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INNOVEX INC
Form 10-Q
February 17, 2009

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

FORM 10-Q

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

for the quarterly period ended January 3, 2009

or

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

for the transition period from to

Commission File Number 0-13143

Innovex, Inc.

(Exact name of registrant as specified in its charter)

Minnesota
(State or other jurisdiction of
incorporation or organization)

41-1223933
(IRS Employer
Identification No.)

3033 Campus Drive, Suite E180, Plymouth, MN 55441
(Address of principal executive offices)

(763) 383-4000
(Registrant's telephone number, including area code)

(Former name, former address and former fiscal year if changed since
last report)

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

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 definition of "accelerated filer" and "large accelerated filer" in
rule 12b-2 of the Exchange Act.

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company

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

As of February 3, 2009, 19,443,153 shares of the Company's common

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stock, \$.04 par value per share, were outstanding.

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PART 1
FINANCIAL INFORMATION

ITEM 1 FINANCIAL STATEMENTS

INNOVEX, INC. AND SUBSIDIARIES
Condensed Consolidated Balance Sheets
(Unaudited)

ASSETS

Current assets:

Cash and equivalents	\$	2
Accounts receivable, less allowance for doubtful accounts of \$230,000 and \$190,000		8
Inventories		7
Other current assets		1

Total current assets

Property, plant and equipment, net of accumulated depreciation of \$58,552,000 and \$56,599,000

Assets held for sale

Other assets

Janua
20

2
8
7
1

20

33

1

\$ 55
=====

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LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT)

Current liabilities:

Current maturities of long-term debt	\$ 4
Line of credit	33
Accounts payable	16
Accrued compensation	
Other accrued liabilities	2

Total current liabilities	56
---------------------------	----

Long-term debt, less current maturities	17
---	----

Stockholders' equity (deficit):

Common stock, \$.04 par value; 30,000,000 shares authorized, 19,443,153 and 19,418,799 shares issued and outstanding	
Capital in excess of par value	62
Accumulated deficit	(81)

Total stockholders' equity (deficit)	(18)
--------------------------------------	------

\$ 55
=====

See accompanying notes to condensed consolidated financial statements.

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INNOVEX, INC. AND SUBSIDIARIES
Condensed Consolidated Statements of Operations
(Unaudited)

	Three January 3, 2009

Net sales	\$ 13,665,0
Costs and expenses:	
Cost of sales	15,926,3
Selling, general and administrative	1,617,0
Royalty expense	
Engineering	425,0
Restructuring charges	611,5
Net loss on sale of assets	
Interest expense	911,2
Interest income	(19,1
Net other (income) expense	(1,129,7

Net loss before income taxes	(4,677,3
Income taxes	

Net loss	\$ (4,677,3
	=====
Net loss per share:	
Basic	\$ (0.

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Diluted	\$ (0.
=====	
Weighted average shares outstanding:	
Basic	19,431,1
=====	
Diluted	19,431,1
=====	

See accompanying notes to condensed consolidated financial statements.

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INNOVEX, INC. AND SUBSIDIARIES
Condensed Consolidated Statements of Cash Flows
(Unaudited)

	Three January 3, 2009

CASH FLOWS FROM OPERATING ACTIVITIES:	
Net loss	\$ (4,677,3
Adjustments to reconcile net loss to net cash used in operating activities:	
Depreciation and amortization	1,984,9
Stock compensation expense	43,3
Other non-cash items	2,4
Changes in operating assets and liabilities:	
Accounts receivable	6,315,2
Inventories	2,145,0
Other current assets	232,7
Other long term assets	2,4
Accounts payable	(6,629,7
Accrued compensation and other accrued liabilities	(1,663,2

Net cash used in operating activities	(2,243,9

CASH FLOWS FROM INVESTING ACTIVITIES:	
Capital expenditures	(865,3
Proceeds from sale of assets	

Net cash used in investing activities	(865,3

CASH FLOWS FROM FINANCING ACTIVITIES:	
Principal payments on long-term debt	(492,8
Issuance of long-term debt	
Effect of currency translation on long-term debt	(606,2
Net activity on line of credit	585,6
Proceeds from exercise of stock options and employee stock purchase plan	

Net cash provided by (used in) financing activities	(513,4

Decrease in cash and equivalents	(3,622,7

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Cash and equivalents at beginning of period		6,531,5

Cash and equivalents at end of period	\$	2,908,8

SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:

Cash paid for:

Interest	\$	1,022,0
Income taxes	\$	

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INNOVEX INC. AND SUBSIDIARIES

Notes to Condensed Consolidated Financial Statements

NOTE 1 - FINANCIAL INFORMATION

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with the instructions on Form 10-Q and do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. The unaudited condensed consolidated financial statements include the accounts of Innovex, Inc. and its subsidiaries (the "Company") after elimination of all significant intercompany transactions and accounts. In the opinion of management, all adjustments (consisting of normal recurring adjustments) necessary for a fair presentation of operating results have been made. Operating results for interim periods are not necessarily indicative of results that may be expected for the year as a whole.

The Company utilizes a fiscal year that ends on the Saturday nearest to September 30 which results in a 52 or 53 week year rather than a twelve-month fiscal year. The Company's actual fiscal quarters end on the Saturday closest to the end of the calendar quarter. All quarters presented in these financial statements contain either 13 or 14 weeks. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted. For further information, refer to the consolidated financial statements and footnotes included in the Company's Annual Report on Form 10-K for the year ended September 27, 2008.

Preparation of the Company's condensed consolidated financial statements requires management to make estimates and assumptions that affect reported amounts of assets and liabilities and related revenues and expenses. Actual results could differ from these estimates.

NOTE 2 - LIQUIDITY

The Company has historically financed its operations primarily through cash from operating activities, sales of equity securities, bank credit facilities and employee stock option exercises. Cash and equivalents were \$2.9 million at January 3, 2009 and \$6.5 million at September 27, 2008. Long-term debt was \$17.3 million at January 3, 2009 and \$19.0 million at September 27, 2008 excluding current maturities of \$4.1 million and \$3.5 million, respectively. Short-term debt was \$33.3 million at January 3, 2009 and \$32.7 million at September 27, 2008 respectively. During the three months ended January 3, 2009 and December 29, 2007, the Company incurred losses from continuing operations of \$4.7 million and \$7.9 million, respectively. Operating activities used cash of \$2.2 million and \$9.6 million during the three months ended January 3, 2009 and December 29, 2007, respectively. As of January 3, 2009, the Company had a working capital deficit of \$36.4 million.

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Total unused debt availability as of January 3, 2009 was approximately \$1.1 million under the Company's short-term packing credit and working capital facilities. Utilization of the packing credit facility availability is dependent on presenting qualifying customer purchase orders to the banks for draw down.

The Company will require additional capital resources for its business. The Company completed restructuring its long-term credit facilities with its Thai lenders in June 2008. The restructuring reduced the required principal payments for fiscal year 2008 and fiscal year 2009 by approximately \$6.0 million and \$9.0 million, respectively. In addition, on December 30, 2008, the Company's Thai lenders provided the Company with an approval to extend the repayment date of packing credit facilities that were originally due on December 29, 2008 to February 27, 2009. The sixty day payment date extension affected 173.1 million Baht or approximately \$5.0 million owed to both banks.

The Company will continue to work with its Thai lenders to explore additional restructuring of its existing debt as well as to consider an additional working capital facility or long-term financing. The Company has not received any approval of a further extension of the February 27, 2009 repayment of certain credit packing facilities and the Company's ability to repay the 173.1 million Baht or approximately \$5.0 million of packing credits due on February 27, 2009 depends on its prevailing cash on hand and its ability to present qualifying customer purchase orders to the bank for draw down. The Company's ability to continue as a going concern depends upon its ability to obtain additional financing or to further restructure its credit facilities with its lenders. The Company believes that its immediate need for capital to finance its day-to-day business activities over the next quarter could potentially be provided, if at all, by its current lenders in the form of a restructuring of its debt to reduce required payments and to provide additional lending. No assurance can be given that additional working capital will be obtained in an amount that is sufficient for the Company's needs, in a timely manner or on terms and conditions acceptable to the Company or its shareholders.

The Company's financing needs and the financing alternatives available to it are subject to change depending on, among other things, general economic and market conditions, changes in industry buying patterns, customer demand for its AFC, stacked memory flex, FPD flex and other new products, the Company's ability to meet its loan covenant requirements, cash flow from operations and management estimates as to future revenue and expenses.

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NOTE 3 - RESTRUCTURING CHARGES

Corporate business functions relocation:

On October 1, 2007, the Company announced a plan to relocate some of its corporate business functions, including administrative, sales and engineering to Thailand and discontinue manufacturing activity at its Korat, Thailand facility as the FSA product was expected to reach its end of life by the end of the fiscal 2008 second quarter. The restructuring was triggered by the previous move of the Company's manufacturing operations to Thailand and the presence of its banking sources and most of its customers and suppliers in Asia. In addition, incremental cost reductions are required for the Company to return to profitability. Restructuring charges of \$174,000 related to the planned corporate business functions move were recorded in the first quarter of fiscal 2009. These charges were comprised of \$171,000 one time termination benefits and \$3,000 for moving and closing costs. The Company expects to incur minimal expenditure in relation to the restructuring plan for the remaining fiscal year 2009.

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Litchfield and Eastlake restructuring:

On January 16, 2006, the Company announced a plan to move prototyping and high volume manufacturing from its Litchfield, Minnesota facilities to its Lamphun, Thailand facilities. On September 25, 2006, the Company expanded the previously announced Litchfield restructuring to close the entire Litchfield facility and move the remaining development efforts to its Thailand facilities. The plan announced in September 2006 was to accelerate the end of life production for FSA flexible circuits in Litchfield and discontinue use of that facility by the end of April 2007. The plan also included acceleration of production end-of-life at the Company's Eastlake, Ohio laminate material manufacturing facility. The restructuring was triggered by the Company's need to reduce its cost structure in order to compete effectively and as a result of lower than expected revenue.

A purchase agreement has been signed to sell the Litchfield facilities for \$2.3 million. The sale is expected to close after the buyer arranges financing. Given the prior delays in closing, the Company is unable to estimate when, if ever, the sale will close. Restructuring charges of \$438,000 related to the Litchfield and Eastlake restructuring were recorded in the fiscal 2009 first quarter. These charges were comprised of \$354,000 for costs related to the Eastlake facility lease and \$84,000 for charges incurred to complete the transfer of equipment from Litchfield to Thailand. Remaining expenditures of approximately \$500,000 are expected as part of the plan primarily related to completing the transfer of equipment to Thailand. The accrued restructuring charges related to Litchfield and Eastlake was \$592,000 at January 3, 2009.

NOTE 4 - NET INCOME (LOSS) PER SHARE

The Company's basic net income (loss) per share is computed by dividing net income (loss) by the weighted average number of outstanding common shares. The Company's diluted net income (loss) per share is computed by dividing net income (loss) by the weighted average number of outstanding common shares and common share equivalents relating to stock options when dilutive. Options to purchase 1,792,068 shares of common stock were outstanding during the three month period ending January 3, 2009, but were excluded from the computation of common share equivalents because they were anti-dilutive. Options to purchase 1,876,212 shares of common stock were outstanding during the three month period ending December 29, 2007, but were excluded from the computation of common share equivalents because they were anti-dilutive.

NOTE 5 - STOCK BASED COMPENSATION

The Company recorded \$43,000 and \$112,000 of related compensation expense for the three-month periods ended January 3, 2009 and December 29, 2007, respectively. This expense is included in selling, general and administrative expense. There was no tax benefit from recording this non-cash expense.

The compensation expense did not result in any significant increase in both basic and diluted net loss per share for the three months ended January 3, 2009, but increased both basic and diluted net loss per share by \$0.01 for the three months ended December 29, 2007. As of January 3, 2009, \$302,000 of total unrecognized compensation costs related to non-vested awards is expected to be recognized over a weighted average period of approximately 1.2 years.

The Company uses the Black-Scholes option pricing model to determine the weighted average fair value of options. The fair value of options at date of grant and the assumptions utilized to determine such values are indicated in the following table. No adjustment was made to the Black-Scholes calculation to reflect that the options are not freely traded:

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	Three Months Ended	
	January 3, 2009	December 29, 2007
Risk-free interest rate	0.89%	4.03%
Expected volatility	158%	65%
Expected life (in years)	2.5	2.9
Dividend yield	--	--
Weighted average fair value of options granted	\$ 0.12	\$ 0.41

The Company has options outstanding under its 1987 Employee Stock Option Plan and its 1994 Stock Option Plan. The Company's stock option plans provide for incentive and non-qualified stock options to be granted to directors, officers and other key employees or consultants. The stock options granted generally have a ten-year life, vest over a period of six months to five years, and have an exercise price equal to the fair market value of the stock on the date of grant. New shares are issued under existing registration statements upon exercise. At January 3, 2009 the Company had 629,708 shares of common stock available for issuance under the plans.

Additionally, on November 25, 2008, the Company granted Mr. Dauenhauer an option to purchase 250,000 shares of the Company's common stock outside of any existing shareholder-approved plan. The November 25, 2008 option was issued in consideration of the cancellation by the Company of an option granted to Mr. Dauenhauer in April 2008. The November 25, 2008 option was structured to have substantially the same terms as the cancelled April 2008 option, including an exercise price of \$0.365 per share and vesting with respect to one-third of the option shares on April 16, 2009, 2010 and 2011. On November 25, 2008, the Company also approved a grant to Mr. Dauenhauer of an option to purchase 25,000 shares of the Company's common stock outside of any existing shareholder-approved plan, but with substantially the same terms as an option granted on October 23, 2008, including an exercise price of \$0.165 per share and vesting with respect to one-third of the underlying shares on October 23, 2009, 2010 and 2011. At January 3, 2009, there were options to purchase a total of 275,000 shares of the Company's common stock outstanding that were granted outside any existing shareholder-approved plan.

The Company also has a restricted stock plan that provides for grants of common stock to key employees of the Company other than the Chief Executive Officer and the four highest paid executives of the Company other than the Chief Executive Officer. The common stock grants vest over three years. At January 3, 2009, the Company had 8,499 shares of common stock available for issue under the plan.

Transactions under the stock option and restricted stock plans, as well as grants outside of such plans, during the three months ended January 3, 2009 are summarized as follows:

	Number of Shares Under Option	Weighted Average Exercise Price
Outstanding at September 27, 2008	1,637,842	2.29
Granted	890,050	0.22
Forfeited	317,848	1.38
Exercised	24,354	--
Outstanding at January 3, 2009	2,185,690	1.60

The following table summarizes information concerning currently outstanding and exercisable stock options:

Range of Exercise Prices	Number Outstanding	Options Outstanding		Options Exercisable
		Weighted Average Remaining Contractual Life	Weighted Average Exercise Price	
\$ 0.00 - \$0.91	1,556,280	9.4 years	\$ 0.33	128,
1.44 - 2.41	217,810	6.7 years	2.22	149,
2.71 - 4.84	226,850	6.2 years	3.75	166,
5.29 - 7.81	59,250	4.0 years	6.53	57,
8.90 - 9.80	96,950	5.0 years	9.33	96,
12.59 - 13.08	28,550	2.3 years	13.04	28,
	2,185,690		1.60	627,

NOTE 6 - INVENTORIES

Inventories are comprised of the following (in thousands):

	January 3, 2009	September 27, 2008
Raw materials and purchased parts	\$ 4,078	\$ 5,569
Work-in-process and finished goods	3,776	4,430
	\$ 7,854	\$ 9,999

NOTE 7 - DERIVATIVE INSTRUMENTS - FOREIGN CURRENCY TRANSLATION

The Company had, during the previous fiscal quarters, entered into forward exchange contracts. These forward exchange contracts were recorded at fair value with related fair value gains or losses recorded in income within the caption net other (income) expense. Generally, these contracts had maturities of six months or less. These contracts were entered into to offset the gains or losses on foreign currency denominated assets and liabilities. The Company does not enter into forward exchange contracts for trading purposes and the contracts are not designated as hedges. As at end of January 3, 2009, the Company did not have any open forward exchange contracts to buy Thai baht in return for U.S. dollars. All remaining forward exchange contracts purchased during the previous fiscal quarters have matured and were settled by December 4, 2008 and no additional forward exchange contracts were purchased during the fiscal quarter ended January 3, 2009.

Foreign currency translation (gains) or losses included in net other (income) expense (in thousands):

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	Three months ended	
	January 3, 2009	December 29, 2007
	-----	-----
(Gain) or loss from forward exchange contracts	\$ 353	\$ (206)
Other foreign currency (gain) or loss	(1,526)	809
	-----	-----
Net (gain) or loss from foreign currency transactions	\$ (1,173)	\$ 603
	-----	-----

NOTE 8 - REVENUE RECOGNITION

The Company makes electronic components (flexible circuits) based on customer specifications. The Company's revenue recognition policy is consistently applied regardless of sales channels utilized and product destination. In recognizing revenue in any period, the Company applies the provisions of SEC Staff Accounting Bulletin 104, "Revenue Recognition." Revenue from product sales is recognized when persuasive evidence of an arrangement exists, the product has been delivered, the fee is fixed and determinable and collection of the resulting receivable is reasonably assured.

For all sales, a binding purchase order is used as evidence of an arrangement. The Company also stores inventory in warehouses (JIT hubs - third party owned warehouses) that are located close to the customer's manufacturing facilities. Revenue is recognized on sales from JIT hubs upon the transfer of title and risk of loss, following the customer's acknowledgement of the receipt of the goods. The Company has an implied warranty that the products meet the customer's specification. Credits are issued for customer returns.

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NOTE 9 - INCOME TAXES

The Company records income taxes in accordance with the liability method of accounting. Deferred taxes are provided for temporary differences between the financial reporting and tax bases of assets and liabilities. A valuation allowance is established when the realization of a deferred tax asset becomes less likely than not to occur. The valuation allowance is analyzed periodically by the Company and may result in income tax expense different than statutory rates. The Company's current deferred tax asset valuation allowance fully offsets its deferred tax assets. With the exception of the Alternative Minimum Tax and certain state taxes, the Company will not use cash for domestic income taxes until its net operating losses are fully realized on its tax returns.

NOTE 10- RECENT ACCOUNTING PRONOUNCEMENTS

In December 2007, the FASB issued SFAS No. 141(R), Business Combinations, or SFAS No. 141(R). SFAS No. 141(R) establishes principles and requirements for how an acquirer recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, any non-controlling interest in the acquiree and the goodwill acquired. SFAS No. 141(R) also establishes disclosure requirements to enable the evaluation of the nature and financial effects of the business combination. SFAS No. 141(R) is effective for fiscal years beginning after December 15, 2008. The adoption of SFAS No. 141(R) would change the Company's accounting treatment for business combinations on a prospective basis beginning in the period it is adopted.

In March 2008, the FASB issued SFAS No. 161, "Disclosures about Derivative Instruments and Hedging Activities--an amendment of FASB Statement No. 133" ("FAS 161"). FAS 161 changes the disclosure requirements for derivative instruments and hedging activities. Entities are required to provide enhanced

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disclosures about (a) how and why an entity uses derivative instruments, (b) how derivative instruments and related hedged items are accounted for under Statement 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. The guidance in FAS 161 is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008, with early application encouraged. This Statement encourages, but does not require, comparative disclosures for earlier periods at initial adoption. The Company is currently evaluating the provisions of FASB 161 to determine the impact on the company's consolidated financial statements.

In September 2006, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 157, Fair Value Measurement (SFAS 157). This standard clarifies the principle that fair value should be based on the assumptions that market participants would use when pricing an asset or liability. Additionally, it establishes a fair value hierarchy that prioritizes the information used to develop those assumptions. SFAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007. The Company does not expect the implementation of SFAS 157 will have a material impact on its results of operations or financial condition. The FASB approved the issuance of FASB Staff Position 157-2, which defers the effective date of SFAS 157 until Fiscal Years beginning after November 15, 2008 and for non-financial assets and non-financial liabilities.

The Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 159, Fair Value Option for Financial Assets and Financial Liabilities (SFAS 159). This standard addresses earnings volatility caused by existing accounting standards that require related financial assets and liabilities to be measured using different measurement attributes (such as historical cost and fair value). SFAS 159 is intended to improve financial reporting by giving all entities the option to recognize most financial assets and liabilities and certain other items at fair value. Unrealized gains and losses on items for which the fair value option has been elected should be reported in earnings. SFAS 159 is effective for the first quarter of our fiscal 2009 beginning October 1, 2008. The adoption of SFAS 159 did not have a material effect on our financial condition or results of operations.

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

You should read the following discussion of our financial condition and results of operations in conjunction with the consolidated financial statements and notes to those statements included in this report. This discussion may contain forward-looking statements that involve risks and uncertainties. Our actual results may differ materially from those anticipated in these forward-looking statements as a result of certain factors, including those described under the heading "Risks Related to Our Business" in our Annual Report on Form 10-K for the year ended September 27, 2008, as well as others not now anticipated.

We utilize a fiscal year that ends on the Saturday nearest to September 30. The fiscal 2009 first quarter contains 14 weeks while the remaining quarters contain 13 weeks each.

Overview

We are a leading worldwide provider of flexible circuit interconnect solutions to OEMs in the electronics industry. We offer a full range of customized flexible circuit applications and services from initial design, development and prototype to fabrication, assembly and test on a global basis.

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We target high-volume markets where miniaturization, form and weight are driving factors and flexible circuits are an enabling technology. Applications for flexible circuits currently addressed by us include data storage devices such as hard disk drives, liquid crystal displays (LCDs) for mobile communication devices, tape drives and arrays, flat panel displays (FPDs) and printers. Our customers include Entorian, Hitachi, HP, TPO, Quantum, SAE Magnetics (a subsidiary of TDK), Samsung, Seagate, StorageTek, Western Digital and other leading electronic OEMs.

Net Sales and Revenue Recognition

We manufacture flexible circuits and perform certain additional assembly and test functions on these flexible circuits based on customer specifications. We sell our products directly throughout the world, primarily in North America, Europe and the Pacific Rim countries. We use non-exclusive sales representatives to augment our direct sales efforts. We recognize revenue from the sale of our products upon shipment or delivery of our product to our customers, depending on the customer agreement or shipping terms. We store some inventory in third party owned warehouses that are located close to customers' manufacturing facilities. Sales from third party warehouses are recognized upon the transfer of title and risk of loss which follows the customer's acknowledgment of the receipt of the goods.

Costs and Expenses

Cost of sales consists primarily of:

- o material costs for raw materials and semi-finished components used for assembly of our products;
- o labor costs directly related to manufacture, assembly and inspection of our products;
- o costs of general utilities, production supplies and chemicals consumed in the manufacturing processes;
- o costs related to the maintenance of our manufacturing equipment and facilities;
- o costs related to material and product handling and shipment;
- o depreciation costs related to facilities, machinery and equipment used to manufacture, assemble and inspect our products; and
- o salaries and overhead attributed to our supply chain, process engineering and manufacturing personnel.

Selling, general and administrative expenses primarily consist of:

- o salaries and related selling (commissions, travel, business development and program management), administrative, finance, human resources, regulatory, information services and executive personnel expenses;
- o other significant expenses related to external accounting, software maintenance and legal and regulatory fees; and
- o overhead attributed to our selling, general and administrative personnel.

Engineering expenses include costs associated with the design, development and testing of our products and processes. These costs consist primarily of:

- o salaries and related development personnel expenses;
- o overhead attributed to our development and test engineering personnel; and
- o prototyping costs related to the development of new products.

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Restructuring charges are those costs primarily related to manufacturing facility closures, severance and product discontinuations. On October 1, 2007, we announced a plan to relocate some of our corporate business functions, including administrative, sales and engineering, to Lamphun, Thailand and discontinue manufacturing activity at our Korat, Thailand location as the Flex Suspension Assembly product reached its end of life by the end of the fiscal 2008 second quarter. On January 16, 2006, we announced a plan to transfer our high volume manufacturing operations from Litchfield, Minnesota to Thailand. On September 25, 2006, we announced a plan to accelerate the end of life production for our FSA flexible circuits in Litchfield and discontinue the use of that facility by the end of March 2007. Concurrently, we also planned to accelerate the end of life production of flexible circuit laminate material at our Eastlake, Ohio facility and reduce indirect labor and general and administrative expenses at our other U.S. and Thailand locations.

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Results of Operations

The following table sets forth certain operating data as a percentage of net sales for the periods indicated:

	For the Three Months Ended	
	January 3, 2009	December 29, 2007
Net Sales	100%	100%
Cost of goods sold	116.6	104.9
Gross profit	(16.6)	(4.9)
Operating expenses:		
Selling, general and administrative and royalty expense	11.8	12.8
Engineering	3.1	3.3
Restructuring and asset impairment	4.5	10.8
Net (gain) loss on sale of assets	--	--
Total operating expenses	19.4	26.9
Income (loss) from operations	(36.0)	(31.8)
Interest and other expense, net	1.8	(6.1)
Income (loss) before provision (benefit) for income taxes	(34.2)	(37.9)
Provision (benefit) for income taxes	--	--
Net income (loss)	(34.2)%	(37.9)%

Comparison of Three Months Ended January 3, 2009 and December 29, 2007

Net Sales

Our net sales were \$13.7 million for the three months ended January 3, 2009, compared to \$20.8 million for the three months ended December 29, 2007, a decrease of 34%. The decline was primarily driven by a \$7.1 million decrease in flex suspension assembly (FSA) revenue and \$0.9 million decrease in actuator flex circuit (AFC) revenue, offset by a \$0.9 million increase in flat panel display (FPD) revenue. The decline in FSA revenue reflects the completion of our FSA customer's transition to its next generation of disk drive products which use an alternative technology. As a result of overall market uncertainty experienced during the fiscal 2009 first quarter as well as customer shutdowns during the holiday season, our AFC and FPD product demand were negatively impacted and the revenue growth from these products was insufficient to cover the shortfall in FSA revenue.

FPD applications generated 50% of our net sales for the three months ended January 3, 2009, compared to 29% for the three months ended December 29, 2007. Sales of AFC's to the disk drive industry were 44%, compared to 34%, FSA sales to disk drive industry were 0% compared to 34%, sales from integrated circuit packaging, network system application and sales from other industry applications were 6% and 3% for the three months ended January 3, 2009 and December 29, 2007, respectively.

Gross Profit (Loss)

Our gross profit (loss) was (\$2.3 million) for the three months ended January 3, 2009 compared to a gross profit (loss) of (\$1.0 million) for the three months ended December 29, 2007. Our gross margin for the three months ended January 3, 2009 decreased to (16.6%), from (4.9%) for the three months ended December 29, 2007. The decrease in gross margin as compared to the prior year reflects the decreased fixed cost absorption driven by lower revenue resulting in a higher level of excess manufacturing capacity and labor.

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Selling, General and Administrative and Royalty Expense

Selling, general and administrative expenses including royalty expenses for the three months ended January 3, 2009 were \$1.6 million, compared to \$2.7 million in the three months ended December 29, 2007, a decrease of 41%. As a percentage of net sales, selling, general and administrative expenses were 12% for the three months ended January 3, 2009, down from 13% from the same period in the prior year. Royalty expense was zero for the three months ended January 3, 2009 due to the end of life cycle for the FSA product which was royalty bearing. The dollar decrease in selling, general and administrative expenses from the prior year primarily reflects lower payroll expenses related to reductions in U.S. sales and administrative positions.

Engineering

Engineering expenses for the three months ended January 3, 2009 were \$425,000, compared to \$685,000 for the three months ended December 29, 2007, a decrease of 38%. The decrease was primarily the result of reducing or transferring engineering positions to our lower salary base Thailand facility as a result of closing our U.S. facilities. As a percentage of net sales,

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engineering expenses were 3.1% of sales for the three months ended January 3, 2009 compared to 3.3% for the same period in the prior year.

Restructuring

Corporate business functions relocation:

On October 1, 2007, we announced a plan to relocate some of our corporate business functions, including administrative, sales and engineering, to Thailand and discontinue manufacturing activity at our Korat, Thailand facility as the FSA product was expected to reach its end of life by the end of the fiscal 2008 second quarter. The restructuring was triggered by the previous move of our manufacturing operations to Thailand and the presence of our banking sources and most of our customers and suppliers in Asia. In addition, incremental cost reductions are required for us to return to profitability.

Asset impairment charges of \$400,000 related to the plan were recorded in the fiscal 2007 fourth quarter. The impaired assets were primarily equipment used in the FSA manufacturing process at the Korat facility. The assets were written down to their estimated net realizable value which is negligible as a result of their age and specialized nature. Restructuring charges of \$174,000 related to the planned corporate business functions relocation and Korat restructuring were recorded in the first quarter of fiscal 2009. These charges were comprised of \$171,000 in one time termination benefits and \$3,000 for moving and closing costs. Total restructuring charges related to the corporate office relocation restructuring through January 3, 2009 were \$3.8 million. These charges were comprised of \$3.2 million for one time termination benefits, \$200,000 for moving and closing costs and \$400,000 of asset impairment charges. Future expenditures expected to be incurred in relation to the restructuring plan are anticipated to be minimal.

The restructuring plan called for the elimination of 594 positions in the U.S. and Thailand consisting of 466 direct labor positions, 97 indirect labor production support positions and 31 administrative positions. As of January 3, 2009, all of these positions have been eliminated.

Litchfield and Eastlake restructuring:

On January 16, 2006, we announced a plan to move prototyping and high volume manufacturing from our Litchfield, Minnesota facilities to our Lamphun, Thailand facilities. On September 25, 2006, we expanded the previously announced Litchfield restructuring to close the entire Litchfield facility and move the remaining development efforts to our Thailand facilities. The plan announced in September 2006 was to accelerate the end of life production for FSA flexible circuits in Litchfield and discontinue use of that facility by the end of April 2007. The plan also included acceleration of production end-of-life at our Eastlake, Ohio laminate material manufacturing facility. In June 2006, as part of the plan, we divested our low-volume etched metal product line also located at our Litchfield facilities. The restructuring was triggered by our need to reduce our cost structure in order to compete effectively and as a result of our lower than expected level of revenue.

While several action items related to the expanded restructuring plan remain open, all of the expected savings were realized as of September 29, 2007. Asset impairment charges related to the expanded restructuring plan of \$8.1 million and \$2.0 million were recorded in the first and fourth quarters, respectively, of fiscal 2006 for a total of \$10.1 million. The assets that were impaired include the Litchfield facilities and related equipment. The fair value of these assets was determined using appraised values. The fair value of the Litchfield facility impairment was determined from an independent appraisal performed by Ruhland Commercial Consultants, Ltd. The fair value of the equipment located at the facilities was determined from appraisals performed by

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Asset Reliance International, LLC. Assets that were not transferred to Lamphun, Thailand were sold or disposed. A \$900,000 loss on the sale of assets was recorded during the fiscal 2007 third quarter as the remaining assets were sold.

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Manufacturing operations were completed in the Eastlake facility in February 2007 and decommission of the facility was substantially completed by the end of March 2008. Manufacturing operations in the Litchfield facilities were completed during April 2007 and decommission of the facilities was completed by the end of the fiscal 2007 third quarter. A purchase agreement has been signed to sell the Litchfield facilities for \$2.3 million. The sale is expected to close after the buyer arranges financing. Given the prior delays in closing, the Company is unable to estimate when, if ever, the sale will close.

Restructuring charges of \$438,000 related to the Litchfield and Eastlake restructuring were recorded in the fiscal 2009 first quarter. Total restructuring charges related to the Eastlake and Litchfield restructuring excluding asset impairments charges through January 3, 2009 were \$8.7 million. These charges were comprised of \$3.3 million for one time termination benefits, \$4.0 million for moving and closing costs and \$1.4 million costs incurred related to the Eastlake facility lease. Remaining expenditures of approximately \$500,000 are expected as part of the plan primarily related to completing the transfer of equipment to Thailand.

Net (Gain) Loss on the Sale of Assets

There were no sales of assets recorded in the fiscal 2009 first quarter compared to a net loss on the sale of assets of \$800 for the three months ended December 29, 2007.

Net Interest and Other (Income) Expense

Net interest expense was \$0.9 million for the three months ended January 3, 2009 and \$0.7 million for the three months ended December 29, 2007. The increase was driven by higher level of debt outstanding in fiscal 2009. Net other income was \$1.1 million in the three months ended January 3, 2009 as compared to net other expenses of \$585,000 in the three months ended December 29, 2007. The change was related to a foreign currency valuation gain being recorded in the fiscal 2009 first quarter which was driven by the value of the U.S. dollar strengthening against the Thai baht during the quarter, resulting in a decrease in the value of our baht denominated debt. The foreign currency valuation gain of approximately \$1.5 million in the three months ended January 3, 2009 was partly offset by the loss of approximately \$350,000 associated with our forward contracts placed previously. Our Thailand debt is denominated in Thai baht, and as a result, we have a significant short position in Thai baht. We made the decision in fiscal 2007 to reduce the level of forward contracts we place to purchase Thai baht to offset this short position because of the short term cash risks associated with placing these contracts. As a result, large changes in the value of the U.S. dollar versus the Thai baht will drive significant foreign currency valuation gains or losses as the value of our baht denominated debt increases or decreases.

Income Taxes

No net income tax expense or benefit was recorded for the three months ended January 3, 2009 and December 29, 2007 as the deferred tax valuation allowance was increased to offset the tax benefit generated during the quarter. The deferred tax assets continue to be fully reserved.

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Critical Accounting Policies

Our significant accounting policies are described in Note A to the Consolidated Financial Statements and the Management's Discussion and Analysis of Financial Condition and Results of Operations included in our Annual Report for the year ended September 27, 2008. The accounting policies used in preparing our interim 2009 Consolidated Financial Statements is the same as those described in our Annual Report.

Liquidity and Capital Resources

We have historically financed our operations primarily through cash from operating activities, sales of equity securities, bank credit facilities and employee stock option exercises. Cash and equivalents were \$2.9 million at January 3, 2009 and \$6.5 million at September 27, 2008. As of January 3, 2009, the Company had a working capital deficit of \$36.4 million.

For the three months ended January 3, 2009, net cash used in operating activities of \$2.2 million primarily resulted from the net loss for the period net of non-cash charges and a \$6.6 million decrease in accounts payable, partially offset by a \$2.1 million decrease in inventory and \$6.3 million decrease in accounts receivable. The decrease in inventory level was primarily driven by the overall soft demand. The decline in accounts payable was mainly due to the pay down of our liabilities and partly due to the lower inventory purchases made during the quarter. The decrease in accounts receivable was partly driven by the lower revenue as well as partly due to the improvement in our Days Sales Outstanding (DSO) from 62 days in the fiscal 2008 first quarter to 59 days in the fiscal 2009 first quarter.

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Net cash used in investing activities was \$865,000 in the first three months of fiscal 2009, compared to \$369,000 in the first three months of fiscal 2008. The net cash used in investing activities pertained to capital spending related to process improvements at our Thailand facility.

Net cash used in financing activities was \$513,000 in the first three months of fiscal 2009, compared to net cash provided by financing activities of \$7.3 million in the first three months of fiscal 2008.

For the first three months of fiscal 2009, net cash used in financing activities was the result of scheduled debt repayments of \$493,000 on our existing Thailand debt facilities and U.S. based debt, a \$606,000 decrease in the U.S. dollar foreign exchange valuation of the Thai baht denominated debt and partially offset by the \$586,000 borrowed under our short-term Thailand packing credit facilities. For the first three months of fiscal 2008, net cash provided by financing activities was primarily related to the \$8.6 million borrowed under our short-term Thailand packing credit facilities, a \$1.1 million draw down under our long term Thailand credit facilities and a \$0.4 million increase in the U.S. dollar foreign exchange valuation of the Thai baht denominated debt partially offset by the normally scheduled debt payments on our existing Thailand debt facilities and U.S. based debt.

In December 2006, we entered into a new credit facility with Bank of Ayudhya Public Company Limited (BAY) and TMB Bank Public Company Limited (TMB) which expanded our existing credit facilities with these banks. The new Third Credit Facilities Agreement provided for an additional 600 million baht facility to be used for procurement of equipment within 24 months from the December 19, 2006 effective date. We drew down approximately \$9.5 million under this new credit facility in fiscal 2007 and \$1.6 million in the fiscal 2008 first and second quarters. In June 2004, we entered into the Second Credit Facilities

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Agreement with BAY and TMB which expanded the existing credit facility with these banks. The Second Credit Facilities Agreement is now comprised of a 660 million baht long-term facility, a 400 million baht long-term facility, packing credit facilities totaling 1,100 million baht, short-term working capital facilities totaling 90 million baht and a 10 million baht overdraft facility. The Thailand facilities are secured by certain receivables, inventory and assets held by us in Thailand. As of January 3, 2009, we had approximately \$21.0 million (or 735 million baht) outstanding under our long-term Thailand credit facilities and a \$33.3 million (or 1,161 million baht) outstanding balance under our packing and short-term Thailand credit facilities. Total unused availability as of January 3, 2009 was approximately \$1.1 million (or 39 million baht) under our short-term packing credit and working capital facilities. Utilization of the packing credit facility availability is dependent on presenting qualifying customer purchase orders to the banks for draw down.

In June 2008, we completed the restructuring of our long-term debt facility with our Thai lenders. As part of the restructuring, our debt repayment schedules were modified resulting in a \$6.0 million reduction in repayments required to be made in the remainder of the fiscal 2008 and \$9.0 million reduction in payments required to be made in fiscal 2009. In addition, the undrawn portion available under the Third Credit Facilities Agreement of 600 million baht will be cancelled as part of the bank restructuring. No gain or loss was recorded as a result of the restructuring because it was determined by the Company to be a modification under EITF-96-19.

On December 30, 2008, both Thai lenders provided us with an approval to extend the repayment date of packing credit facilities that were originally due on December 29, 2008 to February 27, 2009. The sixty day payment date extension affected approximately 173.1 million baht owed to both banks. We have not received any approval of a further extension of the February 27, 2009 payment of certain credit packing facilities and our ability to repay the 173.1 million Baht or approximately \$5.0 million of packing credits due on February 27, 2009 depends on our prevailing cash on hand and our ability to present qualifying customer purchase orders to the bank for draw down.

In January 2005, we entered into a financing agreement with US Federal Credit Union under which we borrowed \$4.0 million. An additional \$3.1million was borrowed under that agreement on April 15, 2005. In addition to normally scheduled payments, a principal payment of \$1.5 million was made on June 27, 2006 related to sale of the business, facility and assets of our etched metal components business. An additional principal payment of \$4 million was made on May 18, 2007 related to the sale of the Maple Plain facility. As of January 3, 2009, \$0.4 million was outstanding under our US Federal credit facility. While the note is due February 1, 2010, the final payment is scheduled to be made during the fourth quarter of fiscal 2009 as a result of the prepayments. Payments under the underlying note are calculated using a 25 year amortization with the remaining principal amount due at maturity. The note is secured by our Litchfield facilities and any proceeds from the sale of those facilities will be used to pay down the outstanding note balance.

We will require additional capital resources for our business. Our ability to continue as a going concern depends primarily on our ability to obtain additional financing or to further restructure our credit facilities with our lenders. We will continue to work with our Thai lenders to explore additional restructuring of our existing debt as well as to consider an additional working capital facility or long-term financing. We believe that our immediate need for capital to finance our day-to-day business activities over the next quarter could potentially be provided, if at all, by our current lenders in the form of a restructuring of our debt to reduce required payments and to provide

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additional lending. No assurance can be given that additional working capital will be obtained in an amount that is sufficient for our needs, in a timely manner or on terms and conditional acceptable to us or our shareholders. If we are unable to obtain additional financing or restructure our credit facilities (including an extension for the February 27, 2009 repayment or restructuring of the amounts owed), our ability to make the required payments on our debt will be impaired and may result in payment or covenant defaults, acceleration of our indebtedness, seizure by the banks of assets that secure our indebtedness, loss of control of our business, cessation of business or bankruptcy. Our financial statements have been prepared assuming that we will continue as a going concern. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

Contractual Obligations

The table below discloses a summary of the Company's specified contractual obligations at January 3, 2009 (in thousands):

	Under 1 Year	1 to 3 Years	3 to 5 Years	After
	-----	-----	-----	-----
Long-term Debt Obligations (1)	\$ 4,106	\$ 11,613	\$ 5,690	
Operating Leases	348	577	204	
	-----	-----	-----	-----
Total	\$ 4,454	\$ 12,190	\$ 5,894	
	=====	=====	=====	=====

(1) Includes interest at a fixed rate of 7% on a portion of the debt and excludes interest on all debt with variable interest rates.

Recent Accounting Pronouncements

In March 2008, the FASB issued SFAS No. 161, "Disclosures about Derivative Instruments and Hedging Activities--an amendment of FASB Statement No. 133" ("FAS 161"). FAS 161 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 Statement 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. The guidance in FAS 161 is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008, with early application encouraged. This Statement encourages, but does not require, comparative disclosures for earlier periods at initial adoption. The Company is currently evaluating the provisions of FASB 161 to determine the impact on the company's consolidated financial statements.

In September 2006, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 157, Fair Value Measurement (SFAS 157). This standard clarifies the principle that fair value should be based on the assumptions that market participants would use when pricing an asset or liability. Additionally, it establishes a fair value hierarchy that prioritizes the information used to develop those assumptions. SFAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007. We have not yet determined the impact that the implementation of SFAS 157 will have on our results of operations or financial condition.

The Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 159, Fair Value Option for Financial Assets

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and Financial Liabilities (SFAS 159). This standard addresses earnings volatility caused by existing accounting standards that require related financial assets and liabilities to be measured using different measurement attributes (such as historical cost and fair value). SFAS 159 is intended to improve financial reporting by giving all entities the option to recognize most financial assets and liabilities and certain other items at fair value. Unrealized gains and losses on items for which the fair value option has been elected should be reported in earnings. SFAS 159 is effective for the first quarter of our fiscal 2009 beginning October 1, 2008. The adoption of SFAS 159 did not have a material effect on our financial condition or results of operations.

Forward Looking Statements

Statements included in this Management's Discussion and Analysis of Financial Condition and Results of Operations, elsewhere in this report and in future filings by the Company with the SEC, except for the historical information contained herein and therein, are "forward-looking statements" that involve risks and uncertainties. These risks and uncertainties include: the increased utilization by our largest customer of alternative interconnect technologies that compete with our FSA product, AFC and FPD revenue may not increase enough to offset decreases in our FSA revenue, any interruption in the operations of the Company's single source suppliers or any failure of any of the Company's single source suppliers to timely deliver an adequate supply of

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components, the timely availability and acceptance of new products, the impact of competitive products and pricing, changes in our customers' market share, impact of restructuring charges, changes in manufacturing efficiencies, ability to secure additional financing, continued cash availability under our credit facilities, fluctuations in currency rates and other risks detailed from time to time in our reports filed with the Securities and Exchange Commission, including those risks described under Part I, Item 1A. "Risk Factors" in our Annual Report on Form 10-K for the year ended September 27, 2008. In addition, a significant portion of the our revenue is generated from the disk drive, flat panel display, stacked memory substrate, consumer electronics and data storage industries and the global economic softness has had and may have in the future, an adverse impact on our operations. We disclaim any obligation subsequently to revise any forward-looking statements to reflect subsequent events or circumstances or the occurrence of unanticipated events.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK

The following discusses our exposure to market risk related to changes in interest rates and foreign currency exchange rates. These exposures may change over time as business practices evolve and could have a material adverse impact on our business, financial condition and results of operations.

Our earnings and cash flows are subject to fluctuations resulting from changes in foreign currency exchange rates. While we transact business primarily in U.S. dollars, a portion of our sales and expenses are denominated in foreign currencies. Changes in the relation of foreign currencies to the U.S. dollar will affect our cost of sales and operating margins and could result in exchange gains or losses. To reduce the impact of certain foreign currency fluctuations, we may enter into short-term forward foreign currency exchange contracts in the regular course of business to manage our risk exposure, not as speculative instruments. Typically, these contracts have maturities of 6 months or less. The forward exchange contracts generally require us to exchange Thailand baht for U.S. dollars or U.S. dollars for Thailand baht at maturity, at rates agreed to

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at inception of the contracts. These contracts are not designated as hedges, therefore, the gains and losses on foreign currency transactions are included in income.

We periodically review the outlook for expected currency exchange rate movements as well as the policy on desired future foreign currency cash flow positions (long, short or balanced) for those currencies in which we have significant activity. Expected future cash flow positions and strategies are continuously monitored. At January 3, 2009, the Company did not have any open forward exchange contracts to buy Thai baht in return for U.S. dollars. All remaining forward exchange contracts purchased during previous fiscal quarters have matured and were settled by December 4, 2008. No assurance can be given that our strategies will prevent future currency fluctuations from adversely affecting our business, financial condition and results of operations.

We are exposed to interest rate risk as a large portion of our interest-bearing debt is subject to interest rates which fluctuate with changes in market interest rates or are periodically reset based on market interest rates. A large change in market interest rates could have an adverse impact on our business, financial condition and results of operations.

ITEM 4. CONTROLS AND PROCEDURES

(a) Evaluation of Disclosure Controls and Procedures

The Company's Chief Executive Officer, Terry M. Dauenhauer, and Chief Financial Officer, Randy L. Acres, have evaluated the Company's disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934) as of the end of the period covered by this report. Based upon this review, they have concluded that these controls and procedures are effective.

(b) Changes in Internal Control Over Financial Reporting

There have been no changes in internal control over financial reporting that occurred during the fiscal period covered by this report that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

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PART II - OTHER INFORMATION

Responses to Items 1A, 2, 3, 4 and 5 are omitted since these items are either inapplicable or the response thereto would be negative.

ITEM 1. LEGAL PROCEEDINGS

We are party to certain lawsuits in the ordinary course of business. We do not believe that these proceedings, individually or in the aggregate, will have a material adverse effect on our business, financial condition or results of operations.

ITEM 6. EXHIBITS

The following exhibits are included herein:

- 31.1 Certification of Chief Executive Officer pursuant Rules 13a-14 and 15d-14 of the
- 31.2 Certification of Principal Financial Officer pursuant Rules 13a-14 and 15d-14 of
- 32 Certificate pursuant to 18 U.S.C. Section 1350.

SIGNATURES

Pursuant to the requirements 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.

INNOVEX, INC.

Date: February 17, 2009

By /s/ Terry M. Dauenhauer

Terry M. Dauenhauer
President and Chief Executive Officer

By /s/ Randy Acres

Randy Acres
Senior Vice President and Chief
Financial Officer