasurer) and employees, known as the CPS Code of Conduct. The CPS Code of Conduct is available by contacting our human resource department.

#### Item 11. Executive Compensation

## Executive Officer Summary Compensation Table

The following table shows compensation earned during the three most recent fiscal years by our chief executive officer, chief financial officer, and all other officers whose salary and bonus exceeded \$100,000. Grant Bennett is both our chief executive officer and chief financial officer. For the purpose of executive compensation and related person disclosure, we refer to these individuals collectively as the Named Executive Officers.

## NAMED EXECUTIVE OFFICER SUMMARY COMPENSATION TABLE

| Name &<br><u>Position</u> | <u>Year</u> | Salary<br><u>(\$)</u> | Bonus<br><u>(\$)</u> | Stock<br>Awards<br><u>(\$)</u> | Option<br>Awards<br><u>(\$)</u> | Non-Equity<br>Incen-tive Plan<br>Com-pen-sation<br><u>(\$)</u> | Change in<br>Pension Value<br>and Non                          | All Other<br>Com-pen-sation<br><u>(\$)</u> |
|---------------------------|-------------|-----------------------|----------------------|--------------------------------|---------------------------------|--|--|--|
|                           |             |                       |                      |                                |                                 |  | qualified<br>Deferred<br>Com-pensation<br>Earnings <u>(\$)</u> |  |
| Grant                     | 2008        | \$136,298             | \$20,051             | \$0                            | \$0                             | \$0  | \$0  | \$0  |
| Bennett                   | 2007        | \$131,251             | --                   | \$0                            | \$0                             | \$0  | \$0  | \$0  |
| CEO, CFO                  | 2006        | \$126,742             | \$70,000             | \$0                            | \$0                             | \$0  | \$0  | \$0  |
| Richard                   | 2008        | \$134,789             | \$10,051             | \$0                            | \$0                             | \$0  | \$0  | \$0  |
| Adams                     | 2007        | \$125,841             | --                   | \$0                            | \$0                             | \$0  | \$0  | \$0  |
| VP<br>Operations          | 2006        | \$104,761             | \$36,420             | \$0                            | \$0                             | \$0  | \$0  | \$0  |
| Mark                      | 2008        | \$104,677             | \$5,054              | \$0                            | \$0                             | \$0  | \$0  | \$0  |
| Occhionero                | 2007        | \$100,901             | --                   | \$0                            | \$0                             | \$0  | \$0  | \$0  |
| VP<br>Marketing           | 2006        | \$ 97,015             | \$16,765             | \$0                            | \$0                             | \$0  | \$0  | \$0  |
| Cheryl                    | 2008        | \$95,885              | \$5054               | \$0                            | \$0                             | \$0  | \$0  | \$0  |
| Oliveira                  | 2007        | \$87,716              | --                   | \$0                            | \$0                             | \$0  | \$0  | \$0  |
| VP Sales                  | 2006        | \$82,339              | \$10,270             | \$0                            | \$0                             | \$0  | \$0  | \$0  |

Change-of-Control Agreements

None of the Named Executive Officers described in the Summary Compensation Table above have entered into a change-of-control agreement with the Company. All options granted to all employees, including the officers listed above, are subject to accelerated vesting in the event of a change of control as described in the option plans.

Stock

**Option Grants And Exercises**

No stock options were granted to Named Executive Officers or any other Company employees in fiscal 2008.

In fiscal 2008 a total of 8,000 stock options were granted to Daniel C. Snow upon his election to the Company's Board of Directors.

No stock options were exercised by Named Executive Officers during fiscal 2008.

AGGREGATED OPTION EXERCISES IN FISCAL 2008  
AND FISCAL 2008 YEAR END OPTION VALUES FOR  
NAMED EXECUTIVE OFFICERS

| <u>Name</u>        | Shares<br>Acquired<br>On<br>Exercise<br>(#) | Value<br>Realized<br>(\$) | Number of Securities Underlying Unexercised Options<br>at December 27, 2008 |                        |  | Value of Unexercised<br>In-the-Money Options at<br>December 27, 2008 |              |                     |
|--------------------|---|---------------------------|---|------------------------|--|--|--------------|---------------------|
|                    |   |                           | Exer-cisable  | Exer-cise<br>Price     | Expir-ation<br>Date                                  | Un-<br>exer-cisable  | Exer-cisable | Un-<br>exer-cisable |
| Grant<br>Bennett   | 0   | \$0                       | 0   | --                     | --   | 0  | \$0          | \$0                 |
| Richard<br>Adams   | 0   | \$0                       | 348,750   | \$0.30<br>to<br>\$1.25 | August 20,<br>2009<br>through<br>January<br>12, 2015 | 0  | \$216,912    | \$0                 |
| Mark<br>Occhionero | 0   | \$0                       | 165,500   | \$0.30<br>to<br>\$1.25 | August<br>20,2009<br>Through<br>January              | 0  | \$102,225    | \$0                 |

12, 2015

|                 |   |     |        |        |                |   |   |     |
|-----------------|---|-----|--------|--------|----------------|---|---|-----|
| Cheryl Oliveira | 0 | \$0 | 50,000 | \$1.37 | August 8, 2015 | 0 | 0 | \$0 |
|-----------------|---|-----|--------|--------|----------------|---|---|-----|

The value of unexercised in-the-money options is based on the fair market value of our common stock as of December 27, 2008 of \$1.20 per share, minus the exercise price, multiplied by the number of shares underlying the option.

#### Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

The following table sets forth certain information, as of December 27, 2008, with respect to the beneficial ownership of the Company's Common Stock by (i) each person known by the Company to own beneficially more than 5% of the outstanding shares of Common Stock, (ii) each Director of the Company, (iii) each Executive Officer of the Company named above in the Summary Compensation Table, and (iv) all Directors and Officers as a group:

| <u>Name and Address of Beneficial Owner</u>   | <u>Common Stock Beneficially Owned</u> | <u>Notes (1)</u> | <u>Percentage of Shares of Common Stock Outstanding</u> |
|---|--|------------------|---|
| ARD Master, L.P.<br>85 Devonshire Street<br>6 <sup>th</sup> Floor<br>Boston, MA 02109 | 2,184,789                              | (2)              | 17.3%   |
| Norman J. Wechsler<br>P.O. Box 5123<br>Mt. Crested Butte, CO 81225                    | 1,530,629                              | (3)              | 12.1%   |
| <b>DIRECTORS AND OFFICERS:</b>  |  |                  |   |
| Grant C. Bennett<br>Director & Officer  | 1,576,554                              |                  | 12.5%   |
| Richard W. Adams<br>Vice President Operations and<br>Engineering                      | 383,750                                | (4)              | 3.0%  |
| Mark A. Occhionero<br>Vice President Marketing and Senior<br>Scientist                | 180,900                                | (5)              | 1.4%  |
| Cheryl Oliveira   | 50,000                                 | (6)              | *   |



## Vice President Sales

|  |           |     |       |
|--|-----------|-----|-------|
| Daniel C. Snow<br>Director                           | 8,000     | (7) | *     |
| Francis J. Hughes, Jr.<br>Director                   | 2,256,789 | (8) | 17.8% |
|  | -----     |     | ----- |
| All directors and officers<br>as a group (6 persons) | 4,455,993 | (9) | 35.2% |
|  | =====     |     | ===== |

\*Less than 1% of the total number of outstanding shares of Common Stock.

1. The inclusion herein of any shares of Common Stock deemed beneficially owned does not constitute an admission of beneficial ownership of those shares. Unless otherwise indicated, each stockholder referred to above has sole voting and investment power with respect to the shares listed.
2. Consists of 2,184,789 shares owned by ARD Master L.P., Excludes options to purchase 72,000 shares of common stock held by Mr. Hughes.
3. Consists of 59,200 shares owned by WCI and 1,471,429 shares owned by CYB Master LLC. Mr. Wechsler may be deemed to be the beneficial owner of these shares by virtue of being the sole person in a position to direct the voting and investment decisions of both CYB and WCI.
4. Consists of 35,000 shares owned by Mr. Adams and options to purchase 348,750 shares of common stock.
5. Consists of 15,400 shares owned by Dr. Occhionero and options to purchase 165,500 shares of common stock.
6. Consists of options to purchase 50,000 shares of common stock.
7. Consists of options to purchase 8,000 shares of common stock
8. Consists of shares described in Footnote 2 above owned by ARD Master, L.P., and options to purchase 72,000 shares of common stock held by Mr. Hughes.
9. Consists of all shares and options to purchase shares owned by Messrs. Hughes, Snow, Bennett, Adams, Occhionero and Ms. Oliveira.

## Compliance with Section 16(a) of the Exchange Act

Section 16(a) of the Securities Exchange Act of 1934 requires our directors, executive officers, and persons who own more than ten percent of a registered class of our equity securities to file with the Securities and Exchange Commission initial reports of ownership and reports of changes in ownership of our common stock and other equity securities. Officers, directors and greater than ten percent stockholders are required by Securities and Exchange Commission regulations to furnish us with copies of all Section 16(a) forms they file.

To our knowledge, based solely on a review of the copies of the reports furnished to us and written representations that no other reports were required, during the fiscal year ended December 27, 2008, all Section 16(a) filing requirements applicable to our officers, directors and greater than ten percent stockholders were complied with and no reports or transactions were filed late.

COMPENSATION COMMITTEE REPORT

## General

Compensation of our senior executives is determined by the Compensation Committee of the Board, or the Committee. The Committee, comprised entirely of independent directors as defined in Rule 4200(a)(15) of the National Association of Securities Dealers' listing standards, meets to set annual salaries in advance and bonuses for the current year, to review annual goals and to reward outstanding annual performance of executive officers and to grant stock options pursuant to our stock plans. The Committee has considered executive officers' compensation matters at several meetings in 2008. During those meetings, the Committee consulted with senior management, reviewed and approved corporate goals and objectives relevant to compensation matters, evaluated the performance of certain executives and considered, among other factors, third party studies of executive compensation for comparable companies, and the Company's performance and relative stockholder return. The results of some of the actions taken from those meetings are included under the heading "*Executive Officer Compensation*" in Form 10-K.

While management may have been present during a part of Committee discussions regarding officers' compensation during the last fiscal year, Committee decisions with respect to the compensation of our Chief Executive Officer and other executives were reached in private session without the presence of any member of management.

Stockholder comments to the Committee are welcomed and should be addressed to the Secretary of the Company at our principal executive office.

## Compensation Philosophy

Our primary goal is to align compensation with our business objectives and performance. Our aim is to attract, retain and reward executive officers and other key employees who contribute to our long-term success and to motivate those individuals to enhance long-term stockholder value. To establish this relationship between executive compensation and the creation of stockholder value, the Board has adopted a total compensation package comprised of base salary, bonus and stock option awards. Key elements of this compensation package are:

- We intend to pay competitively with leading companies with which we compete for talent.
- We maintain annual incentive opportunities sufficient to provide motivation to achieve specific operating goals and to generate rewards that are intended to bring total compensation to competitive levels.
- We provide meaningful equity-based incentives for executives and other key employees to ensure that individuals are motivated over the long-term to respond to our business challenges and opportunities as owners and not just as employees.

## Base Salary

The Committee reviews each executive officer's base salary on an annual basis. Among those factors taken into consideration in setting salaries for executives are (1) individual and corporate performance, (2) level of responsibility, (3) prior experience, (4) breadth of knowledge of the industry, and (5) competitive pay practices.

## Bonus

We believe that executive performance may be maximized through a system of incentive awards. Toward this end, the Committee adopted several years ago a discretionary cash incentive plan and has paid bonuses some years and not paid bonuses some years. For all cash incentive arrangements, the award earned depends primarily on the extent to which our performance objectives are achieved. Each fiscal year the Committee will review and approve our annual performance objectives and our executive officers' performance. Our objectives consist of operating, strategic and financial goals that are considered to be critical to our overall goal: building stockholder value. For the fiscal year ended December 27, 2008, the Committee had determined that the primary goal in building stockholder value was meeting sales growth and profit targets.

Long-Term Incentives

Our long-term incentive program presently consists of our 1999 Stock Incentive Plan.

Chief Executive Officer Compensation

The annual salary of Mr. Bennett was established by the Committee in 2000 at \$132,000 and has not changed since that time. Actual amounts paid for salary in each fiscal year as reported above have deviated from that amount due to timing of the biweekly payroll. Several years ago Mr. Bennett recommended to the Committee that no stock options be awarded to him because his stock ownership position already firmly aligned his interests with those of the Company, and the options thereby made available could be awarded to other members of the management team; the Committee accepted Mr. Bennett's recommendation and since becoming CEO he has not been awarded any options.

Mr. Bennett's salary and bonus will continue to be evaluated at least annually by the Committee, and any changes will be determined in accordance with the criteria described under the headings "*Base Salary*," "*Bonus*," and "*Long-Term Incentives*" in this report, and otherwise reflect the Committee's assessment of (1) his performance, (2) his skills in relation to other CEO's in our industry, (3) its confidence in his ability to lead our continued development, and (4) his broad involvement in our operations.

Certain Tax Considerations

Section 162(m) of the Internal Revenue Code may limit us to a deduction for federal income tax purposes of not more than \$1 million of compensation paid to certain executive officers in a taxable year, if considered unreasonable. No employee's compensation exceeded \$1 million and the Committee believes it is highly unlikely any employee's covered compensation will exceed this amount in the foreseeable future.

Compensation Committee Interlocks and Insider Participation

As discussed in the report above, Grant Bennett our President, Chief Executive Officer and Treasurer, is not a member of the Committee but participated in the deliberations of the Board concerning executive officer compensation, except where the decision directly involved his own compensation package.

From the members of the Compensation Committee:

- Daniel C. Snow (Chairman)
- Francis J. Hughes, Jr.

Item 13. Certain Relationships and Related Transactions

None.

Item 14. Principal Accounting Fees and Services.

Fees paid to the Company's independent accountants in the last two fiscal years are:

|            | <u>Wolf &amp; Company PC</u> |             |
|------------|------------------------------|-------------|
|            | <u>2008</u>                  | <u>2007</u> |
| Audit fees | \$ 77,400                    | \$ 74,250   |
|            | =====                        | =====       |

Audit Fees consist of aggregate fees for professional services rendered for the audit of our annual financial statements and review of the interim financial statements included in quarterly reports or services that are normally provided by the independent auditor in connection with statutory and regulatory filings or engagements for the fiscal years ended December 27, 2008 and December 29, 2007, respectively.

Policy on Audit Committee Pre-Approval of Audit and Permissible Non-Audit Services of Independent Auditors.

At present, our Audit Committee approves each engagement for audit or non-audit services before we engage Wolf & Company, P.C.(Wolf & Company) to provide those services. Our audit committee has not established any pre-approval policies or procedures that would allow our management to engage Wolf & Company to provide any specified services with only an obligation to notify the audit committee of the engagement for those services. None of the services provided by Wolf & Company for fiscal 2008 was obtained in reliance on the waiver of the pre-approval requirement afforded in SEC regulations.

AUDIT COMMITTEE REPORT

Our Audit Committee consists of two independent members of the Board of Directors as defined in Rule 4200(a)(15) of the National Association of Securities Dealers` listing standards.

The primary purpose of the Audit Committee is to assist the Board in fulfilling its responsibility to oversee management`s conduct of our financial reporting process, including the process of preparing the financial reports and other financial information we provide to any governmental or regulatory body, the public or other users thereof, our systems of internal accounting and financial controls, the annual independent audit of our financial statements and our legal compliance and ethics programs as established by management and the Board. Management is responsible for the preparation, presentation, and integrity of our financial statements, accounting and financial reporting principles, internal controls, and procedures designed to ensure compliance with accounting standards, applicable laws and regulations. The independent auditors are responsible for auditing our financial statements and expressing an opinion as to their conformity with generally accepted accounting principles.

The Audit Committee has reviewed and discussed the audited financial statements for the fiscal year ended December 27, 2008 with management. Furthermore, the Audit Committee has discussed with Wolf & Company, P.C., our independent auditors for the fiscal year ended December 27, 2008, the matters required to be discussed by Statement on Auditing Standards No. 61. The Audit Committee has received the written disclosures from Wolf & Company, P.C., required by Independence Standards Board Standard No. 1 and has discussed with Wolf & Company, P.C., such auditing firm`s independence.

Based on these reviews and discussions, the Audit Committee recommended to the Board that the audited financial statements be included in this, our Annual Report on Form 10-K for the fiscal year ended December 27, 2008.

The Audit Committee has also recommended to the Board the selection of Wolf & Company, P.C., as the Company`s independent auditors for the fiscal year ending December 26, 2009, and the Board has approved that recommendation.

From the members of the Audit Committee:

Francis J. Hughes, Jr. (Chairman)

Daniel C. Snow

Part IV

Item 15. Exhibits, Financial Statement Schedules.

(a) Documents filed as part of this Form 10-K.

1. Financial Statements

The financial statements filed as part of this Form 10-K are listed on the Index to Financial Statements of this Form 10-K.

2. Exhibits

The exhibits to this Form 10-K are listed on the Exhibit Index of this Form 10-K.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

CPS TECHNOLOGIES CORPORATION

By: /s/ Grant C. Bennett  
President  
March 27, 2009

Pursuant to the Requirements of the Securities Act of 1934, this report has been signed by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

| <u>Signature</u>                                       | <u>Title</u>   | <u>Date</u>    |
|--|--|----------------|
| <u>/s/ Grant C. Bennett</u><br>Grant C. Bennett        | President, Treasurer and Director<br>(Principal Executive Officer) | March 27, 2009 |
| <u>/s/ Francis J. Hughes, Jr.</u><br>Francis J. Hughes | Director   | March 27, 2009 |
| <u>/s/ Daniel C. Snow</u><br>Daniel C. Snow            | Director   | March 27, 2009 |

CPS TECHNOLOGIES CORPORATION  
EXHIBIT INDEX

| Exhibit No. | Description   |
|-------------|---|
| 3.1*        | Restated Certificate of Incorporation of the Company, as amended, is incorporated herein by reference to Exhibit 3 to the Company's Registration Statement on Form 8-A (File No. 0-16088)             |
| 3.2*        | By-laws of the Company, as amended, are incorporated herein by reference to Exhibit 3.2 to the Company's Registration Statement on Form S-1 (File No. 33-14616)(the '1987 S-1Registration Statement') |
| 4.1*        | Specimen certificate for shares of Common Stock of the Company is incorporated herein by reference to Exhibit 4 to the 1987 S-1 Registration Statement  |
| 4.2*        | Description of Capital Stock contained in the Restated Certificate of Incorporation of the Company, as amended, filed as Exhibit 3.1  |
| 10.5*(1)    | Retirement Savings Plan, effective September 1, 1987 is incorporated by reference to Exhibit 10.35 to the Company's 1989 S-1 Registration Statement   |
| 10.21*      | 1999 Stock Incentive Plan adopted by the Company's Board of Directors on January 22, 1999   |
| 23.1        | Consent of Wolf & Company, P.C.   |
| 31.1        | Certification Pursuant to Exchange Act Rule 13a-14(a), as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.  |
| 32.1        | Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.   |

\* Incorporated herein by reference.

(1) Management Contract or compensatory plan or arrangement filed as an exhibit to this Form pursuant to Items 14(a) and 14(c) of Form 10-K.

INDEX TO FINANCIAL STATEMENTS  
OF  
CPS TECHNOLOGIES CORPORATION

Report of Independent Registered Public Accounting Firm

Balance Sheets as of December 27, 2008 and December 29, 2007

Statements of Income for the years ended December 27, 2008, December 29, 2007  
and December 30, 2006

Statements of Stockholders` Equity for the years ended December 27, 2008,  
December 29, 2007 and December 30, 2006

Statements of Cash Flows for the years ended December 27, 2008, December 29,  
2007 and December 30, 2006

Notes to Financial Statements

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders,  
CPS Technologies Corporation  
Norton, Massachusetts

We have audited the accompanying balance sheets of CPS Technologies Corporation as of December 27, 2008 and December 29, 2007 and the related statements of income, stockholders` equity and cash flows for each of the three years in the period ended December 27, 2008. These financial statements are the responsibility of the Corporation`s management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of CPS Technologies Corporation as of December 27, 2008 and December 29, 2007, and the results of its operations and its cash flows for each of the three years in the period ended December 27, 2008, in conformity with accounting principles generally accepted in the United States of America.

/s/ Wolf & Company, P.C.  
Boston, Massachusetts  
March 27, 2009

CPS TECHNOLOGIES CORPORATION  
BALANCE SHEETS

|   | December 27,<br>2008 | December 29,<br>2007 |
|---|----------------------|----------------------|
| ASSETS  | -----                | -----                |
| Current assets:   |                      |                      |
| Cash and cash equivalents   | \$ 1,158,419         | \$ 472,059           |
| Accounts receivable-trade,<br>net of allowance for doubtful accounts<br>of \$5,461 as of December 27, 2008 and<br>December 27, 2007 | 2,139,688            | 2,389,672            |
| Inventories   | 1,689,700            | 1,416,264            |
| Prepaid expenses  | 65,954               | 54,791               |
| Deferred taxes  | 843,155              | 544,000              |
|   | -----                | -----                |
| Total current assets  | 5,896,916            | 4,876,786            |
|   | -----                | -----                |
| Property and equipment:   |                      |                      |
| Production equipment  | 5,859,635            | 5,316,228            |
| Furniture and office equipment  | 262,976              | 211,984              |
|   | -----                | -----                |
| Total cost  | 6,122,611            | 5,528,212            |
| Accumulated depreciation<br>and amortization  | (4,054,105)          | (3,454,899)          |
| Construction in progress  | 401,587              | 56,962               |
|   | -----                | -----                |
| Net property and<br>equipment   | 2,470,093            | 2,130,275            |
|   | -----                | -----                |
| Total assets  | \$8,367,009          | \$7,007,061          |
|   | =====                | =====                |

(continued)

See accompanying notes to financial statements.

CPS TECHNOLOGIES CORPORATION  
BALANCE SHEETS



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|   | December 27,<br>2008 | December 29,<br>2007 |
|---|----------------------|----------------------|
| LIABILITIES AND STOCKHOLDERS`   |                      |                      |
| EQUITY  | -----                | -----                |
| Current liabilities:  |                      |                      |
| Accounts payable  | \$ 288,934           | \$ 508,129           |
| Accrued expenses  | 680,707              | 488,047              |
| Current portion of obligations<br>under capital leases  | 264,489              | 331,233              |
|   | -----                | -----                |
| Total current liabilities   | 1,234,130            | 1,327,409            |
| Obligations under capital<br>leases less current portion  | 152,193              | 273,638              |
|   | -----                | -----                |
| Total liabilities   | 1,386,323            | 1,601,047            |
|   | -----                | -----                |
| Stockholders` Equity  |                      |                      |
| Common stock, \$0.01 par value,<br>authorized 15,000,000 shares;<br>issued 12,647,842 shares<br>at December 27, 2008<br>and 12,574,842 shares at<br>December 29, 2007 | 126,479              | 125,749              |
| Additional paid-in capital  | 32,904,670           | 32,805,064           |
| Accumulated deficit   | (25,989,628)         | (27,463,964)         |
| Less cost of 22,883 common shares repurchased   | (60,835)             | (60,835)             |
|   | -----                | -----                |
| Total stockholders` equity  | 6,980,686            | 5,406,014            |
|   | -----                | -----                |
| Total liabilities and stockholders`<br>equity   | \$ 8,367,009         | \$ 7,007,061         |
|   | =====                | =====                |

See accompanying notes to financial statements.

CPS TECHNOLOGIES CORPORATION  
STATEMENTS OF INCOME  
FOR THE YEARS ENDED DECEMBER 27, 2008, DECEMBER 29, 2007,

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AND DECEMBER 30, 2006

|  | 2008          | 2007          | 2006          |
|--|---------------|---------------|---------------|
|  | -----         | -----         | -----         |
| Revenues:  |               |               |               |
| Product sales  | \$ 14,455,874 | \$ 12,446,569 | \$ 11,907,701 |
| Research and development under<br>cooperative agreement          | 357,213       | --            | --            |
|  | -----         | -----         | -----         |
| Total revenues   | 14,813,087    | 12,446,569    | 11,907,701    |
| Cost of product sales  | 10,517,846    | 9,346,100     | 8,634,156     |
| Cost of research and development<br>under cooperative agreement  | 310,451       | --            | --            |
|  | -----         | -----         | -----         |
| Gross Margin   | 3,984,790     | 3,100,469     | 3,273,545     |
| Selling, general, and<br>administrative                          | 2,600,411     | 2,150,162     | 1,753,326     |
|  | -----         | -----         | -----         |
| Income from operations   | 1,384,379     | 950,307       | 1,520,219     |
| Other expense, net   | (44,464)      | (60,109)      | (30,164)      |
|  | -----         | -----         | -----         |
| Income before income tax   | 1,339,915     | 890,198       | 1,490,055     |
| Income tax benefit   | (134,421)     | (58,400)      | (288,000)     |
|  | -----         | -----         | -----         |
| Net income   | \$ 1,474,336  | \$ 948,598    | \$ 1,778,055  |
|  | =====         | =====         | =====         |
| Net income per<br>basic common share                             | \$ 0.12       | \$ 0.08       | \$ 0.14       |
| Weighted average number of<br>basic common shares<br>outstanding | 12,612,990    | 12,542,962    | 12,472,778    |
| Net income per<br>diluted common share                           | \$ 0.11       | \$ 0.07       | \$ 0.14       |
| Weighted average number of<br>diluted common shares              |               |               |               |

outstanding 13,242,707 13,298,687 13,066,641

See accompanying notes to financial statements.

CPS TECHNOLOGIES CORPORATION  
STATEMENTS OF STOCKHOLDERS' EQUITY  
FOR THE YEARS ENDED DECEMBER 27, 2008, DECEMBER 29, 2007,  
AND DECEMBER 30, 2006

|  | Common stock        |              | Additional<br>Paid-in<br>capital | Accumulated<br>deficit | Stock<br>repurchased | Stock-<br>holders'<br>equity |
|--|---------------------|--------------|----------------------------------|------------------------|----------------------|------------------------------|
|  | Number<br>of shares | Par<br>Value |                                  |                        |                      |                              |
| Balance at<br>December 31,<br>2005   | 12,349,092          | 123,491      | 32,679,094                       | (30,190,617)           | (60,835)             | 2,551,133                    |
| Share-based<br>compensation<br>expense   | --                  | --           | 1,751                            | --                     | --                   | 1,751                        |
| Tax benefit<br>from<br>share-based<br>compensation                               | --                  | --           | 15,000                           | --                     | --                   | 15,000                       |
| Issuance of<br>common<br>stock pursuant<br>to<br>exercise of<br>stock<br>options | 195,750             | 1,958        | 33,277                           | --                     | --                   | 35,235                       |
| Net Income   | --                  | --           | --                               | 1,778,055              | --                   | 1,778,055                    |
| Balance at<br>December 30,<br>2006   | 12,544,842          | 125,449      | 32,729,122                       | (28,412,562)           | (60,835)             | 4,381,174                    |
| Share-based<br>compensation<br>expense   | --                  | --           | 52,086                           | --                     | --                   | 52,086                       |

|  |            |            |               |                 |             |              |
|--|------------|------------|---------------|-----------------|-------------|--------------|
| Tax benefit from share-based compensation                      | --         | --         | 3,606         | --              | --          | 3,606        |
| Issuance of common stock pursuant to exercise of stock options | 30,000     | 300        | 20,250        | --              | --          | 20,550       |
| Net Income   | --         | --         | --            | 948,598         | --          | 948,598      |
|  | -----      | -----      | -----         | -----           | -----       | -----        |
| Balance at December 29, 2007                                   | 12,574,842 | \$ 125,749 | \$ 32,805,064 | \$ (27,463,964) | \$ (60,835) | \$ 5,406,014 |
| Share-based compensation expense                               | --         | --         | 19,877        | --              | --          | 19,877       |
| Tax benefit from share-based compensation                      | --         | --         | 6,819         | --              | --          | 6,819        |
| Issuance of common stock pursuant to exercise of stock options | 73,000     | 730        | 72,910        | --              | --          | 73,640       |
| Net Income   | --         | --         | --            | 1,474,336       | --          | 1,474,336    |
|  | -----      | -----      | -----         | -----           | -----       | -----        |
| Balance at December 27, 2008                                   | 12,647,842 | \$ 126,479 | \$ 32,904,670 | \$ (25,989,628) | \$ (60,835) | \$ 6,980,686 |

=====

See accompanying notes to financial statements.

CPS TECHNOLOGIES CORPORATION  
 STATEMENTS OF CASH FLOWS  
 FOR THE YEARS ENDED DECEMBER 27, 2008, DECEMBER 29, 2007,  
 AND DECEMBER 30, 2006

|   | 2008         | 2007         | 2006         |
|---|--------------|--------------|--------------|
|   | -----        | -----        | -----        |
| Cash flows from operating activities:   |              |              |              |
| Net income  | \$ 1,474,336 | \$ 948,598   | \$ 1,778,055 |
| Adjustments to reconcile net income<br>to cash provided by operating<br>activities: |              |              |              |
| Share-based compensation  | 26,696       | 55,692       | 16,751       |
| Depreciation and amortization   | 599,206      | 488,949      | 395,028      |
| Deferred taxes  | (299,155)    | (144,000)    | (400,000)    |
| Changes in operating assets and liabilities:  |              |              |              |
| Accounts receivable - trade   | 249,984      | 528,484      | (1,685,068)  |
| Inventories   | (273,436)    | (554,237)    | (115,284)    |
| Prepaid expenses  | (43,380)     | (20,293)     | 17,208       |
| Accounts payable  | (219,195)    | (473,422)    | 668,722      |
| Accrued expenses  | 192,660      | (26,539)     | 234,229      |
|   | -----        | -----        | -----        |
| Net cash provided by operating<br>activities  | \$ 1,707,716 | \$ 803,232   | \$ 909,641   |
|   | -----        | -----        | -----        |
| Cash flows from investing activities:   |              |              |              |
| Purchases of property and equipment   | (741,677)    | (537,076)    | (954,369)    |
|   | -----        | -----        | -----        |
| Net cash used in<br>investing activities  | \$ (741,677) | \$ (537,076) | \$ (954,369) |
|   | -----        | -----        | -----        |
| Cash flows from financing activities:   |              |              |              |
| Payment of capital lease obligations  | (353,319)    | (332,187)    | (220,509)    |
| Proceeds from issuance of common<br>stock   | 73,640       | 20,550       | 35,235       |
|   | -----        | -----        | -----        |
| Net cash used in financing activities   | \$ (279,679) | \$ (311,637) | \$ (185,274) |
|   | -----        | -----        | -----        |
| Net increase (decrease) in cash and cash equivalents                                | 686,360      | (45,481)     | (230,002)    |

|  |              |            |            |
|--|--------------|------------|------------|
| Cash and cash equivalents at beginning of year           | 472,059      | 517,540    | 747,542    |
|  | -----        | -----      | -----      |
| Cash and cash equivalents at end of year                 | \$ 1,158,419 | \$ 472,059 | \$ 517,540 |
|  | =====        | =====      | =====      |
| Supplemental cash flow information:                      |              |            |            |
| Acquisition of production equipment under capital leases | \$ 165,130   | \$ 425,717 | \$ 205,914 |
| Prepaid expenses transferred to equipment                | \$ 32,217    | --         | --         |
| Income taxes paid  | \$ 79,459    | \$ 150,298 | \$ 27,862  |
| Interest paid  | \$ 44,960    | \$ 61,608  | \$ 30,164  |

See accompanying notes to financial statements.

CPS Technologies Corporation  
Years Ended December 27, 2008, December 29, 2007, and December 30, 2006  
Notes to Financial Statements

#### (1) Nature of Business

The Company provides advanced material solutions to the electronics, robotics, automotive and other industries. The Company's primary advanced material solution is metal matrix composites which are a combination of metal and ceramic.

CPS also assembles housings and packages for hybrid circuits. These housings and packages may include components made of metal-matrix composites or they may include components made of more traditional materials such as aluminum, copper-tungsten, etc.

The Company sells into several end markets including the wireless communications infrastructure market, high-performance microprocessor market, motor controller market, and other microelectronic and structural markets. In 2008 the Company also entered into a cooperative agreement with the U.S. Army to further develop its composite technology to produce armor.

#### (2) Summary of Significant Accounting Policies

##### (2)(a) Principles of Consolidation

Prior to March 2007, the consolidated financial statements included the accounts of Ceramics Process Systems (the "Company") and its wholly-owned subsidiary, CPS Superconductor Corporation ("CPSS"). All intercompany balances and transactions have been eliminated in consolidation.

In March 2007, CPS Superconductor Corporation was renamed CPS Technologies Corporation, and the parent Company, Ceramics Process Systems Corporation, was merged into it. This resulted in the Company assuming the name CPS Technologies Corporation, and Ceramics Process Systems Corporation ceasing to exist.

This merger between entities under common control had no effect on the financial statements of the consolidated Company.

##### (2)(b) Cash and Cash Equivalents

The Company considers all highly liquid investments with a maturity of three months or less at the date of purchase to be cash equivalents.

(2)(c) Accounts Receivable

The Company reports its accounts receivable at the invoiced amount less an allowance for doubtful accounts. The Company's management provides appropriate provisions for uncollectible accounts based upon factors surrounding the credit risk and activity of specific customers, historical trends, economic conditions and other information. Adjustments to the allowance are charged to operations in the period in which information becomes available that may affect the allowance.

(2)(d) Inventories

Inventories are stated at the lower of cost, as determined under the first-in, first-out method (FIFO), or market. A reserve for obsolete inventories, if any, is based on factors regarding the sales and usage of such inventories, including inventories manufactured for specific customers.

(2)(e) Property and Equipment

Property and equipment are stated at cost. Depreciation of equipment is calculated on a straight-line basis over the estimated useful life, generally five years for production equipment and three to five years for furniture and office equipment. Amortization of equipment under capital leases is calculated on a straight-line basis over the shorter of the life of the lease or the estimated useful life of the equipment. Maintenance and repairs are charged to expense as incurred. Upon retirement or sale, the cost and related accumulated depreciation or amortization are removed from their respective accounts. Any gains or losses on the disposition of property and equipment are included in the results of operations in the period in which they occur.

(2)(f) Impairment of Long-Lived Assets

The Company reviews long-lived assets for impairment whenever circumstances and situations change such that there is an indication that the carrying amounts may not be recovered. Recoverability is assessed based on estimated undiscounted future cash flows. As of December 27, 2008 and December 29, 2007, the Company believes that there has been no impairment of its long-lived assets.

(2)(g) Revenue Recognition

The Company recognizes revenue in accordance with the provision of the Securities and Exchange Commission Staff Accounting Bulletin ("SAB") No. 104 which establishes guidance in applying generally accepted accounting principles to revenue recognition in financial statements. SAB No. 104 requires that four basic criteria must be met before revenue can be recognized: (1) persuasive evidence of an arrangement exists; (2) delivery has occurred or services rendered; (3) the price to the buyer is fixed or determinable; and (4) collectibility is reasonably assured.

The Company's shipping terms are customarily FOB shipping point. Revenues for products sold in the normal course of business are recognized upon shipment when delivery terms are FOB shipping point and all other revenue recognition criteria have been met.

The Company has entered into consigned inventory agreements with several customers. For products shipped under consigned inventory agreements, the Company recognizes revenue when the customer notifies the Company that they have picked the product from the consigned inventory.

In 2008, the Company entered into a Cooperative Agreement with the US Army Research Laboratory to perform research and development concerning hybrid metal matrix composite encapsulated ceramic armor technology. The Cooperative Agreement is a four-year agreement which is 95% funded by the US Department of Defense and 5% funded by CPS.

Revenues on this Cooperative Agreement are recognized proportionally as costs are incurred. We are reimbursed for reasonable and allocable costs up to the reimbursement limits set by the Cooperative Agreement. All payments to the Company for work performed on this Cooperative Agreement are subject to audit and adjustment by the Defense Contract Audit Agency. Adjustments are recognized in the period made.

While this Cooperative Agreement extends for four years, funding is provided incrementally on a year-to-year basis if contract terms are met and Congress has authorized the funds. As of December 27, 2008, the Company has recognized \$357,213 of revenue on the Cooperative Agreement. The total estimated funding to be received over the four year term is \$8.34M. The Company's cost share amounts to \$439,000 over the term of the Cooperative Agreement. Should funding be tentatively delayed or if business initiatives change, we may choose to devote resources to other activities, including internally funded research and development. Funding for the Cooperative Agreement for the first year amounting to \$1.048M has been authorized of which \$357K was invoiced in 2008.

#### (2)(h) Research and Development Costs

In 2008, research and development costs were incurred related to the Cooperative Agreement with the US Army. These costs consist of labor, including applicable overhead expenses, materials and other costs associated with our Cooperative Agreement. Total expenditures incurred in 2008 under this Cooperative Agreement amounted to \$376,014 of which \$310,451 is included in cost of research and development under cooperative agreement in the Statement of Income. \$357,213 of these costs were funded by the US Army in 2008 and is classified as research and development cooperative agreement revenues in the Statement of Income. The \$18,801 funded by CPS consists of \$16,340 of direct and indirect costs in connection with the contract included in costs of research and development under cooperative agreements and the Company's allocated portion of general and administrative expenses allowed under the contract included in selling, general and administrative expenses of \$2,461.

Unfunded research and development costs, if any, are charged to expense as incurred and were \$0 in 2008, 2007 and 2006.

#### (2)(i) Income Taxes

The Company records deferred tax assets and liabilities based on the net tax effects of tax credits, operating loss carryforwards and temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. The Company assesses the likelihood that its deferred tax assets will be recovered from future taxable income and the Company establishes a valuation allowance to reduce deferred tax assets to an amount which it believes to be more likely than not realizable. The valuation allowance is based on the Company's estimates of taxable income by jurisdiction in which it operates and the period over which its deferred tax assets will be recoverable.

The Company's policy is to recognize interest and penalties related to income tax matters in income tax expense. As of December 27, 2008 and December 29, 2007, the Company has no accruals for interest or penalties related to income tax matters.

#### (2)(j) Net Income Per Common Share

Basic net income per common share is calculated by dividing net income by the weighted average number of common shares outstanding during the period. Diluted net income per common share is calculated by dividing net income by



the sum of the weighted average number of common shares plus additional common shares that would have been outstanding if potential dilutive common shares had been issued for granted stock option and stock purchase rights. Common stock equivalents are excluded from the diluted calculations if a net loss is incurred as they would be anti-dilutive.

(2)(k) Comprehensive Income

The Company has no items of comprehensive income, and therefore net income is equal to comprehensive income.

(2)(l) Recent Accounting Pronouncements

In March 2008, the FASB issued Statement No. 161, "Disclosures about Derivative Instruments and Hedging Activities, an amendment of FASB Statement No. 133." This Statement changes the disclosure requirements for derivative instruments and hedging activities. Entities are required to provide enhanced disclosures about (a) how and why an entity uses derivative instruments, (b) how derivative instruments and related hedged items are accounted for under SFAS 133 and its related interpretations, and (c) how derivative instruments and related hedged items affect an entity's financial position, financial performance, and cash flows. This Statement is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008, with early application encouraged. The Company does not expect the adoption of this Statement will have a material impact on its financial statements.

In December 2007, the FASB issued Statement No. 141 (revised 2007), "Business Combinations" ("Statement No. 141(R)"). Statement No. 141(R) establishes principles and requirements for how the acquirer in a business combination recognizes and measures identifiable assets acquired, liabilities assumed, and noncontrolling interests in the acquired company. Statement No. 141(R) further addresses how goodwill acquired or a gain from a bargain purchase is to be recognized and measured and determines what disclosures are needed to enable users of the financial statements to evaluate the effects of the business combination. Statement No. 141(R) is effective prospectively for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008. Earlier application is not permitted. The Company does not expect the adoption of this Statement will have a material impact on its financial statements.

In September 2006 the FASB issued SFAS No. 157, "Fair Value Measurements." SFAS No. 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. In February 2008, the FASB issued a Staff Position which delays the effective date of Statement No. 157 for non-financial assets and non-financial liabilities, except for items that are recognized or disclosed at fair value in the financial statements on a recurring basis, to fiscal years beginning after November 15, 2008. The pronouncement is applicable in cases when assets or liabilities are to be measured at fair value. It does not establish new circumstances in which fair value would be used to measure assets or liabilities. The provisions of SFAS No.157 are effective for fiscal years commencing after November 15, 2007. The Company adopted this statement, except for items covered by the Staff Position, as of January 1, 2008 and the adoption did not have a material impact on the consolidated financial statements.

In December 2006 the Securities and Exchange Commission announced that it has modified reporting requirements for smaller public companies under Section 404 of the Sarbanes-Oxley Act (SOX 404) of 2002. The Commission granted relief to smaller public companies by extending the date by which non-accelerated filers must start providing a report by management assessing the effectiveness of the company's internal control over financial reporting. The compliance date for these companies was moved to fiscal years ending on or after December 15, 2008. The Commission also extended the date by which non-accelerated filers must begin to comply with the Section 404(b)

requirement to provide an auditor's attestation report on internal control over financial reporting in their annual reports. This deadline was moved to the first annual report for a fiscal year ending on or after December 15, 2009. The extension requires all non-accelerated filers to complete only the management's portion of the internal control requirements in their first year of compliance with SOX 404. This modification is intended to provide cost savings and efficiency opportunities to smaller public companies and to assist them as they prepare to comply fully with SOX 404 reporting requirements. The extension will provide these issuers and their auditors additional time to consider and adapt to Auditing Standard No. 5 as well as the guidance for management the Commission has issued to improve the efficiency of the Section 404(b) auditor attestation report process. The Company has made an assessment of its internal control over financial reporting as of December 27, 2008. The Company's report on its assessment is included in Section 9A(T) of this Form 10-K.

(2)(m) Use of Estimates in the Preparation of Financial Statements

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the amounts of revenues and expenses recorded during the reporting period. Significant accounting estimates made by the Company's management include the valuation of accounts receivable, estimated lives of property and equipment, inventory, and deferred tax assets. Such estimates are adjusted by management periodically as a result of existing or anticipated economic changes which effect, or may effect, the Company's financial statements. Actual results could differ from these estimates.

(2)(n) Fiscal Year-End

The Company's fiscal year end is the last Saturday in December which could result in a 52 or 53 week year. Fiscal years 2008, 2007 and 2006 each consisted of 52 weeks.

(2)(o) Share-Based Payments

Effective January 1, 2006, the Company adopted the provisions of SFAS No. 123, "Share-Based Payments (revised 2004)," (SFAS No. 123R) which requires the Company to measure the cost of employee services received in exchange for an award of equity instruments based on the grant date fair value of the award. That cost is recognized over the period during which an employee is required to provide services in exchange for the award, the requisite service period (usually the vesting period). Under SFAS No. 123R, the Company provides an estimate of forfeitures at initial grant date. The Company elected the modified prospective transition method under SFAS No. 123R and accordingly has not restated periods prior to adoption. The Company recognized \$19,877,

\$52,086, and \$1,751 as compensation expense related to stock options granted in 2008, 2007, and 2006, respectively. A tax benefit of \$6,819, \$3,606, and \$15,000 was recognized as additional paid in capital in the years ended December 27, 2008, December 29, 2007, and December 30, 2006, respectively, resulting from the excess tax benefit of share-based awards over the cumulative compensation expense recognized for financial reporting.

(2)(p) Segment Reporting

SFAS No. 131, "Disclosures About Segments of an Enterprise and Related Information", establishes standards for reporting information regarding operating segments in annual financial statements and requires selected information for those segments to be presented in interim financial reports issued to stockholders. SFAS No. 131 also establishes standards for related disclosures about products and services and geographic areas. Operating segments are identified as components of an enterprise about which separate discrete financial information is available for evaluation by the chief operating decision maker, or decision making group, in making decisions about how to allocate resources and

assess performance.

To date, the Company views its operations and manages its business as one segment. We produce and sell advanced material solutions, primarily metal matrix composites, to assemblers of high density electronics and other specialty components and subassemblies. The Company also assembles housings and packages for hybrid circuits, selling to the same customers mentioned above. These customers represent a single market or segment for us with similar stringent and well-defined requirements. The Company's customers, in turn, sell the components and subassemblies which incorporate our products into many different end markets, however, these end markets are two to three levels removed from the Company. The Company makes operating decisions and assesses financial performance only for the Company as a whole and does not make operating decisions or assess financial performance by the end markets which ultimately use our products.

The Cooperative Agreement the Company entered into with the Army Research Laboratory in 2008 uses the same equipment and personnel as does the Company's electronics business described above, and at this early stage does not represent a separate business segment.

### (3) Inventories

As of December 27, 2008 and December 29, 2007 inventories consisted of the following:

|                 | <u>2008</u>  | <u>2007</u>  |
|-----------------|--------------|--------------|
| Raw materials   | \$ 246,614   | \$ 257,387   |
| Work in process | 499,964      | 273,197      |
| Finished goods  | 943,122      | 885,680      |
|                 | -----        | -----        |
| Total           | \$ 1,689,700 | \$ 1,416,264 |
|                 | =====        | =====        |

### (4) Leases and Commitments

At December 27, 2008, the Company had production equipment with a cost of \$1,661,945 and accumulated amortization of \$1,008,712 pursuant to the Company's equipment lease line with Sovereign Bank which was increased from \$1 million to \$1.5 million in 2007. At December 29, 2007, the Company had production equipment with a cost of \$1,496,815 and accumulated amortization of \$762,653 under capital leases. All leases on the lease line as of December 27, 2008 are three year leases with a one dollar buyout and annual interest rates from 7.2% to 8.6%.

Future payments required under capital lease obligations pursuant to the lease line are as follows at December 27, 2008:

|                                     |            |
|-------------------------------------|------------|
| 2009                                | \$ 287,619 |
| 2010                                | 124,817    |
| 2011                                | 34,332     |
|                                     | -----      |
| Total future minimum lease payments | 446,768    |

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|  |            |
|--|------------|
| Less amount representing interest          | 30,086     |
| at rates ranging between 7.2% and 8.6%     | -----      |
| Present value of net future lease payments | 416,682    |
| Less current portion                       | 264,489    |
|  | -----      |
| Long-term obligation under capital leases  | \$ 152,193 |
|  | =====      |

Interest expense was \$45 thousand, \$62 thousand, and \$30 thousand for 2008, 2007, and 2006, respectively.

The Company entered into a 10-year lease for the Norton facilities effective on March 1, 2006. The leased facilities comprise approximately 38 thousand square feet. Prior to entering into this lease, the Company was renting a portion of the facilities as a tenant-at-will. Rental expense for operating leases is recognized on a straight-line basis over the term of the lease and

was \$114 thousand, \$109 thousand and \$103 thousand for 2008, 2007 and 2006, respectively.

Future minimum rental payments over the terms of the facility lease agreement are approximately as follows:

Fiscal year:

|            |            |
|------------|------------|
| 2009       | \$ 118,750 |
| 2010       | 120,000    |
| 2011       | 127,500    |
| 2012       | 138,500    |
| 2013       | 140,000    |
| Thereafter | 337,250    |
|            | -----      |
|            | \$ 982,000 |
|            | =====      |

(5) Share-Based Compensation Plans

The Company adopted the 1999 Stock Incentive Plan ("1999 Plan") on January 22, 1999. Under the terms of the 1999 Plan all of the Company's employees, officers, directors, consultants and advisors are eligible to be granted options, restricted stock awards, or other stock-based awards. All outstanding options are nonstatutory stock options exercisable at the fair market value of the stock on the date of grant, and expire ten years from the date of grant. The options granted to employees generally vest in equal annual installments over a five-year period. The options granted to directors generally vest one year from date of grant.

Under the 1999 Plan a total of 1,250,000 shares of common stock are available for issuance, of which 162,750 shares remain available for grant as of December 27, 2008.

As of December 27, 2008, the 1999 Plan is the only stock option plan from which awards can be made as all other option plans have expired. The 1989 Stock Option plan expired on February 22, 1999 and no additional options can be granted from this plan. As of December 27, 2008 there are no options outstanding under the 1989 Plan. All options

outstanding as of December 29, 2007 are from the 1999 Plan.

A summary of stock option activity for all the above plans as of December 27, 2008 and changes during the year then ended is presented below:

|                                  | <u>Shares</u> | <u>Weighted<br/>Average<br/>Exercise<br/>Price</u> | <u>Weighted<br/>Remaining<br/>Contractual<br/>Life (years)</u> | <u>Aggregate<br/>Intrinsic<br/>Value</u> |
|----------------------------------|---------------|--|--|--|
| Outstanding at beginning of year | 1,062,250     | \$ 0.71  |  |  |
| Granted at fair market value     | 8,000         | \$ 1.70  |  |  |
| Exercised                        | (73,000)      | \$ 1.01  |  |  |
| Forfeited/expired                | (8,000)       | \$ 2.17  |  |  |
|                                  | -----         |  |  |  |
| Outstanding at end of year       | 989,250       | \$ 0.68  | 4.02   | \$ 514,410                               |
|                                  | =====         |  |  | =====                                    |
| Options exercisable at year-end  | 981,250       | \$ 0.68  | 4.02   | \$510,250                                |
|                                  | =====         |  |  | =====                                    |

The total intrinsic value of options exercised during fiscal years 2008, 2007 and 2006 was \$73,180, \$43,600, and \$189,878, respectively. As of December 27, 2008, there was \$6,926 of total unrecognized compensation cost related to nonvested share-based compensation arrangements granted under the plans; that cost is expected to be recognized during fiscal year 2009.

Cash received from option exercises under all share-based payment arrangements for the years ended December 27, 2008, December 29, 2007 and December 30, 2006 was \$73,640, \$20,550 and \$35,235, respectively.

The fair value of each option grant under SFAS No. 123(R) is estimated on the date of grant using the Black-Scholes option-pricing model. The following table presents the annualized weighted average values of the significant assumptions used to estimate the fair values of the options:

|                                       | <u>2008</u> | <u>2007</u> | <u>2006</u> |
|---------------------------------------|-------------|-------------|-------------|
| Risk-free interest rate               | 3.58%       | 4.13%       | 4.37%       |
| Expected life in years                | 7           | 7           | 7           |
| Expected volatility                   | 103%        | 126%        | 128%        |
| Expected dividend yield               | 0           | 0           | 0           |
| Weighted average fair value of grants | \$ 1.44     | \$ 2.20     | \$ 1.38     |

All options are granted with an exercise price equal to the fair market value of the underlying common stock on the date of grant.

#### (6) Accrued Expenses

Accrued expenses at December 27, 2008 and December 29, 2007 consist of the following:

|                              | <u>2008</u> | <u>2007</u> |
|------------------------------|-------------|-------------|
| Accrued legal and accounting | \$ 56,572   | \$ 51,950   |
| Accrued payroll              | 393,871     | 311,324     |
| Accrued other                | 97,789      | 77,573      |
| Accrued income tax payable   | 132,475     | 47,200      |
|                              | -----       | -----       |
|                              | \$ 680,707  | \$ 488,047  |
|                              | =====       | =====       |

#### (7) Revolving Line of Credit

In May 2008, the Company renewed a \$1 million revolving line of credit with Sovereign Bank. The line of credit is secured by the accounts receivable and other assets of the Company, has an interest rate of prime plus one percent (1%) and a one-year term. Under the terms of the agreement, the Company is required to maintain its operating accounts with Sovereign Bank. The line of credit and the lease line are cross defaulted and cross collateralized. The Company is also subject to certain financial covenants within the terms of the line of credit that require the Company to maintain a targeted rolling four quarter debt service coverage ratio as well as targeted debt to equity and current ratios. At December 27, 2008, the Company was in compliance with these covenants. Management believes it is likely that Sovereign Bank and the Company will renew the line at the end of the term. In 2008, there were no borrowings under this line of credit.

#### (8) Income Taxes

Components of income tax expense (benefit) for each year are as follows:

|                               | <u>2008</u> | <u>2007</u> | <u>2006</u> |
|-------------------------------|-------------|-------------|-------------|
| Current                       |             |             |             |
| United States:                |             |             |             |
| Federal                       | \$ 27,350   | \$ 22,000   | \$ 29,000   |
| State                         | 137,384     | 63,600      | 83,000      |
|                               | -----       | -----       | -----       |
| Current income tax provision: | 164,734     | 85,600      | 112,000     |
|                               | -----       | -----       | -----       |
| Deferred:                     |             |             |             |
| United States:                |             |             |             |
| Federal                       | (228,470)   | (135,000)   | (395,200)   |

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|                                  |              |             |              |
|----------------------------------|--------------|-------------|--------------|
| State                            | (70,685)     | (9,000)     | (4,800)      |
|                                  | -----        | -----       | -----        |
| Deferred income tax benefit, net | (299,155)    | (144,000)   | (400,000)    |
|                                  | -----        | -----       | -----        |
| Total                            | \$ (134,421) | \$ (58,400) | \$ (288,000) |
|                                  | =====        | =====       | =====        |

Deferred tax assets (liabilities) as of December 27, 2008 and December 29, 2007 are as follows:

|                              | <u>December 27, 2008</u> | <u>December 29, 2007</u> |
|------------------------------|--------------------------|--------------------------|
| Deferred Tax Assets:         |                          |                          |
| Net operating loss           |                          |                          |
| carryforwards                | \$ 1,682,000             | \$ 2,281,000             |
| Credit carryforwards         | 128,000                  | 81,000                   |
| Inventory                    | 192,000                  | 200,000                  |
| Accrued liabilities          | 34,000                   | 26,000                   |
| Depreciation                 | --                       | 8,000                    |
| Other                        | 2,155                    | 2,000                    |
|                              | -----                    | -----                    |
| Gross deferred tax assets    | 2,038,155                | 2,598,000                |
| Valuation allowance          | (1,174,000)              | (2,054,000)              |
|                              | -----                    | -----                    |
| Net deferred tax assets      | \$ 864,155               | \$ 544,000               |
|                              | -----                    | -----                    |
| Deferred Tax Liabilities:    |                          |                          |
| Depreciation                 | 21,000                   | --                       |
|                              | -----                    | -----                    |
| Gross deferred tax liability | 21,000                   | --                       |
|                              | -----                    | -----                    |
| Net deferred tax asset       | \$843,155                | \$ 544,000               |
|                              | =====                    | =====                    |

At December 27, 2008 and December 29, 2007, the Company had net operating loss carryforwards of approximately \$4,900,000 and \$7,000,000 respectively available to offset future income for U.S. Federal income tax purposes. These operating loss carryforwards expire in various amounts from 2009 through 2023. During 2008, the Company used approximately \$1,300,000 of net operating loss carryforwards. The valuation allowance for deferred tax assets of \$1,174,000 and \$2,054,000 at December 27, 2008 and December 29, 2007, respectively, relates to the uncertainty of the utilization of certain deferred tax assets, primarily federal net operating loss carryforwards. The Company believes that it will generate sufficient future taxable income to realize the tax benefits related to the remaining net deferred tax assets. The valuation allowance was calculated in accordance with the provisions of SFAS No. 109, "Accounting for Income Taxes," which requires that a valuation allowance be established or maintained when it is "more likely than not" that all or a portion of deferred tax assets will not be realized.

A summary of the change in the deferred tax asset is as follows:

|                              | <u>2008</u> | <u>2007</u> | <u>2006</u> |
|------------------------------|-------------|-------------|-------------|
| Balance at beginning of year | \$ 544,000  | \$ 400,000  | \$ --       |
| Deferred tax benefit         | 299,155     | 144,000     | 400,000     |
|                              | -----       | -----       | -----       |
| Balance at end of year       | \$ 843,155  | \$ 544,000  | \$400,000   |
|                              | =====       | =====       | =====       |

The income tax benefit for 2008, 2007, and 2006 consists of current federal alternative minimum tax, current state income taxes, and a deferred tax benefit resulting from a reduction in the valuation allowance provided on deferred tax assets in the current year. Income tax (benefit) expense is different from the amounts computed by applying the U.S. federal statutory income tax rate of 34 percent to pretax income as a result of the following:

|  | <u>2008</u>  | <u>2007</u> | <u>2006</u>  |
|--|--------------|-------------|--------------|
| Tax at statutory rate  | \$ 455,600   | \$ 302,700  | \$ 506,600   |
| State tax, net of federal tax benefit  | 44,000       | 36,000      | 55,000       |
| (Benefit) derived from net deferred tax assets fully reserved for in prior periods | 245,979      | 100,900     | (449,600)    |
| (Benefit) derived from the reduction in the valuation allowance                    | (880,000)    | (498,000)   | (400,000)    |
|  | -----        | -----       | -----        |
| Total  | \$ (134,421) | \$ (58,400) | \$ (288,000) |
|  | =====        | =====       | =====        |

Certain provisions of the Internal Revenue Code limit the annual utilization of net operating loss carryforwards if a change in ownership occurs, as defined. The Company believes that it did not have an ownership change through the period ended December 27, 2008. Therefore, as of year-end 2008 all net operating loss carryforwards should be available to offset future taxable income.

#### (9) Retirement Savings Plan

Effective September 1, 1987, the Company established the Retirement Savings Plan (the `Plan`) under the provisions of Section 401 of the Internal Revenue Code. Employees, as defined in the Plan, are eligible to participate in the Plan after 30 days of employment. Under the terms of the Plan, the Company may match employee contributions under such method as described in the Plan and as determined each year by the Board of Directors. No employer matching contributions have been made to the Plan since inception.



(10) Concentrations of Credit Risk, Significant Customers and Geographic Information

Financial instruments which subject the Company to concentrations of credit risk consist principally of cash and trade accounts receivable. The Company maintains such cash deposits in a high credit quality financial institution.

The Company extends credit to customers who consist principally of microelectronics systems companies in the United States, Europe and Asia. The Company generally does not require collateral or other security as a condition of sale rather relying on credit approval, balance limitation and monitoring procedures to control credit risk of trade accounts receivable. Management conducts on-going credit evaluations of its customers, and historically the Company has not experienced any significant credit-related losses with respect to its trade accounts receivable. As of December 27, 2008, the Company had trade accounts receivable due from four customers that accounted for 63% of total trade accounts receivable as of that date. Management believes that any credit risks have been properly provided for in the accompanying financial statements.

Revenues from significant customers as a percentage of total revenues in 2008, 2007 and 2006 were as follows:

| <u>Significant Customer</u> | <u>Percent of Total Revenues</u> |             |             |
|-----------------------------|----------------------------------|-------------|-------------|
|                             | <u>2008</u>                      | <u>2007</u> | <u>2006</u> |
| A                           | 35%                              | 24%         | 22%         |
| B                           | 28%                              | 22%         | 21%         |
| C                           | 8%                               | 11%         | 20%         |
| D                           | 5%                               | 9%          | 15%         |

The Company's revenue was derived from the following countries in 2008, 2007 and 2006:

| <u>Country</u>           | <u>Percent of Total Revenues</u> |             |             |
|--------------------------|----------------------------------|-------------|-------------|
|                          | <u>2008</u>                      | <u>2007</u> | <u>2006</u> |
| United States of America | 66%                              | 68%         | 78%         |
| Germany                  | 28%                              | 23%         | 16%         |
| Canada                   | 1%                               | 5%          | 5%          |
| Other                    | 5%                               | 4%          | 1%          |

Many of the Company's customers based in the United States conduct design, purchasing and payable functions in the United States, but do manufacturing overseas. Revenue generated from shipments made to customers' locations outside the United States accounted for 79%, 69% and 66% of total revenue in 2008, 2007 and 2006, respectively.

All of the Company's long-lived assets and operations are located in the United States.

(11) Net Income Per Share

The following reconciles the basic and diluted net income per share calculations.

|  | <u>For the years ended</u>     |                                |                                |
|--|--------------------------------|--------------------------------|--------------------------------|
|  | <u>Dec. 27,</u><br><u>2008</u> | <u>Dec. 29,</u><br><u>2007</u> | <u>Dec. 30,</u><br><u>2006</u> |

Basic Computation:

Numerator:

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|  |              |            |              |
|--|--------------|------------|--------------|
| Net income                                       | \$ 1,474,336 | \$ 948,598 | \$ 1,778,055 |
| Denominator:                                     |              |            |              |
| Weighted average<br>common shares<br>outstanding | 12,612,990   | 12,542,962 | 12,472,778   |
| Basic net income per share                       | \$ 0.12      | \$ 0.08    | \$ 0.14      |
| Diluted Computation:                             |              |            |              |
| Numerator:                                       |              |            |              |
| Net income                                       | \$1,474,336  | \$ 948,598 | \$ 1,778,055 |
| Denominator:                                     |              |            |              |
| Weighted average<br>common shares<br>outstanding | 12,612,990   | 12,542,962 | 12,472,778   |
| Stock options                                    | 629,717      | 755,725    | 593,863      |
|  | -----        | -----      | -----        |
| Total shares                                     | 13,242,707   | 13,298,687 | 13,066,641   |
|  | =====        | =====      | =====        |
| Diluted net income per share                     | \$ 0.11      | \$ 0.07    | \$ 0.14      |

The computation of diluted earnings per common share in 2006 excludes the effect of the potential exercise of options to purchase 33,000 shares, respectively, because the effect would be anti-dilutive.

(12) Allowance for Doubtful Accounts

Activity in the allowance for doubtful account was as follows for fiscal years 2008, 2007, and 2006:

|                        | <u>2008</u> | <u>2007</u> | <u>2006</u> |
|------------------------|-------------|-------------|-------------|
| Beginning balance      | \$ 5,461    | \$ 5,461    | \$ 5,461    |
| Provision for bad debt | --          | --          | --          |
| Charge-offs            | --          | --          | --          |
|                        | -----       | -----       | -----       |
| Ending balance         | \$ 5,461    | \$5,461     | \$5,461     |
|                        | =====       | =====       | =====       |