

**WINLAND**  
**ELECTRONICS, INC.**

**1999**

**ANNUAL REPORT**

# BUSINESS DESCRIPTION



Winland Electronics, Inc. designs, engineers and manufactures high quality electronic controls and proprietary products in an ISO-registered, world class electronics manufacturing complex in Mankato, Minnesota. Exceptional engineering and manufacturing capability, superb quality, and efficient, modern procurement practices have fueled the success of Winland's products and have attracted some of the most discriminating, value-driven, and quality-conscious OEM customers in the world.

Market-savvy customers like Select Comfort Corporation, Johnson Worldwide Associates, CIC Systems, Inc., PeopleNet Communications Corporation, and others depend on Winland to enhance customer satisfaction and long-term commercial success. As a result, some OEM customers rely on Winland to complete the design work necessary to launch their new products. Winland has found this type of frequent, multilevel interaction with OEM customers actually creates a degree of mutual dependence and leads to increased customer satisfaction, confidence, and loyalty. In the last fifteen years, Winland has not lost an OEM customer to the competition.

Before 1985, the company derived most of its revenues from the sale of security devices that were designed to monitor and detect changes in temperature and humidity, water leakage, and power failure. Within the security products industry Winland is recognized as being the *Environmental Security Specialist™*.

In 1984, in an effort to diversify its business, the Company began to design and manufacture custom electronic controls and assemblies for OEM customers. During the past few years, a rapid and comprehensive ramp-up of facilities, manufacturing capacity, and technical expertise have helped to position Winland as a leading designer and manufacturer of custom electronic controls in the Midwest. During 1999, aggressive research and development programs supported OEM customer projects and also resulted in the development of two new Winland product lines in high-growth markets.

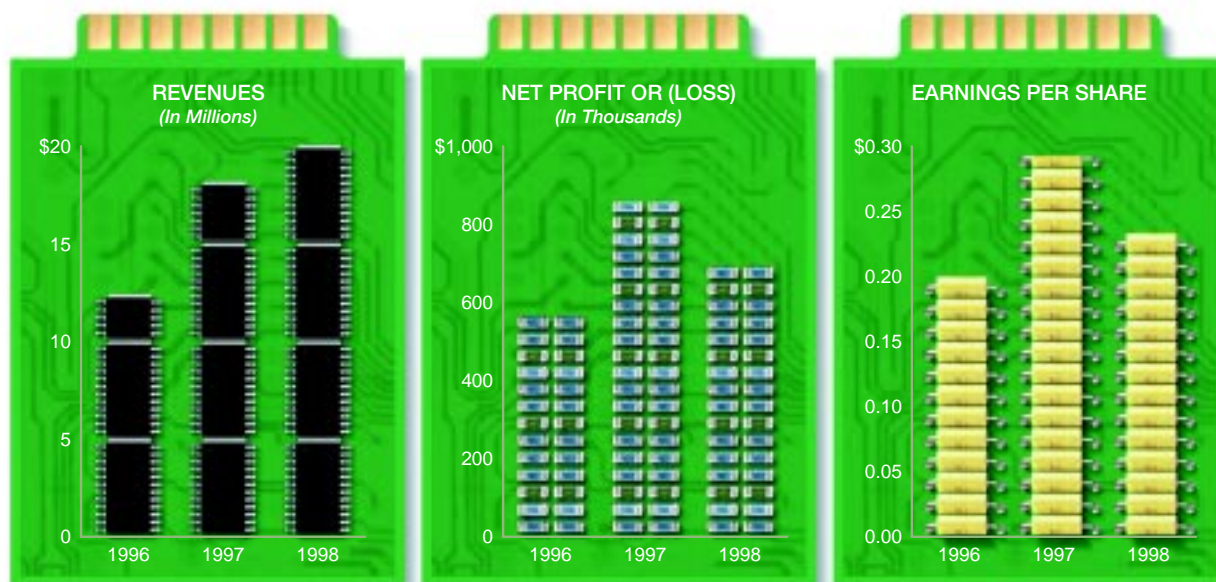
The full range of value added services provided by Winland include design engineering, value engineering, manufacturing engineering, high-end factory automation, testing, out-of-warranty repair, shipping, and warehousing services. These extra services help to distinguish Winland from traditional providers of contract manufacturing and have helped the Company to establish and maintain profitable long-term relationships with OEM customers.

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# FINANCIAL HIGHLIGHTS

	<i>Years ended December 31,</i>		
	<u>1999</u>	<u>1998</u>	<u>1997</u>
<b>FOR THE YEAR</b>			
Net Sales	\$ 19,863,703	\$ 18,175,509	\$ 12,382,878
Net Income	\$ 680,919	\$ 855,595	\$ 566,687
Earnings Before Income Tax	\$ 1,008,919	\$ 1,095,595	\$ 607,181
<b>PER SHARE DATA</b>			
Diluted Earnings Per Share	\$ 0.23	\$ 0.29	\$ 0.20
Weighted Average Common Shares Outstanding Including Potentially Dilutive Shares	3,001,247	2,935,058	2,875,977
<b>AT YEAR END</b>			
Total Shareholders' Equity	\$ 4,536,878	\$ 3,828,068	\$ 2,908,679
Long-term Debt	\$ 3,238,995	\$ 3,429,975	\$ 3,543,461
Total Assets	\$ 11,858,599	\$ 11,630,599	\$ 10,349,120



## CHAIRMAN AND PRESIDENT'S



**W. Kirk Hankins**  
Chairman of the Board and  
Chief Executive Officer



**Lorin E. Krueger**  
President and  
Chief Operating Officer

# LETTER TO

During 1999, Winland's achievements in product quality, new product development, manufacturing efficiency, and information technologies reflected successful completion of the most aggressive, long-term initiatives in the company's history. Two significant outcomes—ISO 9001 registration and the implementation of continuous flow manufacturing (CFM)—will directly benefit Winland's existing customers and, at the same time, help diversify and expand our customer base.

Winland's heavy emphasis on new product and market development resulted in an innovative new line of DC motor controllers and a new, proprietary GPS Antenna product offering. These new products present exciting new opportunities in rapidly expanding markets.

Other key achievements during 1999 included:

- Implementation of a new inventory pull system, being phased in over the past two years, that has improved inventory turns threefold on as many as 150 components from 13 suppliers with a total value of \$5 million
- Initial customer orders for both DC motor controller and GPS Antenna product lines
- Received purchase orders from four new OEM customers during the year
- Honored by *CityBusiness*
- Performed steps needed to begin trading on the American Stock Exchange in January 2000
- Selected as a finalist for the 1999 Minnesota Technology Award
- Received a \$8.5 million purchase order from Select Comfort
- Included in Deloitte & Touche's prestigious "Fast 50" Program for Minnesota, a ranking of the 50 fastest-growing technology companies in the area

# OUR SHAREHOLDERS

Financial results during 1999 reflect Winland's investment in personnel, infrastructure and new methodologies to support long-term growth. For the year ended December 31, 1999, the company recorded net sales of \$19,863,703, a 9.3 percent increase from \$18,175,509 reported during 1998. Net income was \$680,919, or \$0.23 per fully diluted share, for 1999, compared to \$855,595, or \$0.29 per fully diluted share, during 1998.

Although operating income declined to \$1,299,777 during 1999, from \$1,478,599 last year, the effect on pretax income was partially offset by a decline in interest expense during 1999. The decrease in net income was also the result of Winland paying a higher income tax rate during 1999 than during 1998 and previous years, as net operating loss carryforwards were utilized in 1998.


In view of our very high growth rate during the past few years, sales growth during 1999 may seem disappointing. The slowdown caused by deferred order shipments and other customer delays during the second half of the year, gave Winland the opportunity to build a stronger organization, broaden our base of OEM customers, develop additional proprietary products, and solve some challenges that rapid growth had created. Also, the addition of personnel and continued training of existing employees allowed management to devote more time toward acquisition of new OEM customers.

The year 1999 was a busy, productive year, and our staff has demonstrated extraordinary levels of dedication, loyalty, and innovation. Looking forward to 2000 and beyond, we are very optimistic about Winland's ability to grow and become more efficient. At the same time, in order to achieve long-term growth in shareholder value, we will need to continue our investment in people and technology. We appreciate your support and encouragement.

Sincerely,



W. Kirk Hankins



Lorin E. Krueger

March 30, 2000

# BUSINESS REVIEW

## Overview

Throughout the year, Winland's investment in personnel and training, systems and controls, information technology, and capital improvements promoted long-range initiatives necessary to serve customers better and compete in new growth sectors of technology. Powerful new tools, including ISO 9001, CFM (Continuous Flow Manufacturing), and the Arrow Electronic's CARES<sup>SM</sup> Automated Replenishment System, are having a positive impact on every area within Winland's operations.



From the most visible functions in the company like marketing, engineering and manufacturing, to those who work behind the scenes, no department within Winland went without change and improvement during 1999. Accounting and administrative personnel enhanced their capability in many areas that are vital to achieving total customer satisfaction and the high levels of internal support required for continuing growth. Engineering and manufacturing personnel, as well as staff in information technologies, marketing, procurement, and customer service developed and refined systems that meet ISO standards, improve productivity, and enhance quality.

By expanding and leveraging its engineering talent and developing a highly focused intellectual pool of design expertise, the company has widened the gap between itself and traditional contract manufacturing in a more aggressive manner than ever before in its history. For Winland's customers, the evolution and refinement of the

company's capability provides practical benefits—for Winland and its shareholders, it broadens the potential for entry into high-stakes markets like communications and wireless technologies, satellite technology, imbedded software applications, and AC and DC power control.

## ISO 9001. . . a world-class standard for Winland and its customers

Winland's efforts to secure ISO 9001 registration during 1999 are the essence of the company's commitment to empower its people, and to deliver precisely what customers want, with consistent quality, on time, and at a price that promotes customer and industry relationships.

At Winland, ISO 9001 practices support organizational objectives by providing a means to continuously monitor and improve operating systems and by promoting employee empowerment through a documented system. The "culture" of ISO touches every employee at Winland every day, with the objective of achieving 100 percent customer satisfaction.





## Engineering a path into the future

During 1999, Winland invested substantially in engineering department systems, personnel, and equipment both in support of OEM customer projects as well as Winland's proprietary research and development projects. The company implemented improvements within engineering related to ISO elements in design control and documentation and data control, and devel-

oped common reference guides for Project Engineering, Software/Firmware Development, Mechanical Drafting, and Schematic and Printed Circuit Board Development.

Winland's capital investments in engineering were primarily aimed at upgrading test equipment and its capability to utilize full solid modeling of mechanical devices. To accommodate additional research and development projects and to streamline departmental operations, personnel were added in the disciplines of Project Engineering, Continuation Engineering, Component Engineering, and Project Management Coordination. Value engineering solutions played a significant role in enhancing customer satisfaction by reducing or eliminating component costs through the implementation of new designs or the use of upgraded components.

## New Products and Markets

In the most aggressive new product development campaign in the company's history, Winland's research and development engineers successfully launched the new SatSource™ line of GPS antennas and an exciting new DC Motor Controller product line family. These products were created to serve multiple, high growth markets.



Like all Winland proprietary products, new products introduced during 1999 provide customers with choice, flexibility, value, and quality. Again, they give customers exactly what they need, at ISO standards, and with quality and design attributes they deserve.

## Increasing efficiency and improving quality in the manufacturing process

As in most areas of the company, ISO documentation, implementation and registration activities were the most dominant change factors affecting manufacturing during 1999. Key ISO elements involved management accountability, training, process control, quality, corrective action, and document and data control. At the same time, the company adopted CFM (Continuous Flow Manufacturing) as a methodology to eliminate waste, began work on a visual manufacturing floor, and established new measures for manufacturing throughput, quality, customer satisfaction, and safety.

In addition to these substantial upgrades to systems, controls, and methodologies, the company realigned its first shift manufacturing supervisory team, added a supervised second shift, and expanded the manufacturing test engineering area by one engineer and three technical support personnel.

## Supply chain management

During 1999, Winland's purchasing and materials department procured and managed higher volume than during any previous year. At the same time, it continued to refine and automate the purchasing process, established and managed the supplier Year 2000 readiness audit process, and implemented ISO standards. Among other benefits, the effect of these practices and other improvements resulted in increased inventory turns, and reduced financial exposure to inventories.



The company adopted ISO documentation standards for the handling, storage, packaging, preservation, and delivery of materials, and upgraded warehousing, expediting, and shipping procedures.

The company continued to expand the use of its CARES automated replenishment system, procuring approximately \$5 million (approximately one third of total purchased materials) under CARES during the year. CARES benefits the company by increasing inventory turns, automating the procurement process, and reducing the replenishment cycle time with suppliers carrying inventory for the company. As the subject of a feature article in *Purchasing Magazine*, November 18, 1999, Winland's success with CARES was widely recognized during the year.

## Keeping pace in an information revolution

This past year, software and hardware upgrades and/or expansions impacted virtually 100 percent of Winland's information technologies, information systems, and management information systems infrastructure. These included the main database server and development server running under the SCO™ Unix platform, three Novell™ servers, and three Microsoft NT™ servers, as well as an operating system upgrade to client workstations, telecommunications up-

grades, and server room improvements. In addition, the department implemented Winland's internal program to achieve Year 2000 readiness for all hardware and software.

The company completed two upgrades to its Syteline™ ERP system during the year and added the Symix™ Business Intelligence module and Symix Advanced Forms module. These and other additions and upgrades provide Winland with significant cost-saving potential, and make more useful information readily available throughout the company.

Such improvements were achieved at substantially less than market cost as a result of discounts received under authorized reseller certifications held





by the company, the use of software maintenance contracts, and in-house custom programming activities in lieu of outside consulting.

Routinely, the activities and contribution of Winland's information technologies department can have a profound effect on Winland, its customers, and its suppliers. Continued investment in information technologies, systems and management will be fundamental to Winland's future objectives.

### **Winland . . . standing apart in a cluttered marketplace**

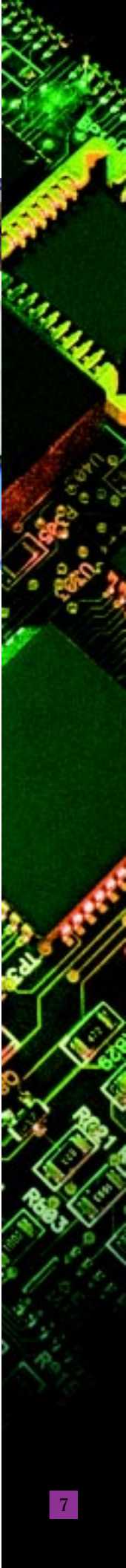
During the past year, Winland's marketing department embarked on the most comprehensive marketing activities in the company's history. Projects included: development and implementation of the company's new strategic sales and marketing plan, the creation of new brand marketing programs, the detailed analysis of a wide variety of competitive factors, the reorganization of a stronger, more effective sales and customer service department, and a host of product and market-specific advertising and marketing programs in support of new and existing products. New marketing and promotional tools were created, including brochures and a new video.

Much of the emphasis of the marketing department was in direct support of the two new product line families created by Winland during the year. However, the overall marketing effort was intended to target customers and markets where Winland can provide the most sustaining, value-added products and services that are consistent with financial objectives and the company's engineering and manufacturing expertise.

Many of the marketing projects, trade show exhibitions, and the advertising campaign initiated in 1999 were established to introduce the new proprietary products and to impact sales in the next eighteen months and beyond. The proactive nature of the company's marketing efforts will be reflected in a variety of ways, including the addition of sales and customer service personnel and an E-commerce website for Winland's products and services.



More than ever before, Winland and its people are "*stepping up to the future together*" with common objectives and a clear vision.



## Growth through Product & Marketplace Expansion

### *The Focus on Providing Solution Advantages*

Last year, Winland expanded its proprietary products with the addition of two new lines. These two new lines are the DC motor control products and the **SatSource™** GPS (Global Positioning System) antenna products. The focus of these new proprietary product lines is to provide a custom control solution which benefits the customer by exactly matching the application requirements. This solution advantage is accomplished through resourceful design versatility, enabling the controls to be customized easily and economically. This approach solves problems, saves money, and offers unparalleled flexibility, so the customer will no longer have to settle for a standard, off-the-shelf product and pay for expensive features that are not needed or required. Winland is proud to work directly with its customers, providing these solutions, positioning itself as the **“custom controls specialist™”**.

## SatSource™ GPS ANTENNAS

The GPS (global positioning system) market is one of the fastest growing segments of the information age. GPS systems are aiding in tracking, navigation and positioning with automobiles, trucks, boats and agricultural equipment. A vital component of GPS (global positioning system) is the GPS antenna. Seeing this opportunity and our experience in developing RF technology devices, Winland designed and began manufacturing its first GPS antenna in 1999, the model GPSAA1. To expand the product family, development of the GPSAA2, a second active antenna design, was also completed for availability during the second quarter of 2000. Both units have internal ground planes to provide a high gain output even when mounted to non-metal surfaces. This provides a benefit of greater signal strength in urban or heavy-forested areas. The designs are rugged for use in mobile environments with a sealed, UV resistant dome enclosure.

The units can be manufactured with custom cable lengths and types, connectors, or several mounting configurations. For the OEM customers, we also offer the model GPSPA2 active board antenna design for use in internally mounting in their own enclosure. Additional product releases are planned for 2000-2001.

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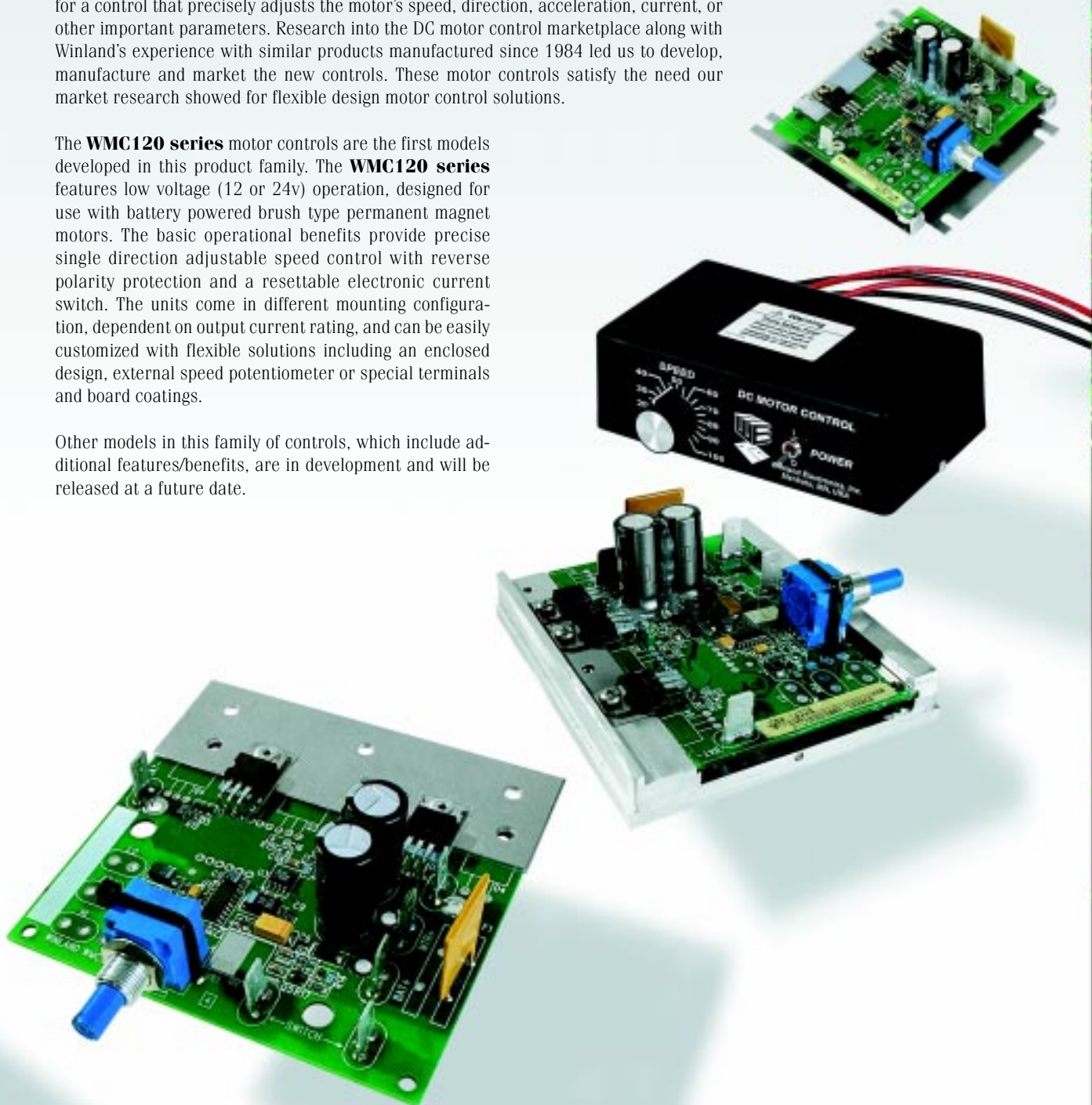
# PROPRIETARY PRODUCT LINES

## DC MOTOR CONTROLS

Low voltage DC motors are used in many everyday applications from wheelchairs, fans or blowers to scooters and automobiles. Many of these applications present opportunities for a control that precisely adjusts the motor's speed, direction, acceleration, current, or other important parameters. Research into the DC motor control marketplace along with Winland's experience with similar products manufactured since 1984 led us to develop, manufacture and market the new controls. These motor controls satisfy the need our market research showed for flexible design motor control solutions.

The **WMC120 series** motor controls are the first models developed in this product family. The **WMC120 series** features low voltage (12 or 24v) operation, designed for use with battery powered brush type permanent magnet motors. The basic operational benefits provide precise single direction adjustable speed control with reverse polarity protection and a resettable electronic current switch. The units come in different mounting configuration, dependent on output current rating, and can be easily customized with flexible solutions including an enclosed design, external speed potentiometer or special terminals and board coatings.

Other models in this family of controls, which include additional features/benefits, are in development and will be released at a future date.





# SELECTED FINANCIAL DATA

The following table sets forth selected financial data for Winland Electronics, Inc. which has been derived from the Company's financial statements. The financial data listed below should be read in conjunction with "Management's Discussion and Analysis or Plan of Operation" and the audited financial statements and related notes thereto included elsewhere in this annual report.

	Years Ended December 31,	
	<u>1999</u>	<u>1998</u>
<b>OPERATIONS DATA:</b>		
Net Sales	\$ 19,863,703	\$ 18,175,509
Cost of Sales	(15,977,721)	(14,255,149)
Gross Profit	3,885,982	3,920,360
Operating Expenses	2,586,205	2,441,761
Other Income and Expenses, Net	(290,858)	(383,004)
Income Before Income Taxes	1,008,919	1,095,595
Income Taxes	328,000	240,000
Net Income	\$ 680,919	\$ 855,595
<b>EARNING PER SHARE DATA:</b>		
Diluted Earnings Per Share	\$ 0.23	\$ 0.29
Weighted Average Common Shares Outstanding Including Potentially Dilutive Shares	3,001,247	2,935,058
<b>BALANCE SHEET DATA:</b>		
Working Capital	\$ 2,501,493	\$ 2,448,966
Total Assets	\$ 11,858,599	\$ 11,630,599
Long-Term Debt	\$ 3,238,995	\$ 3,429,975
Stockholders' Equity	\$ 4,536,878	\$ 3,828,068

#### **Availability of Form 10-KSB**

Shareholders of record may obtain the Company's annual report on Form 10-KSB for the fiscal year ended December 31, 1999, which will be filed with the Securities and Exchange Commission and will be available after April 1, 2000. This report (without exhibits) will be provided without charge upon written request to the Corporate Secretary.

# MD&A

## MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATION

### Results of Operations – 1999 vs. 1998

**Net Sales:** Net sales increased 9.3% to \$19,863,703 for the year ended December 31, 1999, compared to sales of \$18,175,509 for 1998. The growth in net sales is attributed to both increased sales to new and existing OEM customers as well as increased sales of existing security/industrial products for 1999 over 1998.

Major OEM customers have given the Company firm purchase commitments for delivery in 2000, having an aggregate value of \$11.2 million. These purchase commitments are at various stages of completion. The Company also has several smaller agreements with various OEM customers to be fulfilled in 2000.

The Company has continued to position itself as a full service designer and manufacturer of custom controls and assemblies for OEM customers. The loss of any major OEM customer would likely have an adverse effect on the Company's short-term and, potentially long-term, results.

**Gross Profits:** Gross profit was \$3,885,982 or 19.6% of net sales for the year ended December 31, 1999, compared to \$3,920,360 or 21.6% of net sales for the same period in 1998. As a percentage of net sales, gross profits declined 2% for the year ended December 31, 1999 compared to 1998. The decline in gross profit is primarily attributed to the sales mix and sales levels during 1999, as they relate to the fixed manufacturing costs. Some of the increased fixed costs relate to indirect costs incurred for Y2K readiness, additional staffing in the manufacturing area needed to support increased production levels, as well as additional costs associated with the purchase of manufacturing and test equipment to increase speed and reliability of in-process and final product testing; as well as direct and indirect costs associated with ISO 9001 registration achieved in 1999. To a lesser degree, the Company also experienced some loss of efficiencies due to the introduction of new people and new processes related to new customer products.

**Operating Expenses:** General and administrative expense was \$1,344,714 or 6.8% of net sales for the year ended December 31, 1999, compared to \$1,449,376 or 8.0% of net sales for the same period in 1998. The decline in general and

administrative expense as a percentage of net sales is primarily attributed to reduced bonus allowances, reduced bad debt expense and public relations expense, offset in part by increased costs associated with Y2K readiness, additional expenses associated with completion of a 5,000 square foot addition to the current facility, increased professional fees, increased staff expenses needed to support the growth of the organization, and to aid in ISO 9001 registration and continued monitoring to ensure compliance with certification requirements.

Marketing and customer relations expense was \$405,914 or 2.0% of net sales for the year ended December 31, 1999, compared to \$297,964 or 1.6% of net sales for the same period in 1998. The increase in marketing and customer relations expense for 1999 was primarily due to the addition of sales and customer relations personnel and other marketing expenses necessary to introduce two new proprietary product lines. The two new product lines have not yet advanced to the stage of full-scale production. The costs associated with Y2K readiness and ISO 9001 registration also had an impact on the marketing and customer relations expense during 1999.

The new product lines include a line of direct current (DC) motor controls and a line of global positioning system (GPS) antennas. In addition to the introduction of the new proprietary product lines, and continued marketing efforts to promote its other proprietary security/industrial products, the Company continues to work to develop long-term business partnerships with OEM customers.

The Company continues to upgrade its website in order to aid in the achievement of marketing efforts worldwide. The Company plans to add e-commerce capabilities to the website in 2000.

Research and development expense was \$835,577 or 4.2% of net sales for the year ended December 31, 1999, compared to \$694,421 or 3.8% of net sales for 1998. The increase in research and development expense was primarily attributed to increases related to the addition of technical staff needed to maintain and expand its engineering capabilities, as well as the addition of test and development equipment, which resulted in increased depreciation expense. The costs associated with Y2K readiness and ISO 9001 registration also had an impact on the research and development expense during 1999.



**Interest Expense:** Interest expense was \$413,216 or 2.1% of net sales for the year ended December 31, 1999, compared to \$534,127 or 2.9% of net sales for 1998. The reduction in interest is primarily attributed to reduced levels of debt outstanding on the working capital line of credit for 1999 compared to 1998. The interest rate on the line of credit was reduced from 1/2% over the prime rate to the prime rate in late 1998, which had an impact on the interest expense as well.

**Net Income:** The Company reported net income of \$680,919 or \$0.23 per diluted share for the year ended December 31, 1999, compared to net income of \$855,595 or \$0.29 per diluted share for 1998. In 1998, the Company used its remaining net operating loss tax credit carryforwards, and as a result, incurred substantially more income tax expense for 1999 compared to 1998.

Other contributing factors to the decline in net income for 1999 are a reduction of gross profits, offset in part by a decline in other income and expense compared to 1998.

#### **Results of Operations – 1998 vs. 1997**

**Net Sales:** Net sales increased 46.8% to \$18,175,509 for the year ended December 31, 1998, compared to \$12,383,878 for 1997. The growth in net sales is primarily attributed to increased sales to OEM customers during 1998 over 1997. In 1998 and 1997, sales to OEM customers represented 89% and 85% of total net sales. The Company currently has purchase agreements with Select Comfort Corporation to ship approximately \$8.4 million of product during 1999. The Company also has purchase agreements with PeopleNet Communications Corporation to ship approximately \$3.8 million in product in 1999. In addition to the above mentioned agreements, the Company also has several smaller agreements with various OEM customers to be fulfilled in 1999.

The Company has continued to position itself as a full service designer and manufacturer of custom controls and assemblies for OEM customers. The loss of any OEM customer would likely have an adverse effect on the Company's short-term and, potentially long-term, results. The Company's marketing research indicates that a large potential market exists for electronic design and manufacturing services and that this market continues to grow rapidly.

**Gross Profit:** Gross profit was \$3,920,360 or 21.6% of net sales for the year ended December 31, 1998, compared to \$2,729,315 or 22% of net sales for 1997. As a percentage of net sales, gross profit remained relatively constant.

**Operating Expenses:** General and administrative expense was \$1,449,376 or 8.0% of net sales for the year ended December 31, 1998, compared to \$1,043,788 or 8.4% of net sales for 1997. The decline as a percentage of net sales in such expenses is primarily attributed to administrative efficiencies the Company realized. The actual general and administrative expense increased \$405,588 for 1998 over 1997 due to the administrative support needed for the increased sales.

Marketing and customer relations expense was \$297,964 or 1.6% of net sales for the year ended December 31, 1998, compared to \$245,708 or 2.0% of net sales for 1997. The increase in marketing and customer relations expense as compared to 1997, arose in part to the Company's efforts to secure new, long-term OEM customer relationships to design and manufacture custom controls and assemblies. The actual marketing expense increased \$52,256 for 1998 over 1997. In late 1998, to enable the Company to continue to offer exceptional service to its OEM and security/industrial customers, the marketing and customer relations department expanded its support personnel.

Research and development expense was \$694,421 or 3.8% of net sales for the year ended December 31, 1998, compared to \$471,357 or 3.8% of net sales for 1997. Although as a percentage of net sales the research and development expense remained constant for 1998 compared to 1997, the actual research and development expense increased \$223,064 in 1998 over 1997. The increased research and development expense was needed to support the Company's efforts to expand its engineering capabilities with the addition of technical staff and the acquisition of additional test and development equipment, which resulted in increased depreciation expense being recognized.

**Interest Expense:** Interest expense was \$534,127 or 2.9% of net sales for the year ended December 31, 1998, compared to \$445,158 or 3.6% of net sales for 1997. The increase in actual expense is primarily associated with additional short-term borrowing and borrowing through capital lease agreements on equipment needed to support the increased sales. The Company believes the additions of capital equipment will likely positively affect quality and efficiencies in current and future periods.

**Net Income:** The Company reported net income of \$855,595 or \$0.29 per diluted share for the year ended December 31, 1998, compared to net income of \$566,687 or \$0.20 per diluted share for 1997. In 1998, the Company used its remaining net operating loss and tax credit carryforwards and as a result has incurred a substantial income tax expense for 1998,

compared to 1997. Even with the increased income tax expense, the net income for 1998 increased 51% over 1997. The Company's increased profitability resulted primarily from increased sales, and increased efficiencies, combined with careful budgeting and cost control.

The Company believes inflation has not significantly affected its results of operations.

**Liquidity and Capital Resources:** Cash provided by operating activities was \$1,497,408 in 1999, compared to \$1,013,656 in 1998. Cash provided by operations was primarily used to purchase additional property and capital equipment, to reduce debt on the revolving line of credit and on long term borrowing, including capital leases, off set in part by additional long term borrowing to finance an addition to the current facility.

The current ratio on December 31, 1999 was 1.7 to 1, compared to 1.6 to 1 on December 31, 1998. Working capital equaled \$2,501,493 on December 31, 1999, compared to \$2,448,966 on December 31, 1998. The increase in working capital primarily reflects reductions in the revolving line of credit balances, accounts payable, and income taxes payable, offset in part by increases in the current portion of long term debt, and decreases in inventory levels.

The Company has a revolving credit agreement with the Norwest Bank Minnesota South N.A. ("Norwest"), with a maximum loan limit of \$3,500,000, subject to additional limitations set forth in the credit agreement. The interest rate is calculated at prime rate. At December 31, 1999, an outstanding balance of \$1,518,501 existed under the line of credit. The agreement expires in August of 2000, at which time the Company anticipates that it will renew its working capital line of credit on terms similar to its existing line. The Company's management believes that the capital available through the current credit agreement, together with cash flows from operations, will be sufficient to meet the Company's capital needs at least through 2000.

The Company is currently indebted to the City of Mankato for a \$1,700,000 building loan and a \$500,000 state small cities loan, both of which are secured by a mortgage on the Company facility. These loans are payable in equal monthly installment payments of approximately \$16,200 until January 2005, at which time it may be necessary for the Company to renew the financing of the building. The Company also has two other mortgage loans entered into in 1999 for an addition to the current facility. The loans are as follows; a \$150,000 loan

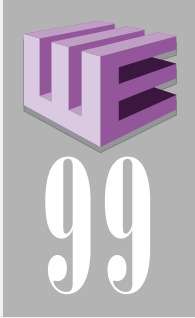
through the Minnesota Initiative Fund with monthly installment payments of approximately \$1700, and a loan from Norwest of \$530,053 with monthly installment payments of approximately \$5,200. Both loans are secured by a mortgage on the Company facility.

**Cautionary Statements:** As provided for under the Private Securities Litigation Reform Act of 1995, the Company wishes to caution investors that the following important factors, among others, in some cases have affected and in the future could affect the Company's actual results of operations and cause such results to differ materially from those anticipated in forward-looking statements made in this document and elsewhere by or on behalf of the Company.

The Company derives a significant portion of its revenues from a small number of major OEM customers which are not subject to any long-term contracts with the Company. If any major customer should for any reason stop doing business with the Company, the Company's business would be adversely affected. Some of the Company's key customers are not large well-established companies, and the business of each customer is subject to various risks such as market acceptance of new products and continuing availability of financing. To the extent that the Company's customers encounter difficulties, or the Company is unable to meet the demands of its OEM customers, the Company could be adversely affected.

The Company's ability to sustain continued increases in revenues and profits is dependent upon its ability to retain existing customers and obtain new customers. The Company competes for new customers with numerous independent contract design and manufacturing firms in the United States and abroad, many of whom have greater financial resources and a more established reputation. The Company's ability to compete successfully in this industry depends, in part, upon the price at which the Company is willing to manufacture a proposed product and the quality of the Company's design and manufacturing services. There is no assurance that the Company will be able to continue to obtain contracts from existing and new customers on financially advantageous terms, and the failure to do so could prevent the Company from achieving the growth it anticipates.

The operations and success of the Company depend, in part, upon the experience and knowledge of W. Kirk Hankins, the Company's Chief Executive Officer, and Chief Financial Officer and Lorin E. Krueger, the Company's President and Chief Operating Officer. The loss of either Mr. Hankins or Mr. Krueger would have a material adverse effect on the Company.



# FINANCIAL REPORT

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## INDEPENDENT AUDITOR'S REPORT

To the Board of Directors  
Winland Electronics, Inc.  
Mankato, Minnesota

We have audited the accompanying balance sheets of Winland Electronics, Inc., as of December 31, 1999 and 1998, and the related statements of income, changes in stockholders' equity, and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Winland Electronics, Inc., as of December 31, 1999 and 1998, and the results of its operations and its cash flows for the years then ended, in conformity with generally accepted accounting principles.

McGLADREY & PULLEN, LLP

Minneapolis, Minnesota  
January 26, 2000



## BALANCE SHEETS

December 31, 1999 and 1998

<b>ASSETS (Note 3)</b>	<b>1999</b>	<b>1998</b>
Current Assets		
Cash	\$ 40,017	\$ 20,656
Accounts receivable, less allowance for doubtful accounts of \$4,000 in 1999; \$155,000 in 1998 (Note 10)	2,530,765	2,482,507
Other receivables	1,107	47,454
Income tax receivable (Note 6)	19,000	—
Inventories (Note 2)	3,453,778	3,763,939
Prepaid expenses	58,591	62,882
Deferred taxes (Note 6)	112,800	124,000
<b>Total current assets</b>	<b>6,216,058</b>	<b>6,501,438</b>
Other Assets		
Patents and trademarks, net of accumulated amortization of \$30,269 in 1999; \$28,735 in 1998	3,971	5,505
	<b>3,971</b>	<b>5,505</b>
Property and Equipment, at cost (Note 4)		
Land and land improvements	272,901	270,009
Building	2,980,268	2,497,067
Machinery and equipment	3,234,166	3,001,256
Data processing equipment	1,305,425	842,352
Office furniture and equipment	367,898	267,472
	<b>8,160,658</b>	<b>6,878,156</b>
Less accumulated depreciation	2,522,088	1,754,500
	<b>5,638,570</b>	<b>5,123,656</b>
	<b>\$ 11,858,599</b>	<b>\$ 11,630,599</b>

See Notes to Financial Statements.

<b><u>LIABILITIES AND STOCKHOLDERS' EQUITY</u></b>	<b><u>1999</u></b>	<u>1998</u>
Current Liabilities		
Note payable to bank (Note 3)	\$ <b>1,518,501</b>	\$ 1,629,227
Current maturities of long-term debt	<b>656,671</b>	573,183
Accounts payable	<b>1,091,964</b>	1,263,326
Accrued expenses:		
Compensation	<b>337,846</b>	310,136
Other	<b>109,583</b>	47,757
Income taxes payable	—	228,843
<b>Total current liabilities</b>	<b><u>3,714,565</u></b>	<u>4,052,472</u>
Deferred Revenue (Note 5)	<b><u>202,161</u></b>	<u>209,084</u>
Long-Term Debt, less current maturities (Notes 3 and 4)	<b><u>3,238,995</u></b>	<u>3,429,975</u>
Deferred Taxes (Note 6)	<b><u>166,000</u></b>	<u>111,000</u>
Commitments and Contingencies (Note 4)		
Stockholders' Equity (Notes 7 and 9)		
Common stock, par value \$0.01 per share; 20,000,000 shares authorized; issued and outstanding 2,901,620 shares in 1999, 2,886,786 shares in 1998	<b>29,016</b>	28,867
Additional paid-in capital	<b>2,169,750</b>	2,142,008
Retained earnings	<b><u>2,338,112</u></b>	<u>1,657,193</u>
	<b><u>4,536,878</u></b>	<u>3,828,068</u>
	<b><u>\$ 11,858,599</u></b>	<u>\$ 11,630,599</u>



# STATEMENTS OF INCOME

Years Ended December 31, 1999 and 1998

	<u>1999</u>	<u>1998</u>
Net sales (Note 10)	\$ <b>19,863,703</b>	\$ 18,175,509
Cost of sales	<u><b>15,977,721</b></u>	<u>14,255,149</u>
<b>Gross profit</b>	<u><b>3,885,982</b></u>	<u>3,920,360</u>
Operating expenses:		
General and administrative	<b>1,344,714</b>	1,449,376
Research and development	<b>835,577</b>	694,421
Marketing	<b>405,914</b>	297,964
	<u><b>2,586,205</b></u>	<u>2,441,761</u>
<b>Operating income</b>	<u><b>1,299,777</b></u>	<u>1,478,599</u>
Other income (expenses):		
Interest expense	<b>(413,216)</b>	(534,127)
Interest income	<b>77,983</b>	151,428
Other	<b>44,375</b>	(305)
	<u><b>(290,858)</b></u>	<u>(383,004)</u>
<b>Income before income taxes</b>	<b>1,008,919</b>	1,095,595
Income taxes (Note 6)	<u><b>328,000</b></u>	<u>240,000</u>
<b>Net income</b>	<u><b>\$ 680,919</b></u>	<u>\$ 855,595</u>
Earnings per share data:		
Basic	\$ <b>0.24</b>	\$ 0.30
Diluted	<b>0.23</b>	0.29
Weighted-average number of common shares outstanding (Note 8):		
Basic	<b>2,894,219</b>	2,837,466
Diluted	<b>3,001,247</b>	2,935,058

See Notes to Financial Statements.

## STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

Years Ended December 31, 1999 and 1998

	Common Shares	Stock Amount	Additional Paid-In Capital	Retained Earnings	Total
Balance on December 31, 1997	2,808,039	\$ 28,080	\$ 2,079,001	\$ 801,598	\$ 2,908,679
Issuance of common stock in accordance with employee stock option and purchase plans (Notes 7 and 9)	78,747	787	63,007	-	63,794
Net income	-	-	-	855,595	855,595
Balance on December 31, 1998	2,886,786	28,867	2,142,008	1,657,193	3,828,068
Issuance of common stock in accordance with employee stock option and purchase plans (Notes 7 and 9)	14,834	149	27,742	-	27,891
Net income	-	-	-	680,919	680,919
Balance on December 31, 1999	<b><u>2,901,620</u></b>	<b><u>\$ 29,016</u></b>	<b><u>\$ 2,169,750</u></b>	<b><u>\$ 2,338,112</u></b>	<b><u>\$ 4,536,878</u></b>

See Notes to Financial Statements.



# STATEMENTS OF CASH FLOWS

Years Ended December 31, 1999 and 1998

	<u>1999</u>	<u>1998</u>
Cash Flows From Operating Activities		
Net income	\$ <b>680,919</b>	\$ 855,595
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	<b>774,340</b>	647,435
Loss on disposal of equipment	-	28,644
Deferred taxes	<b>66,200</b>	4,741
Changes in assets and liabilities:		
Accounts receivable	<b>(48,258)</b>	(901,139)
Other receivables	<b>46,347</b>	(47,454)
Income tax receivable	<b>(19,000)</b>	-
Inventories	<b>310,161</b>	(17,943)
Prepaid expenses	<b>4,291</b>	53,778
Accounts payable	<b>(171,362)</b>	63,149
Accrued expenses, including deferred revenue	<b>82,613</b>	102,421
Income taxes payable	<b>(228,843)</b>	224,429
<b>Net cash provided by operating activities</b>	<b><u>1,497,408</u></b>	<u>1,013,656</u>
Cash Flows From Investing Activities		
Purchases of property and equipment	<b>(1,060,971)</b>	(533,708)
<b>Net cash used in investing activities</b>	<b><u>(1,060,971)</u></b>	<u>(533,708)</u>
Cash Flows From Financing Activities		
Net payments on revolving credit agreement	<b>(110,726)</b>	(104,000)
Proceeds from long-term borrowings	<b>513,726</b>	115,000
Principal payments on long-term borrowings, including capital lease obligations	<b>(847,966)</b>	(557,628)
Proceeds from issuance of common stock	<b>27,890</b>	63,794
<b>Net cash used in financing activities</b>	<b><u>(417,076)</u></b>	<u>(482,834)</u>
<b>Net increase (decrease) in cash</b>	<b>19,361</b>	(2,886)
Cash		
Beginning of year	<b>20,656</b>	23,542
End of year	<b><u>\$ 40,017</u></b>	<u>\$ 20,656</u>
Supplemental Disclosures of Cash Flow Information		
Cash payments for:		
Interest	<b>\$ 423,166</b>	\$ 535,293
Income taxes	<b><u>510,241</u></b>	<u>10,571</u>
Supplemental Schedule of Noncash Investing and Financing Activities		
Capital lease obligations incurred for the purchase of equipment	<b><u>\$ 226,785</u></b>	<u>\$ 407,718</u>

See Notes to Financial Statements.

## NOTES TO FINANCIAL STATEMENTS

### Note 1. Significant Accounting Policies

**Nature of business:** The Company operates in one business segment, which includes the design and manufacture of electronic control devices. Sales are to customers located primarily in the upper Midwest, and credit is granted based upon the credit policies of the Company.

A summary of the Company's significant accounting policies follows:

**Use of estimates:** The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from such estimates and assumptions.

**Revenue recognition:** Revenue from product sales is recognized when shipped.

**Cash:** The Company maintains its cash in bank deposit accounts which, at times, may exceed federally insured limits. The Company has not experienced any losses in such accounts.

**Inventories:** Inventories are stated at the lower of cost (first-in, first-out method) or market.

**Patents and trademarks:** Patents and trademarks are stated at cost and are being amortized using the straight-line method over their economic useful lives.

**Depreciation:** It is the Company's policy to include depreciation expense on assets acquired under capital leases with depreciation expense on owned assets. Depreciation is computed using the straight-line method based on the estimated useful lives of the various assets, as follows:

	Years
Land improvements	17-20
Building	39-40
Machinery and equipment	5-7
Data processing equipment	3-7
Office furniture and equipment	3-7

**Long-lived assets:** The Company reviews its long-lived assets and intangibles periodically to determine potential impairment by comparing the carrying value of the long-lived assets with the estimated future cash flows expected to result from the use of the assets, including cash flows from disposition. Should the sum of the expected future cash flows be less than the carrying value, the Company would recognize an impairment loss. An impairment loss would be measured by comparing the amount by which the carrying value exceeds the fair value of the long-lived assets and intangibles. To date, management has determined that no impairment of long-lived assets exists.

**Income taxes:** Deferred taxes are provided on a liability method whereby deferred tax assets are recognized for deductible temporary differences and operating loss and tax credit carryforwards, and deferred tax liabilities are recognized for taxable temporary differences. Temporary differences are the differences between the reported amounts of assets and liabilities and their tax basis. Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion or all of the deferred tax assets will not be realized. Deferred tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of enactment.

Investment tax credits, research and development credits, and job credits are accounted for by the flow-through method whereby they reduce income taxes currently payable and the provision for income taxes in the period the assets giving rise to the credits are placed in service. To the extent such credits are not currently utilized on the Company's tax return, deferred tax assets, subject to considerations about the need for a valuation allowance, are recognized for the carryforward amount.



## NOTES TO FINANCIAL STATEMENTS

### Note 1. Significant Accounting Policies (Continued)

**Fair value of financial instruments:** In accordance with the requirements of Statement of Financial Accounting Standards (SFAS) No. 107, *Disclosures About Fair Value of Financial Instruments*, management estimates that the carrying value of long-term debt approximates fair value due to the variable-interest feature of the debt. The carrying value of all other financial instruments approximates fair value due to the short-term nature of the instruments.

**Earnings per share:** Basic earnings per share is computed by dividing net earnings by the weighted-average number of common shares outstanding during the period. Diluted earnings per share is computed by dividing net earnings by the weighted-average number of common shares outstanding during the period, including potentially dilutive shares under the treasury stock method.

**Research and development expense:** The Company expenses research and development costs as incurred. Research and development expenses of \$835,577 and \$694,421 were charged to operations during the years ended December 31, 1999 and 1998, respectively.

### Note 2. Inventories

The components of inventory at December 31, 1999 and 1998, are as follows:

	December 31	
	1999	1998
Raw materials	\$2,713,671	\$2,676,738
Work in progress	358,956	565,229
Finished goods	421,289	521,972
Obsolescence reserve	(40,138)	—
Total	<u>\$3,453,778</u>	<u>\$3,763,939</u>



## NOTES TO FINANCIAL STATEMENTS

**Note 3. Financing Arrangement and Long-Term Debt**

**Financing arrangement:** The Company has a \$3,500,000 revolving line-of-credit agreement through August 2000. Interest on advances is at the bank's reference rate (8.50 percent at December 31, 1999) and is due monthly. Advances are due on demand, are secured by substantially all assets of the Company, and are subject to a defined borrowing base equal to 80 percent of qualified accounts receivable and 60 percent of inventories. In addition, the agreement contains certain reporting and operating covenants. Advances outstanding on the revolving line-of-credit agreement at December 31, 1999 and 1998, were \$1,518,501 and \$1,629,227, respectively.

**Long-term debt:** The following is a summary of long-term debt:

	December 31	
	<u>1999</u>	<u>1998</u>
6.941% note payable due in monthly installments of \$15,221, including interest, to January 1, 2005, when the remaining balance is payable, secured by property and equipment	\$ 1,321,914	\$ 1,522,723
4% note payable due in monthly installments of \$3,698, including interest, to January 1, 2005, when the remaining balance is payable, secured by property and equipment	367,768	430,761
Note payable in monthly installments of \$8,334, plus interest at prime plus 0.75%, to October 2001, secured by accounts receivable	183,308	283,316
8.25% note payable, due in monthly installments of \$5,150, including interest, to September 2004, secured by equipment	525,527	—
6% note payable due in monthly installments of \$1,665, including interest, to November 2009, secured by building	150,000	—
8.75% note payable	—	167,660
Capitalized lease obligations, due in various monthly installments, with interest ranging from 8.95% to 9.5%, to October 2000, secured by equipment	21,813	130,584
Capitalized lease obligations, due in various monthly installments, with interest ranging from 8.5% to 9.96%, to August 2001, secured by equipment	223,871	342,219
Capitalized lease obligations, due in various monthly installments, with interest ranging from 7.24% to 10.04%, to October 2002, secured by equipment	432,400	342,389
Capitalized lease obligations, due in various monthly installments, with interest ranging from 8.5% to 9.3%, to April 2003, secured by equipment	193,497	235,804
Capitalized lease obligation, due in monthly installments of \$9,399, with interest at 8.97%, to November 2004, secured by equipment	<u>475,568</u>	<u>547,702</u>
	3,895,666	4,003,158
Less current maturities	<u>656,671</u>	<u>573,183</u>
Total long-term debt	<u>\$ 3,238,995</u>	<u>\$ 3,429,975</u>



## NOTES TO FINANCIAL STATEMENTS

### Note 3. Financing Arrangement and Long-Term Debt (Continued)

Approximate maturities of long-term debt for years subsequent to December 31, 1999, are as follows:

2000	\$ 657,000
2001	661,000
2002	413,000
2003	327,000
2004	347,000
Thereafter	<u>1,491,000</u>
Total	<u>\$ 3,896,000</u>

### Note 4. Commitments and Contingencies

**Capital leases:** The Company is leasing certain equipment under capital leases. The cost and accumulated depreciation of assets acquired under capital leases at December 31, 1999 and 1998, are as follows:

	<u>1999</u>	<u>1998</u>
Cost	\$ 2,489,281	\$ 2,450,678
Accumulated amortization	<u>1,084,803</u>	<u>709,274</u>
Net leased property under capital leases	<u>\$ 1,404,478</u>	<u>\$ 1,741,404</u>

The future minimum lease payments under capital leases and the aggregate present value of the net minimum lease payments at December 31, 1999, are as follows:

2000	\$ 522,000
2001	469,000
2002	262,000
2003	150,000
2004	<u>157,000</u>
Total minimum lease payments	1,560,000
Less amount representing interest	<u>213,000</u>
	<u>\$ 1,347,000</u>

The capital lease obligations are included in long-term debt.

**Operating leases:** The Company leases certain equipment and vehicles under noncancelable operating leases through 2002. The Company is responsible for all repairs and maintenance, insurance, and other related expenses in connection with these leases.

Rental and other related expenses for the above leases for the years ended December 31, 1999 and 1998, were approximately \$126,000 and \$113,000, respectively.

Approximate minimum future annual lease payments under these leases as of December 31, 1999, are as follows:

Years ending December 31:	
2000	\$ 68,000
2001	41,000
2002	<u>2,000</u>
	<u>\$ 111,000</u>

## NOTES TO FINANCIAL STATEMENTS

**Note 5. Deferred Revenue**

During 1994, the Company and the city of Mankato entered into a tax increment financing agreement for the construction of the Company's operating facility. In connection with this agreement, the city donated land and land improvements with a fair value of \$270,009. The fair value of land and land improvements donated was accounted for as deferred revenue and is being amortized over 39 years, which is the life of the building.

**Note 6. Income Taxes**

Components of the provision for income taxes are as follows:

	December 31	
	1999	1998
Currently payable	\$ 261,800	\$ 235,000
Deferred	66,200	5,000
	<u>\$ 328,000</u>	<u>\$ 240,000</u>

During 1998 the Company also received a tax benefit from the carryforward of net operating losses and tax credits totaling approximately \$137,000.

The statutory income tax rate reconciliation to effective rate is as follows:

	December 31	
	1999	1998
Statutory U.S. income tax rate	35%	35%
State taxes, net of federal tax benefit	3%	2%
Tax benefit of NOL and credit carryforwards	-	(11%)
Research and development tax credit	(2%)	(3%)
Other	(3%)	(1%)
Effective income tax rate	<u>33%</u>	<u>22%</u>

Net deferred taxes consist of the following components as of December 31, 1999 and 1998:

	December 31	
	1999	1998
Deferred tax assets:		
Inventory	\$ 55,000	\$ 43,000
Allowance for doubtful accounts	1,000	57,000
Other	56,800	24,000
Deferred tax assets	112,800	124,000
Deferred tax liabilities:		
Property and equipment	166,000	111,000
Net deferred tax assets (liabilities)	<u>\$ (53,200)</u>	<u>\$ 13,000</u>



## NOTES TO FINANCIAL STATEMENTS

### Note 6. Income Taxes (Continued)

The components giving rise to the net deferred tax asset described above have been included in the accompanying balance sheets at December 31, 1999 and 1998, as follows:

	December 31	
	1999	1998
Current assets	\$ 112,800	\$ 124,000
Noncurrent liabilities	166,000	111,000

### Note 7. Stock-Based Compensation Plans

**Stock option plan:** The Company has reserved 750,000 common shares for issuance under qualified and nonqualified stock options for its key employees and directors. Option prices are the market value of the stock at the time the option was granted. Options become exercisable as determined at the date of grant by a committee of the Board of Directors. Options expire over the term of the options, generally five years after the date of grant, unless an earlier expiration date is set at the time of grant.

The Company has adopted the disclosure-only provisions of Statement of Financial Accounting Standards No. 123, *Accounting for Stock-Based Compensation*. Accordingly, no compensation cost has been recognized for the stock option plan. Had compensation cost for the Company's stock option plan been determined based on the fair value at the grant date for awards consistent with the provisions of SFAS No. 123, the Company's earnings and earnings per share would have changed to the pro forma amounts indicated below:

	December 31	
	1999	1998
Net income—as reported	\$ 680,919	\$ 855,595
Net income—pro forma	582,672	750,147
Net income per share, basic—as reported	0.24	0.30
Net income per share, diluted—as reported	0.23	0.29
Net income per share, basic—pro forma	0.20	0.26
Net income per share, diluted—pro forma	0.19	0.25

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option pricing model with the following weighted-average assumptions used for grants in 1999 and 1998:

	December 31	
	1999	1998
Expected life of options	3 years	3 years
Expected dividend yield	0.0%	0.0%
Expected stock price volatility	63.8%	65.2%
Risk-free interest rate	6.2%	5.7%

The pro forma effect on earnings in 1999 and 1998 is not representative of the pro forma effect in future years because it does not take into consideration pro forma compensation expense related to grants made prior to 1995.

## NOTES TO FINANCIAL STATEMENTS

**Note 7. Stock-Based Compensation Plans (Continued)**

Additional information relating to all outstanding options as of December 31, 1999 and 1998, is as follows:

	<u>1999</u>		<u>1998</u>	
	<u>Shares</u>	<u>Weighted-Average Exercise Price</u>	<u>Shares</u>	<u>Weighted-Average Exercise Price</u>
Options outstanding, beginning of year	370,000	\$ 1.89	345,000	\$ 2.25
Options exercised	(9,000)	1.78	(69,400)	0.63
Options expired	(2,000)	1.75	(17,600)	2.50
Options granted	<u>68,000</u>	<u>2.46</u>	<u>112,000</u>	<u>2.11</u>
Options outstanding, end of year	<u>427,000</u>	<u>\$ 1.98</u>	<u>370,000</u>	<u>\$ 1.89</u>
Weighted-average fair value of options granted during the year		\$ 1.20		\$ 0.93

The following table summarizes information about stock options and warrants outstanding at December 31, 1999:

Range of Exercise Prices	Options Outstanding			Options Exercisable	
	<u>Number of Shares</u>	<u>Weighted-Average Remaining Contractual Life (Years)</u>	<u>Weighted-Average Exercise Price</u>	<u>Number of Shares</u>	<u>Weighted-Average Exercise Price</u>
\$1.75	247,000	2.2	\$ 1.75	149,600	\$ 1.75
\$1.875 to \$1.925	78,000	2.1	1.92	62,250	1.93
\$2.344 to \$2.938	<u>102,000</u>	4.7	<u>2.61</u>	<u>72,000</u>	<u>2.68</u>
	<u>427,000</u>		<u>\$ 1.99</u>	<u>286,850</u>	<u>\$ 2.02</u>

At December 31, 1998, there were 204,400 options exercisable at a weighted-average exercise price of \$1.99.

The Company also has outstanding warrants to purchase 37,000 shares of common stock. These warrants are exercisable at \$2.20 per share through March 2000.



## NOTES TO FINANCIAL STATEMENTS

### Note 8. Earnings Per Share

The following table reflects the calculation of basic and diluted earnings per share:

	<u>1999</u>	<u>1998</u>
Earnings per share—basic:		
Income available for common shareholders	\$ <u>680,919</u>	\$ <u>855,595</u>
Weighted-average shares outstanding	2,894,219	2,837,466
Earnings per share—basic	\$ <u>0.24</u>	\$ <u>0.30</u>
Earnings per share—diluted:		
Income available to common shareholders	\$ <u>680,919</u>	\$ <u>855,595</u>
Weighted-average shares outstanding	2,894,219	2,837,466
Dilutive impact of options outstanding	101,671	93,320
Dilutive impact of warrants outstanding	<u>5,357</u>	<u>4,272</u>
Weighted-average shares and potential dilutive shares outstanding	<u>3,001,247</u>	<u>2,935,058</u>
Earnings per share—diluted	\$ <u>0.23</u>	\$ <u>0.29</u>

Options to purchase 102,000 and 40,000 shares of common stock at December 31, 1999 and 1998, respectively, were not included in the computation of diluted earnings per share because the option exercise prices were greater than the average market price of common shares.

### Note 9. Employee Benefit Plans

**Pension plan:** The Company has a qualified defined contribution 401(k) profit-sharing plan for its employees who meet certain age and service requirements. Employees are allowed to make contributions up to 15 percent of their eligible compensation. The plan also provides for a company-sponsored match to be determined each year by the Board of Directors. The Company contributed approximately \$80,600 and \$66,200 to the plan for the years ended December 31, 1999 and 1998, respectively. In addition, the Company may make additional discretionary contributions to the plan to the extent authorized by the Board of Directors. There were no discretionary contributions to the plan for the years ended December 31, 1999 and 1998.

**Stock purchase plan:** The Company has adopted an employee stock purchase plan to provide substantially all employees an opportunity to purchase shares of its common stock through payroll deductions, up to 15 percent of eligible compensation. The plan is carried out in two annual six-month phases beginning January 1 and July 1, the grant dates. On June 30 and December 31, the exercise dates, participant account balances are used to purchase shares of stock at the lesser of 85 percent of the fair value of shares on the grant date or the exercise date. The employee stock purchase plan expires December 31, 2002. A total of 100,000 shares were originally available for purchase under the plan. There were 5,834 and 9,347 shares purchased under the plan for the years ended December 31, 1999 and 1998, respectively.

## NOTES TO FINANCIAL STATEMENTS

**Note 10. Major Customers, International Sales, and Enterprisewide Disclosures**

**Major customers:** The Company has customers which accounted for more than 10 percent of net sales for the years ended December 31, 1999 and 1998, as follows:

	<u>1999</u>	<u>1998</u>
Sales percentage:		
Customer A	36%	47%
Customer B	22%	14%
Customer C	16%	13%
Accounts receivable percentage at December 31:		
Customer A	38%	30%
Customer B	17%	34%
Customer C	15%	10%

**International sales:** Export sales to international customers for 1999 and 1998 were approximately \$613,000 and \$827,000, respectively. Accounts receivable from international customers were approximately \$50,000 and \$20,000 at December 31, 1999 and 1998, respectively.

**Enterprisewide disclosures:** The following table presents revenue from external customers for each of the Company's groups of products and services:

	<u>1999</u>	<u>1998</u>
Proprietary microprocessor and mechanically controlled sensors and alarms	\$ 2,576,600	\$ 1,943,000
Electronic controls and assemblies for OEM customers	<u>17,287,100</u>	<u>16,232,500</u>
	<u>\$ 19,863,700</u>	<u>\$ 18,175,500</u>

## MARKET FOR COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

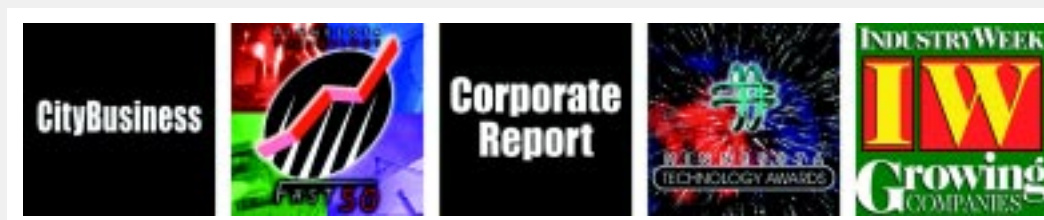
Effective January 27, 2000, the Company's Common Stock was listed on the American Stock Exchange ("AMEX") under the symbol WEX. Prior to being listed on AMEX, the Company's Common Stock was traded on Nasdaq SmallCap Market under the symbol WLET. The following table sets forth the high and the low bid quotations, as reported by the Nasdaq SmallCap Market. The bid quotations represent interdealer prices and do not include retail markets mark-ups, mark-downs or commissions and may not necessarily represent actual transactions.

Fiscal Year Ended	<u>Low</u>	<u>High</u>
<u>December 31, 1999</u>		
First Quarter	2 5/16	3 3/32
Second Quarter	2 1/8	4
Third Quarter	2 3/32	2 7/8
Fourth Quarter	1 7/8	2 1/2

Fiscal Year Ended	<u>Low</u>	<u>High</u>
<u>December 31, 1998</u>		
First Quarter	2 1/4	2 7/8
Second Quarter	2 1/8	3 1/4
Third Quarter	1 5/8	3 1/32
Fourth Quarter	1 3/4	3 1/2

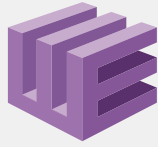
On March 10, 2000, the fair market value of the Company's Common Stock was \$3.188, based on the closing sale price quoted by AMEX on that date. As of December 31, 1999, the Company had approximately 492 shareholders of record.

The Company has never paid cash dividends on its Common Stock. The Board of Directors presently intends to retain earnings for use in the Company's business and does not anticipate paying cash dividends on Common Stock in the foreseeable future. Any future determinations as to the payment of dividends will depend on the financial condition of the Company and such other factors as are deemed relevant by the Board of Directors.



*Recognition for Achievement*





# **WINLAND ELECTRONICS, INC.**

## VISION

Stepping up to the future together.

## MISSION

Winland Electronics is dedicated to providing creative, high quality electronic products and services for a changing world.

## CORE VALUES

### **PEOPLE**

Winland Electronics views people as its most valued resource and bases all human interaction on dignity and respect.

### **INTEGRITY**

Winland is committed to doing the right thing.

### **QUALITY**

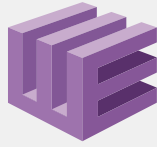
Winland Electronics defines and delivers customer expectations by doing things right.

### **INNOVATION**

Winland uses enthusiasm, creativity and innovation for setting and achieving goals.

### **FISCAL RESPONSIBILITY**

Winland Electronics is committed to fiscal responsibility to benefit our employees, shareholders and community.



# WINLAND ELECTRONICS, INC.

## CORE IDEOLOGIES

The core ideologies of any company are the stories, historical record and legends that create a word picture of the organization. The authors agree that this information constitutes the foundation of this company and its unique characteristics. The list is not in a specific rank order of importance or value.

**Ideology #1:** The organization, at all levels, demonstrates a positive, aggressive, can do persistence to do well.

**Ideology #2:** Everyone works in superior working conditions.

**Ideology #3:** Customers believe that Winland designs, engineers and produces results that benefit them specifically.

**Ideology #4:** People are valued:

- Management believes in its workers.
- Loyalty exists between customers and the company as well as management and workers.
- Faith is demonstrated in many ways.
- People listen to each other.

**Ideology #5:** An outstanding benefits package provides for employee economic security.

**Ideology #6:** Pride is demonstrated everywhere in the organization:

- It appears in the people that are hired.

- It appears in the skills that are inherent in the new workers.
- It appears in the competence of work done by each worker.
- It appears in the high expectations management has of its employees, and employees have of the management.

**Ideology #7:** Recognition occurs for quality performance.

**Ideology #8:** The company is innovative throughout.

**Ideology #9:** Reasonable, well researched risks are commonplace.

**Ideology #10:** There is significant emphasis on the protection of stockholder investment.

**Ideology #11:** Education and promotion opportunities are always available to those who choose to pursue them. People are rewarded who desire to learn and grow.

# ANNUAL MEETING OF SHAREHOLDERS

**The Annual Meeting  
of Shareholders will be held:**

**May 17, 2000 – 7:00 p.m.**

**Winland Corporate Offices  
1950 Excel Drive  
Mankato, Minnesota**

## INDEPENDENT AUDITORS

**McGLADREY & PULLEN, LLP**  
Certified Public Accountants  
Minneapolis, Minnesota

## REGISTRAR AND TRANSFER AGENT

**NORWEST BANK MINNESOTA, N.A.**  
161 North Concord Exchange  
South St. Paul, MN 55075-0738

## CORPORATE COUNSEL

**FREDRIKSON & BYRON, P.A.**  
Minneapolis, Minnesota

# DIRECTORS AND EXECUTIVE OFFICERS

## W. KIRK HANKINS

Chief Executive Officer,  
Chief Financial Officer, and  
Chairman of the Board of Directors of the Company

## LORIN E. KRUEGER

President, Chief Operating Officer, Secretary  
and a Director of the Company

## KIRK P. HANKINS

Vice President of Sales and Marketing  
and a Director of the Company

## S. ROBERT DESSALET

Director of the Company;  
Director of Marketing of RJ Morse Enterprises, Inc.

## THOMAS J. de PETRA

Director of the Company;  
Self-employed management consultant

## DAVID EWERT

Director of the Company;  
President/Chief Operating Officer of Jones Metal  
Products, Inc.

## STEVE VOGEL

Vice President of Engineering

## KIM KLEINOW

Vice President of Procurement and Materials

## TERRY TREANOR

Vice President of Manufacturing



**WINLAND  
ELECTRONICS, INC.**



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