

Microwave Filter Company, Inc.

2019

Financial Statements

To the Shareholders:

As can be seen in the Annual Report, the operating performance of MFC improved in FY19. The company recorded a profit of \$180,864 compared to a loss of \$16,059 last year. The improvement can primarily be attributed to an increase in sales of \$578,527.

It is expected the demand for C band Satcom filters will be on the rise as 5G technology has been implemented in various parts of the world. Mitigating the higher power 5G signal is imperative for the proper operation of C Band earth stations. MFC has been identified as a global leader in the manufacture of Satcom Filters. We have been engaged with operators, consultants, installers and decision makers regarding the production and deployment of the next round of solutions.

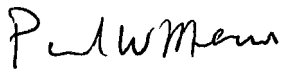
Industry growth was strongest in the Broadcast/Wireless and Cable market segments. The increases were a result of these products being incorporated at the system level by one of our OEM partners.

The Company's largest product group, RF/Microwave, had a 16.8% increase in sales. Microwave's RF products are sold primarily to Original Equipment Manufacturers that serve the mobile radio, commercial communications and defense electronics markets. MFC continues to build relationships with current OEM's and was part of many initiatives that resulted in prototype development and campaigns. Acquisition of new OEM's helped growth in FY19 and has afforded MFC new opportunities in FY20.

In FY19, MFC invested in professional sales training, CRM management, updated marketing efforts and an ERP system for production. We believe these enhancements, partnered with a new Website and multimedia campaign will position MFC to attain a more reliable and profitable future over the coming years.

MFC's strong financial position, backed by a strong cash position, provides the resources needed to execute our strategy. The management staff of MFC is optimistic about the future and is particularly appreciative of our employees during this time,

Sincerely,



Paul W. Mears
Chief Executive Officer



Robert R. Andrews
Chairman of the Board

MANAGEMENT'S DISCUSSION AND ANALYSIS OF RESULTS OF OPERATIONS

Microwave Filter Company, Inc. (MFC) operates primarily in the United States and principally in one industry. The Company extends credit to business customers, including original equipment manufacturers (OEMs), distributors and other end users, based upon ongoing credit evaluations. Microwave Filter Company, Inc. designs, develops, manufactures and sells electronic filters, both for radio and microwave frequencies, to help process signal distribution and to prevent unwanted signals from disrupting transmit or receive operations. Markets served include cable television, television and radio broadcast, satellite broadcast, mobile radio and commercial and defense electronics. NSI's sales consist of spare parts orders.

RESULTS OF OPERATIONS

The following table sets forth the Company's net sales by major product group for each of the fiscal years in the two year period ended September 30, 2019.

Product group	Fiscal 2019	Fiscal 2018
Microwave Filter:		
RF/Microwave	\$ 1,634,760	\$ 1,400,083
Satellite	1,011,347	1,176,034
Broadcast TV	820,514	425,787
Cable TV	453,633	334,897
Niagara Scientific	84	5,010
Total	<u>\$ 3,920,338</u>	<u>\$ 3,341,811</u>
Sales backlog at 9/30	<u>\$ 827,981</u>	<u>\$ 1,301,734</u>

Fiscal 2019 compared to fiscal 2018

Consolidated net sales for the fiscal year ended September 30, 2019 equaled \$3,920,338, an increase of \$578,527 or 17.3%, when compared to consolidated net sales of \$3,341,811 during the fiscal year ended September 30, 2018.

MFC's RF/Microwave product sales increased \$234,677 or 16.8% to \$1,634,760 during the fiscal year ended September 30, 2019 when compared to sales of \$1,400,083 during the fiscal year ended September 30, 2018. MFC's RF/Microwave products are sold primarily to Original Equipment Manufacturers (OEM) that serve the mobile radio, commercial communications and defense electronics markets. Sales to one OEM customer increased \$350,800 to \$1,421,055, or 36.2% of total sales, during the fiscal year ended September 30, 2019 compared to sales of \$1,070,255, or 32% of total sales, during the fiscal year ended September 30, 2018. These sales are in connection with a multiyear program in which the Company is a subcontractor. The Company continues to invest in production engineering and infrastructure development to penetrate OEM market segments as they become popular. MFC is concentrating its technical resources and product development efforts toward potential high volume customers as part of a concentrated effort to provide substantial long-term growth. Over the last year, MFC, in conjunction with various OEM's, has developed and supplied prototypes as well as small production runs in support of new programs being introduced to the marketplace. It is our belief that a continuation of this effort will help increase sales as well as reinforcing MFC's position as a quality manufacturer of RF filters and assemblies.

MFC's Satellite product sales decreased \$164,687 or 14% to \$1,011,347 during the fiscal year ended September 30, 2019 when compared to sales of \$1,176,034 during the fiscal year ended September 30, 2018. The decrease can be attributed to a decrease in demand for filters which suppress strong out-of-band interference caused by military and civilian radar systems and other sources. Management expects demand for these types of filters to continue with the proliferation of earth stations world wide and increased sources of interference.

MFC's Broadcast TV product sales increased \$394,727 or 92.7% to \$820,514 for the fiscal year ended September 30, 2019 when compared to sales of \$425,787 for the fiscal year ended September 30, 2018. The increase can primarily be attributed to one customer.

MFC's Cable TV product sales increased \$118,736 or 35.5% to \$453,633 during the fiscal year ended September 30, 2019 when compared to Cable TV product sales of \$334,897 during the fiscal year ended September 30, 2018. Management continues to project flat or a decrease in demand for Cable TV products due to the shift from analog to digital television. Due to the inherent nature of digital modulation versus analog modulation, fewer filters will be required. The Company has developed filters for digital television and there will still be requirements for analog filters for limited applications in commercial and private cable systems.

At September 30, 2019, the Company's total backlog of orders, which represents firm orders from customers, equaled \$827,981 compared to \$1,301,734 at September 30, 2018. The total Company backlog at September 30, 2019 is scheduled to ship during fiscal 2020. However, backlog is not necessarily indicative of future sales. Accordingly, the Company does not believe that its backlog as of any particular date is representative of actual sales for any succeeding period.

Gross profit increased \$314,530 to \$1,640,414 during the fiscal year ended September 30, 2019 when compared to gross profit of \$1,325,884 during the fiscal year ended September 30, 2018. The increase in gross profit can be attributed the higher sales volume providing a higher base to absorb overhead expenses.

Selling, general and administrative (SG&A) expenses increased \$125,437 or 9.4% to \$1,459,147 during the fiscal year ended September 30, 2019 when compared to SG&A expenses of \$1,333,710 during the fiscal year ended September 30, 2018. The increase can be attributed to higher payroll costs.

Other income (expense) was an expense of \$353 for the fiscal year ended September 30, 2019 compared to expense of \$8,183 for the fiscal year ended September 30, 2018 primarily due to interest expense of \$11,084 offset by interest income of \$8,039 and miscellaneous non-operating income of \$2,692 for the fiscal year ended September 30, 2019 and interest expense of \$13,366 offset by interest income of \$1,243 and miscellaneous non-operating income of \$3,940 for the fiscal year ended September 30, 2018. Other income generally consists of sales of scrap material, the forfeiture of non-refundable deposits and other incidental items.

The Company recorded income taxes of \$50 and \$50 for the fiscal year ended September 30, 2019 and September 30, 2018. Any other provision for income tax expense was fully offset by a reversal of a portion of the Company's valuation allowance. Any benefit for losses has been subject to a valuation allowance since the realization of the deferred tax benefit is not considered more likely than not. As required by FASB ASC 740 the Company has evaluated the positive and negative evidence bearing upon the realization of its deferred tax assets. The Company has determined that, at this time, it is more likely than not that the Company will not realize all of the benefits of federal and state deferred tax assets, and, as a result, a valuation allowance was established. See Note 7 to the consolidated financial statements.

Independent Accountant's Review Report

November 27, 2019

To the Board of Directors and Stockholders of
Microwave Filter Company, Inc.

Opinion on the Financial Statements

We have reviewed the accompanying consolidated financial statements of Microwave Filter Company, Inc. and Subsidiaries (The "Company") as of September 30, 2019, and the related statements of income, changes in stockholders' equity, and cash flows for the year then ended, and the related notes to the consolidated financial statements. A review includes primarily applying analytical procedures to management's financial data and making inquiries of company management. A review is substantially less in scope than an audit, the objective of which is the expression of an opinion regarding the consolidated financial statements as a whole. Accordingly, we do not express such an opinion.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement whether due to fraud or error.

Accountant's Responsibility

Our responsibility is to conduct the review engagement in accordance with Statements on Standards for Accounting and Review Services promulgated by the Accounting and Review Services Committee of the AICPA. Those standards require us to perform procedures to obtain limited assurance as a basis for reporting whether we are aware of any material modifications that should be made to the consolidated financial statements for them to be in accordance with accounting principles generally accepted in the United States of America. We believe that the results of our procedures provide a reasonable basis for our conclusion.

Accountant's Conclusion

Based on our review, we are not aware of any material modifications that should be made to the accompanying consolidated financial statements in order for them to be in accordance with accounting principles generally accepted in the United States of America.

Report on 2018 Financial Statements

The September 30, 2018, consolidated financial statements were audited by us, and we expressed an unmodified opinion on them in our report dated December 5, 2018. We have not performed any auditing procedures since that date.

Dannible & McKee, LLP

MICROWAVE FILTER COMPANY, INC.
AND SUBSIDIARIES

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Microwave Filter Company and Subsidiaries
Consolidated Balance Sheets

Assets	September 30,	
	Unaudited 2019	Audited 2018
Current assets:		
Cash and cash equivalents	\$ 718,071	\$ 674,045
Accounts receivable-trade, net of allowance for doubtful accounts of \$4,000 and \$4,000	490,784	402,760
Inventories, net of obsolete inventory reserve of \$491,363 and \$463,286	375,747	377,603
Prepaid expenses and other current assets	87,389	54,416
Total current assets	1,671,991	1,508,824
Property, plant and equipment, net	272,344	261,474
Total Assets	\$ 1,944,335	\$ 1,770,298
 Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	\$ 125,851	\$ 116,938
Customer deposits	78,129	35,278
Accrued payroll and related expenses	47,753	38,711
Accrued compensated absences	87,667	90,449
Notes Payable - Short Term	53,456	51,101
Other current liabilities	15,346	28,838
Total current liabilities	408,202	361,315
Notes Payable - Long Term	165,615	219,071
Total other liabilities	165,615	219,071
Total liabilities	573,817	580,386
 Stockholders' equity:		
Common stock, \$.10 par value. Authorized 5,000,000 shares Issued 4,324,140 in 2019 and 2018, Outstanding 2,579,179 in 2019 and 2,579,680 in 2018	432,414	432,414
Additional paid-in capital	3,248,706	3,248,706
Accumulated deficit	(615,580)	(796,444)
Common stock in treasury, at cost, 1,744,961 shares in 2019 and 1,744,460 shares in 2018	(1,695,022)	(1,694,764)
Total stockholders' equity	1,370,518	1,189,912
Total Liabilities and Stockholders' Equity	\$ 1,944,335	\$ 1,770,298

See independent accountant's review report and related notes to financial statements.

Microwave Filter Company and Subsidiaries
Consolidated Statements of Operations

	For the Years Ended September 30	
	Unaudited	Audited
	<u>2019</u>	<u>2018</u>
Net sales	\$ 3,920,338	\$ 3,341,811
Cost of goods sold	<u>2,279,924</u>	<u>2,015,927</u>
Gross profit	1,640,414	1,325,884
Selling, general and administrative expenses	<u>1,459,147</u>	<u>1,333,710</u>
Profit (loss) from operations	181,267	(7,826)
Non-operating income (expense)		
Interest income	8,039	1,243
Interest expense	(11,084)	(13,366)
Miscellaneous	<u>2,692</u>	<u>3,940</u>
Profit (loss) before income taxes	180,914	(16,009)
Provision for income taxes	(<u>50</u>)	(<u>50</u>)
NET PROFIT (LOSS)	\$ <u><u>180,864</u></u>	\$ (<u><u>16,059</u></u>)
Per share data:		
Basic and Diluted Earnings (Loss)		
Per Common Share	\$ 0.07	\$ (0.01)
Shares used in computing net earnings (loss) per common share:		
Basic and diluted	2,579,392	2,579,681

See independent accountant's review report and related notes to financial statements.

Microwave Filter Company and Subsidiaries
Consolidated Statements of Stockholders' Equity
For the Years Ended September 30, 2019 and 2018

	Common Stock		Additional	Accumulated Deficit	Treasury Stock		Total
	Shares	Amt	Paid-in Capital		Shares	Amt	Stockholders' Equity
	<u>Shares</u>	<u>Amt</u>	<u>Capital</u>		<u>Shares</u>	<u>Amt</u>	<u>Equity</u>
September 30, 2017 (Audited)	4,324,140	\$ 432,414	\$ 3,248,706	\$ (780,385)	1,744,456	\$ (1,694,761)	\$ 1,205,974
Net loss				(16,059)			(16,059)
Purchase of treasury stock					4	(3)	(3)
September 30, 2018 (Audited)	<u>4,324,140</u>	<u>432,414</u>	<u>3,248,706</u>	<u>(796,444)</u>	<u>1,744,460</u>	<u>(1,694,764)</u>	<u>1,189,912</u>
(Unaudited)							
Net profit				180,864			180,864
Purchase of treasury stock					501	(258)	(258)
September 30, 2019 (Unaudited)	<u><u>4,324,140</u></u>	<u><u>\$ 432,414</u></u>	<u><u>\$ 3,248,706</u></u>	<u><u>\$ (615,580)</u></u>	<u><u>1,744,961</u></u>	<u><u>\$ (1,695,022)</u></u>	<u><u>\$ 1,370,518</u></u>

See independent accountant's review report and related notes to financial statements.

Microwave Filter Company and Subsidiaries
Consolidated Statements of Cash Flows

	For the Years Ended September 30	
	Unaudited	Audited
	<u>2019</u>	<u>2018</u>
Cash flows from operating activities:		
Net profit (loss)	\$ 180,864	\$ (16,059)
Adjustments to reconcile net profit (loss) to net cash provided by (used in) operating activities:		
Depreciation	50,450	72,652
Inventory obsolescence provision	28,077	17,893
Changes in assets and liabilities:		
Accounts receivable-trade	(88,024)	(52,057)
Inventories	(26,221)	62,662
Prepaid and other current assets	(32,973)	(26,558)
Accounts payable and customer deposits	51,764	3,974
Accrued payroll, compensated absences and related expenses	6,260	(7,040)
Other current liabilities	(13,492)	6,815
Net cash provided by operating activities	<u>156,705</u>	<u>62,282</u>
Cash flows from investing activities:		
Capital expenditures	(61,320)	(7,348)
Net cash used in investing activities	<u>(61,320)</u>	<u>(7,348)</u>
Cash flows from financing activities:		
Repayment of note payable	(51,101)	(48,826)
Purchase of treasury stock	(258)	(3)
Net cash used in financing activities	<u>(51,359)</u>	<u>(48,829)</u>
Net increase in cash and cash equivalents	44,026	6,105
Cash and cash equivalents at beginning of year	<u>674,045</u>	<u>667,940</u>
Cash and cash equivalents at end of year	\$ <u><u>718,071</u></u>	\$ <u><u>674,045</u></u>
Supplemental disclosures of cash flows:		
Cash paid during the year for :		
Interest	\$ 11,263	\$ 13,538
Taxes	\$ 50	\$ 50

See independent accountant's review report and related notes to financial statements.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

a. Nature of Business

Microwave Filter Company, Inc. (MFC) operates primarily in the United States and principally in one industry. The Company extends credit to business customers based upon ongoing credit evaluations. Microwave Filter Company, Inc. designs, develops, manufactures and sells electronic filters, both for radio and microwave frequencies, to help process signal distribution and to prevent unwanted signals from disrupting transmit or receive operations. Markets served include cable television, television and radio broadcast, satellite broadcast, mobile radio, commercial communications and defense electronics.

b. Basis of Consolidation

The consolidated financial statements include the accounts of Microwave Filter Company, Inc. (MFC) and its wholly-owned subsidiaries, Niagara Scientific, Inc. (NSI) and Microwave Filter International, LTD. (MFI) (dormant); located in Syracuse, New York. All significant intercompany balances and transactions have been eliminated in consolidation.

c. Revenue Recognition

Effective October 1, 2018, the Company adopted Accounting Standards Update (“ASU”) No. 2014-09, *Revenue from Contracts with Customers (Topic 606)*, using the modified retrospective method. This update outlined a comprehensive new revenue recognition model designed to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The new standard also requires additional quantitative and qualitative disclosures, as explained below. The adoption allows companies to apply the new revenue standard to reporting periods beginning in the year the standard is first implemented, while prior periods continue to be reported in accordance with previous accounting guidance. Since the adoption of Accounting Standards Codification (“ASC”) 606 did not have a significant impact on the recognition of revenue, the Company did not have an opening retained earnings adjustment or an effect on prior reported periods.

Pursuant to Topic 606, revenues are recognized upon the application of the following steps:

- Identification of the contract, or contracts, with a customer;
- Identification of the performance obligations in the contract;
- Determination of the transaction price;
- Allocation of the transaction price to the performance obligations in the contract; and
- Recognition of revenues when, or as, the contractual performance obligations are satisfied.

The Company accounts for a contract with a client when it has written approval, the contract (or customer sales order) is committed, the rights of the parties, including payment terms, are identified, the contract has commercial substance and consideration is probable of collection.

The Company allocates the transaction price to each performance obligation on a standalone selling price basis, as agreed-upon between the customer and the Company in the related customer sales order.

Revenue is recognized when the performance obligation has been satisfied: at the time products are shipped and title and risk of loss have passed to the customer, and the collection of the related receivable is probable. Billings in advance of the Company’s performance of such work are reflected as customer deposits in the accompanying condensed consolidated balance sheet.

Product Warranty

The Company has established a warranty reserve which provides for the estimated cost of product returns based upon historical experience and any known conditions or circumstances. No revenues are recognized in connection with the performance of the warranty repair or fulfillment function. The warranty obligation is affected by product that does not meet specifications and performance requirements and any related costs of addressing such matters. Products must be returned within one year of the date of purchase. The warranty liability was insignificant at September 30, 2019 and September 30, 2018.

Disaggregation of Revenue

The following tables provide details of revenue by major products group:

Product group	Fiscal 2019	Fiscal 2018
	Unaudited	Audited
Microwave Filter:		
RF/Microwave	\$ 1,634,760	\$ 1,400,083
Satellite	1,011,347	1,176,034
Broadcast TV	820,514	425,787
Cable TV	453,633	334,897
Niagara Scientific	84	5,010
Total	<u>\$ 3,920,338</u>	<u>\$ 3,341,811</u>
Sales backlog at 9/30	<u>\$ 827,981</u>	<u>\$ 1,301,734</u>

d. Cash and Cash Equivalents

The Company's financial instruments that are exposed to concentrations of credit risk consist primarily of cash and accounts receivable. Cash and cash equivalents consist of cash in banks and money market funds. The Company considers all highly liquid investments with original maturities of three months or less to be cash equivalents. The Company's cash is held at federally insured institutions and balances may periodically exceed insured limits. The Company has not experienced any losses in such accounts and believes it is not exposed to any significant credit risk with respect to cash. The Company also routinely assesses the financial strength of its customers and, as a consequence, believes that its trade accounts receivable credit risk exposure is limited.

e. Trade Accounts Receivable and Allowance for Doubtful Accounts

Trade accounts receivable are recorded at the invoiced amount and do not bear interest. The allowance for doubtful accounts is the Company's best estimate of the amount of probable credit losses in the Company's existing accounts receivable. The Company reviews its allowance for doubtful accounts monthly. Past due balances are reviewed individually for collectability. Account balances are charged off against the allowance after all means of collection have been exhausted and the potential for recovery is considered remote. The Company does not have any off-balance-sheet credit exposure related to its customers.

f. Inventories and Reserve for Obsolescence

Inventories are stated at the lower of cost determined on the first-in, first-out method or net realizable value.

Net realizable value is determined as the estimated selling price in the normal course of business minus the cost of completion, disposal and transportation.

The Company records a reserve for obsolete or excess inventory. The Company considers inventory quantities greater than a three year supply based on current year activity as well as any additional specifically identified inventory to be excess. The Company also provides for the total value of inventories that are determined to be obsolete based on criteria such as customer demand and changing technologies.

g. Research and Development

Costs in connection with research and development, which amount to \$372,702 and \$334,851 for the fiscal years 2019 and 2018, respectively, are charged to operations as incurred.

h. Property, Plant and Equipment

Property, plant and equipment are recorded at cost. Depreciation is provided using the straight-line method over the estimated useful lives of the respective assets. Buildings and building improvements are depreciated over an estimated service life of 10 to 30 years. Machinery and equipment are depreciated over an estimated useful life of 3 to 10 years. Office equipment and fixtures are depreciated over an estimated useful life of 3 to 10 years. At the time of sale or retirement, the cost and accumulated depreciation are removed from the respective accounts and the resulting gain or loss is recognized in income.

i. Income Taxes

The Company accounts for income taxes under FASB ASC 740-10. Deferred tax assets and liabilities are based on the difference between the financial statement and income tax basis of assets and liabilities as measured by the enacted tax rates which are anticipated to be in effect when these differences reverse. The deferred tax provision is the result of the net change in the deferred tax assets and liabilities. A valuation allowance is established when it is necessary to reduce deferred tax assets to amounts expected to be realized. The Company has provided a full valuation allowance against its deferred tax assets.

The Company follows FASB ASC 740-10, which clarifies the accounting for uncertainty in income taxes recognized in an entity's financial statements and prescribes a recognition threshold and measurement attributes for financial statement disclosure of tax positions taken or expected to be taken on a tax return. Additionally, it provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. The Company will include interest on income tax liabilities in interest expense and penalties in operations if such amounts arise. The Company determined it has no uncertain tax positions and therefore no amounts are recorded.

j. Earnings Per Share

The Company presents basic earnings per share ("EPS"), computed based on the weighted average number of common shares outstanding for the period, and when applicable diluted EPS, which gives the effect to all dilutive potential shares outstanding (i.e. options) during the period after restatement for any stock dividends. There were no dividends declared during the fiscal year ended September 30, 2019 and 2018. Profit (loss) used in the EPS calculation is net profit (loss) for each year. There were no dilutive potential shares outstanding for the years ended September 30, 2019 and 2018.

k. Fair Value of Financial Instruments

The carrying value of the Company cash and cash equivalents, accounts receivable and accounts payable approximate fair value because of the short maturity of those instruments. The carrying value of the Company's note payable approximates its fair value.

The Company currently does not trade in or utilize derivative financial instruments.

l. Miscellaneous Non-operating Income

Miscellaneous non-operating income generally consists of sales of scrap material and the forfeiture of non-refundable deposits and other incidental items.

m. Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States 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. Estimates also affect the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

n.. Impairment of Long-Lived Assets

The carrying values of long-lived assets other than goodwill are generally evaluated for impairment only if events or changes in facts and circumstances indicate that carrying values may not be recoverable. Any impairment determined would be recorded in the current period and would be measured by comparing the fair value of the related asset to its carrying value. Fair value is generally determined by identifying estimated undiscounted cash flows to be generated by those assets. No impairments have been recorded for the fiscal years ended September 30, 2019 and 2018.

o. New Accounting Pronouncements

In February 2016, the FASB issued FASB ASU No. 2016-02, *Leases (Topic 842)*. The core principle of Topic 842 is that a lessee should recognize the assets and liabilities that arise from leases. For operating leases, a lessee is required to recognize a right-of-use asset and a lease liability, initially measured at the present value of the lease payments, in the statement of financial position. For leases with a term of 12 months or less, a lessee is permitted to make an accounting policy election by class of underlying asset not to recognize lease assets and lease liabilities. The accounting applied by a lessor is largely unchanged from that applied under previous GAAP. This ASU is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Earlier application is permitted. In transition, lessees and lessors are required to recognize and measure leases at the beginning of the earliest period presented using a modified retrospective approach. The Company is currently evaluating the effect that the adoption of this ASU will have on its financial statements.

p. Subsequent Events

Management has evaluated subsequent events through November 27, 2019, the date which the consolidated financial statements were available for issue.

2. INVENTORIES

Inventories net of provision for obsolescence consisted of the following:

	September 30	
	Unaudited 2019	Audited 2018
Raw materials and stock parts	\$ 333,638	\$ 306,658
Work-in-process	16,752	37,062
Finished goods	25,357	33,883
	<u>\$ 375,747</u>	<u>\$ 377,603</u>

The Company's reserve for obsolescence equaled \$491,363 at September 30, 2019 and \$463,286 at September 30, 2018.

3. PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment consisted of the following:

	September 30	
	Unaudited 2019	Audited 2018
Land	\$ 143,000	\$ 143,000
Building and improvements	1,983,499	1,928,599
Machinery and equipment	3,501,925	3,501,925
Office equipment and fixtures	1,925,598	1,919,178
	7,554,022	7,492,702
Less: Accumulated depreciation	7,281,678	7,231,228
Property, plant and equipment, net	\$ 272,344	\$ 261,474
Depreciation expense	\$ 50,450	\$ 72,652

4. NOTES PAYABLE

On July 2, 2013, Microwave Filter Company, Inc. (the "Company") entered into a Ten Year Term Loan with KeyBank National Association in the amount of Five Hundred Thousand and No/100 Dollars (\$500,000.00). The amount of all advances outstanding together with accrued interest thereon shall be due and payable on July 2, 2023 ("Maturity"). The Company shall pay interest on the outstanding principal balance of this Note at the rate per annum equal to 4.5%. The net proceeds from the Term Loan will be available to provide working capital as needed. The total amount outstanding as of September 30, 2019 and 2018 was \$219,071 and \$270,172 respectively. Interest accrued as of September 30, 2019 and 2018 was \$767 and \$946 respectively.

The Company has secured this Note by: (a) a Mortgage, Assignment of Rents, Security Agreement and Fixture Filing which creates a 1st lien on real property situated in the Town of Dewitt, County of Onondaga, and State of New York and known as 6743 Kinne Street, East Syracuse, New York; (b) a General Assignment of Rents and Leases; (c) an Environmental Compliance and Indemnification; and (d) such other security as may now or hereafter be given to Lender as collateral for the loan. The future obligations of the loan are as follows:

(Unaudited) Year Ended September 30,	Principal Payments	Interest Payments	Total Payments
2020	\$ 53,456	\$ 8,908	\$ 62,364
2021	55,972	6,392	62,364
2022	58,680	3,684	62,364
2023	50,963	1,007	51,970
	<u>\$ 219,071</u>	<u>\$ 19,991</u>	<u>\$ 239,062</u>

The Company is required to comply with a loan covenant requiring submission to the Bank of audited financial statements subsequent to year end. The Company has received a waiver of non-compliance with this covenant.

5. PROFIT SHARING AND 401-K PLANS

The Company maintains both a non-contributory profit sharing plan and a contributory 401-K plan for all employees over the age of 21 with one year of service. Annual contributions to the profit sharing plan are determined by the Board of Directors and are made from current or accumulated earnings, while contributions to the 401-K plan were matched at a rate of 100% of an employee's first 6% of contributions during fiscal 2019. The maximum corporate match was 6% of an employee's compensation during fiscal 2019.

The Company's matching contributions to the 401-K plan for the years ended September 30, 2019 and 2018 were \$67,670 and \$71,392, respectively. Additionally, the Company may make discretionary contributions to the non-contributory profit sharing plan. These contributions were \$0 in 2019 and 2018.

6. OBLIGATIONS UNDER OPERATING LEASES

The Company leases equipment under an operating lease agreement expiring on March 31, 2022. Rental expense under this lease for the year ended September 30, 2019 was \$5,103.

Minimum rental commitments at September 30, 2019 for this lease are:

Year Ended September 30	Lease Payments
2020	\$ 6,804
2021	6,804
2022	3,402
	<u>\$ 17,010</u>

7. INCOME TAXES

The components of the provision for income taxes in the accompanying consolidated statements of operations are as follows:

	Year Ended September 30,	
	Unaudited 2019	Audited 2018
Currently payable:		
Federal	\$ 0	\$ 0
State	50	50
Deferred (credit)	<u>0</u>	<u>0</u>
	<u>\$ 50</u>	<u>\$ 50</u>

The components of the provision for income taxes differs from the amount that would result from applying the federal statutory rate for the periods ended September 30, 2019 and 2018 is as follows:

	Year ended September 30,			
	Unaudited		Audited	
	2019		2018	
	Amount	%	Amount	%
Statutory tax rate	\$ 37,992	21.0 %	\$ 8,797	24.2 %
Effect of change in income tax rates	(0)	(- %)	(87,833)	(242.1 %)
Research and development tax credits	(18,412)	(10.2 %)	(14,728)	(40.5 %)
Valuation allowance change	(19,580)	(10.8 %)	93,764	258.4 %
Permanent differences	<u>0</u>	<u>0.0 %</u>	<u>0</u>	<u>0.0 %</u>
	<u>\$ 0</u>	<u>0.0 %</u>	<u>\$ 0</u>	<u>0.0 %</u>

The temporary differences which give rise to deferred tax assets and (liabilities) at September 30 are as follows:

	Unaudited <u>2019</u>	Audited <u>2018</u>
Inventory	\$ 106,771	\$ 101,398
Accrued warranty	2,625	2,625
Accrued vacation	14,420	15,004
Accounts receivable	885	885
Accelerated depreciation	24,501	22,477
Research and development tax credit carryforward	323,769	305,357
AMT credit carryforward	37,521	37,521
NOL carryforward	187,584	232,389
Valuation allowance	(<u>698,076</u>)	(<u>717,656</u>)
Net deferred tax assets	\$ <u><u>0</u></u>	\$ <u><u>0</u></u>

During December 2017, the Tax Cuts and Jobs Act (the “ACT”) was signed into law reducing the Federal corporate income tax rate from 34 percent to 21 percent. Based on the provisions of the ACT, the Company remeasured their net deferred tax assets applying the lower income tax rates to the Company’s net deferred tax assets. In addition, in accordance with the applicable Internal Revenue Code, the Company is required to calculate its current tax provision for fiscal 2018 using a blended corporate tax rate, resulting in a reduction in the effective current tax rate from 34.00 percent to 24.25 percent. The Company has provided a full valuation allowance against its net deferred tax assets. Accordingly, no impact arising from the change in the tax rates arising from the provisions of the ACT is reflected in these consolidated financial statements.

As required by FASB ASC 740 the Company has evaluated the positive and negative evidence bearing upon the realization of its net deferred tax assets. The Company has determined that, at this time, it is more likely than not that the Company will not realize all of the benefits of federal and state net deferred tax assets, and, as a result, a valuation allowance was established. The research and development tax credit carryforwards and NOL carryforwards generated through September 30, 2019, of approximately \$320,000 and \$593,000 expire at various times through 2037. Pursuant to the ACT, any of the Company’s newly-generated Federal NOL carryforwards can be carried forward indefinitely, while being limited to 80% of taxable income (determined without regard to the deduction.) As of September 30, 2019, the Company’s Federal AMT credit carryforward of approximately \$35,000 is available in any year prior to 2022, in an amount equal to 50% (100% for tax years beginning in 2021) of the excess minimum tax credit for the tax year, over the amount of the credit allowable for the year against the regular tax liability. The Company is currently open to audit under the statute of limitations by the Internal Revenue Service for the fiscal years September 30, 2017 through September 30, 2019. The Company has no uncertain tax positions. As of September 30, 2019 and 2018 there is no accrual for interest or penalties related to uncertain tax positions.

8. INDUSTRY SEGMENT DATA

The Company’s primary business segment involves the operations of Microwave Filter Company, Inc. (MFC) which designs, develops, manufactures and sells electronic filters, both for radio and microwave frequencies, to help process signal distribution and to prevent unwanted signals from disrupting transmit or receive operations.

9. SIGNIFICANT CUSTOMERS

Sales to two customers represented 53.5% of total sales for the fiscal year ended September 30, 2019 compared to sales to one customer who represented 32% of total sales for the fiscal year ended September 30, 2018. A loss of these customers or programs related to these customers could materially impact the Company.

10. LEGAL MATTERS

None.

11. LIQUIDITY AND CAPITAL RESOURCES

MFC defines liquidity as the ability to generate adequate funds to meet its operating and capital needs. The Company's primary source of liquidity has been funds provided by operations and its existing cash balances.

	September 30	
	2019	2018
Cash & cash equivalents	\$ 718,071	\$ 674,045
Working capital	\$ 1,263,789	\$ 1,147,509
Current ratio	4.10 to 1	4.18 to 1
Long-term debt	\$ 165,615	\$ 219,071

Cash and cash equivalents increased \$44,026 to \$718,071 at September 30, 2019 when compared to \$674,045 at September 30, 2018. The increase was a result of \$156,705 in net cash provided by operating activities, \$61,320 in net cash used for capital expenditures, \$51,101 in net cash used for repayment of a note payable and \$258 in net cash used to purchase treasury stock.

Net cash provided by operating activities fluctuates between periods primarily as a result of differences in sales and net income and the timing of the collection of accounts receivable, purchase of inventory, and payment of accounts payable.

The \$61,320 in fixed asset purchases consisted of \$54,900 to replace part of the roof, \$4,575 used to purchase computer software and \$1,845 to purchase computer equipment.

On July 2, 2013, Microwave Filter Company, Inc. (the "Company") entered into a Ten Year Term Loan with KeyBank National Association in the amount of Five Hundred Thousand and No/100 Dollars (\$500,000.00). The amount of all advances outstanding together with accrued interest thereon shall be due and payable on July 2, 2023 ("Maturity"). The Company shall pay interest on the outstanding principal balance of this Note at the rate per annum equal to 4.5%. The net proceeds from the Term Loan will be available to provide working capital as needed. The total amount outstanding as of September 30, 2019 and 2018 was \$219,071 and \$270,172, respectively.

The Company has secured this Note by: (a) a Mortgage, Assignment of Rents, Security Agreement and Fixture Filing which creates a 1st lien on real property situated in the Town of Dewitt, County of Onondaga, and State of New York and known as 6743 Kinne Street, East Syracuse, New York; (b) a General Assignment of Rents and Leases; (c) an Environmental Compliance and Indemnification; and (d) such other security as may now or hereafter be given to Lender as collateral for the loan.

Management believes that its working capital requirements for the foreseeable future will be met by its existing cash balances, future cash flows from operations and its current credit arrangements.

Off-Balance Sheet Arrangements

At September 30, 2019 and 2018, the Company did not have any unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities, which might have been established for the purpose of facilitating off-balance sheet arrangements.