

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 31, 2018

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 No. 001-8125

TOROTEL, INC.

(Exact name of registrant as specified in its charter)

MISSOURI
(State or other jurisdiction of incorporation or
organization)

44-0610086
(I.R.S. Employer Identification No.)

520 N. ROGERS ROAD, OLATHE,
KANSAS
(Address of principal executive offices)

66062
(Zip Code)

(913) 747-6111
(Registrant's telephone number, including area code)

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 has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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

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

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Securities Exchange Act of 1934). Yes No

As of March 13, 2018, there were 5,995,750 shares of Common Stock, \$0.01 par value, outstanding.

TOROTEL, INC. AND SUBSIDIARIES

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

CONSOLIDATED CONDENSED BALANCE SHEETS

	(Unaudited)	
	January 31, 2018	April 30, 2017
ASSETS		
Current assets:		
Cash	\$ 409,000	\$ 298,000
Trade receivables, net	1,913,000	2,007,000
Inventories	2,953,000	2,739,000
Prepaid expenses and other current assets	204,000	217,000
Property held for sale	688,000	688,000
	<u>6,167,000</u>	<u>5,949,000</u>
Leasehold improvements	611,000	532,000
Equipment	3,916,000	3,718,000
	<u>4,527,000</u>	<u>4,250,000</u>
Less accumulated depreciation	3,170,000	2,937,000
Property, plant and equipment, net	<u>1,357,000</u>	<u>1,313,000</u>
Deferred income taxes	644,000	747,000
Other assets	256,000	256,000
Total Assets	<u>\$ 8,424,000</u>	<u>\$ 8,265,000</u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Current maturities of long-term debt	\$ 1,736,000	\$ 603,000
Trade accounts payable	790,000	1,205,000
Accrued liabilities	643,000	319,000
Customer deposits	23,000	33,000
	<u>3,192,000</u>	<u>2,160,000</u>
Long-term debt, less current maturities	162,000	445,000
Stockholders' equity:		
Common stock; par value \$0.01; 6,000,000 shares authorized; 5,995,750 shares issued and outstanding	60,000	60,000
Capital in excess of par value	12,410,000	12,329,000
Accumulated deficit	(7,400,000)	(6,729,000)
	<u>5,070,000</u>	<u>5,660,000</u>
Total Liabilities and Stockholders' Equity	<u>\$ 8,424,000</u>	<u>\$ 8,265,000</u>

The accompanying notes are an integral part of these statements.

CONSOLIDATED CONDENSED STATEMENTS OF OPERATIONS (Unaudited)

	Three Months Ended		Nine Months Ended	
	January 31, 2018	January 31, 2017	January 31, 2018	January 31, 2017
Net sales	\$ 4,529,000	\$ 3,702,000	\$ 13,742,000	\$ 11,657,000
Cost of goods sold	3,091,000	2,657,000	9,686,000	7,920,000
Gross profit	1,438,000	1,045,000	4,056,000	3,737,000
Operating expenses:				
Engineering	267,000	215,000	806,000	662,000
Selling, general and administrative	1,140,000	1,146,000	3,783,000	3,353,000
	1,407,000	1,361,000	4,589,000	4,015,000
Earnings (loss) from operations	31,000	(316,000)	(533,000)	(278,000)
Other expense:				
Interest expense, net	28,000	5,000	53,000	16,000
Earnings (loss) before provision (credit) for income taxes	3,000	(321,000)	(586,000)	(294,000)
Provision (benefit) for income taxes	310,000	(130,000)	85,000	(118,000)
Net earnings (loss)	\$ (307,000)	\$ (191,000)	\$ (671,000)	\$ (176,000)
Basic earnings (loss) per share	\$ (0.06)	\$ (0.04)	\$ (0.13)	\$ (0.03)

The accompanying notes are an integral part of these statements.

CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS (Unaudited)

	Nine Months Ended	
	January 31, 2018	January 31, 2017
Cash flows from operating activities:		
Net loss	\$ (671,000)	\$ (176,000)
Adjustments to reconcile net loss to net cash used in operating activities:		
Stock compensation cost amortized	81,000	33,000
Depreciation	233,000	194,000
Deferred income taxes	103,000	(118,000)
Increase (decrease) in cash flows from operations resulting from changes in:		
Trade receivables	94,000	219,000
Inventories	(214,000)	(939,000)
Prepaid expenses and other assets	13,000	(75,000)
Trade accounts payable	(415,000)	140,000
Accrued liabilities	324,000	46,000
Customer deposits	(10,000)	(15,000)
Net cash used in operating activities	<u>(462,000)</u>	<u>(691,000)</u>
Cash flows from investing activities:		
Capital expenditures	(52,000)	(338,000)
Net cash used in investing activities	<u>(52,000)</u>	<u>(338,000)</u>
Cash flows from financing activities:		
Principal payments on long-term debt	(99,000)	(66,000)
Payments on capital lease obligations	(26,000)	—
Proceeds from line of credit	750,000	124,000
Net cash provided by financing activities	<u>625,000</u>	<u>58,000</u>
Net increase (decrease) in cash	111,000	(971,000)
Cash, beginning of period	298,000	1,846,000
Cash, end of period	<u>\$ 409,000</u>	<u>\$ 875,000</u>
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION		
Cash paid during the year for:		
Interest	\$ 53,000	\$ 16,000
Income taxes	\$ —	\$ 87,000
Non-cash investing and financing activities:		
Equipment financed with proceeds from capital lease	\$ 225,000	\$ —

The accompanying notes are an integral part of these statements.

NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS

NOTE 1 — BASIS OF PRESENTATION

The consolidated condensed balance sheet as of April 30, 2017, which has been derived from the audited financial statements of Torotel, Inc. ("Torotel"), is accompanied by the unaudited interim consolidated condensed financial statements, which reflect the normal recurring adjustments that in the opinion of management are necessary to present fairly Torotel's consolidated financial position at January 31, 2018, and the consolidated results of operations and cash flows for the three and nine months ended January 31, 2018, and 2017, respectively.

The unaudited interim consolidated condensed financial statements have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission ("SEC"). Certain information and note disclosures normally included in the annual financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to those rules and regulations, although management believes the disclosures made are adequate to make the information not misleading. The financial statements contained herein should be read in conjunction with Torotel's consolidated financial statements and related notes filed on Torotel's Form 10-K for the year ended April 30, 2017 as filed with the SEC on July 28, 2017.

In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2014-09, Revenue from Contracts with Customers (Topic 606). The standard is effective for annual reporting periods beginning after December 15, 2017 including interim periods within that reporting period and early adoption permitted for reporting periods beginning after December 15, 2016. The standard will supersede existing revenue recognition guidance, including industry-specific guidance, and will provide companies with a single revenue recognition model for recognizing revenue from contracts with customers. The standard requires revenue to be recognized when promised goods or services are transferred to customers in amounts that reflect the consideration to which the company expects to be entitled in exchange for those goods or services. Adoption of the new rules could affect the timing of revenue recognition for certain transactions. The two permitted transition methods under the new standard are the full retrospective method, in which case the standard would be applied to each prior reporting period presented, or the modified retrospective method, in which case the cumulative effect of applying the standard would be recognized at the date of initial application. The provisions of this new guidance are effective as of the beginning of Torotel's first quarter of fiscal year 2019. We commenced our evaluation of the impact of this standard this year, by evaluating its impact on selected sales orders. With this baseline understanding, we are developing a project plan and assessing any changes that may be needed in our internal control structure to adopt the standard on May 1, 2018. Based on the results of our preliminary evaluation, Torotel believes that this will have a material impact in our first quarter of fiscal 2019. At this time, Torotel is still assessing the adoption method to be utilized.

In February 2016, the FASB issued ASU 2016-02, *Leases (Topic 842)*, in order to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet for those leases classified as operating leases under previous GAAP. ASU 2016-02 requires that a lessee should recognize a liability to make lease payments (the lease liability) and a right-of-use asset representing its right to use the underlying asset for the lease term on the balance sheet. ASU 2016-02 requires expanded disclosures about the nature and terms of lease agreements and is effective for annual reporting periods beginning after December 15, 2018, including interim periods within that reporting period. Early adoption is permitted. Torotel is currently evaluating the potential impact of this standard on its consolidated financial statements. Torotel anticipates the impact will be material to the consolidated financial statements for reporting periods beginning after December 15, 2018, due to the amendment to the lease for Torotel's manufacturing facility that was executed on October 31, 2016. The status of the implementation effort is in the preliminary stage. No significant implementation matters have been identified as needing to be addressed.

NOTE 2 — NATURE OF OPERATIONS

Torotel conducts business primarily through its wholly owned subsidiary, Torotel Products, Inc. ("Torotel Products"). Torotel Products specializes in the custom design and manufacture of a wide variety of precision magnetic

components, consisting of transformers, inductors, reactors, chokes, toroidal coils, high voltage transformers, dry-type transformers and electro-mechanical assemblies, for use in commercial, industrial and military electronics.

NOTE 3—INVENTORIES

The following table summarizes the components of inventories:

	January 31, 2018	April 30, 2017
Raw materials	\$ 1,258,000	\$ 1,305,000
Work in process	823,000	826,000
Finished goods	872,000	608,000
	<u>\$ 2,953,000</u>	<u>\$ 2,739,000</u>

NOTE 4—FINANCING AGREEMENTS

Torotel Products has a financing agreement (the “financing agreement”) with Commerce Bank, N.A. (the “Bank”). The financing agreement provides for a revolving line of credit, a guidance line of credit, and a real estate term loan. Torotel serves as the guarantor to all promissory notes described below. A summary of the notes outstanding under the financing agreement is provided below:

	January 31, 2018	April 30, 2017
4.05% mortgage note payable in monthly installments of \$4,873, including interest, with final payment of \$349,000 due January 27, 2019	\$ 384,000	\$ 415,000
4.00% working capital line of credit with a maturity date of October 20, 2018	750,000	465,000
4.00% building line of credit with a maturity date of March 31, 2018	465,000	-
Capital lease obligations (see Note 11)	199,000	-
Borrowings under an equipment financing line of credit:		
4.75% note payable in monthly installments of \$2,269, including interest, with final payment due May 27, 2018	6,000	28,000
3.75% note payable in monthly installments of \$2,112, including interest, with final payment due April 10, 2018	9,000	25,000
4.05% note payable in monthly installments of \$3,680, including interest, with final payment due January 10, 2020	85,000	115,000
Total long-term debt	<u>1,898,000</u>	<u>1,048,000</u>
Less current installments	1,736,000	603,000
Long-term debt, excluding current installments	<u>\$ 162,000</u>	<u>\$ 445,000</u>

Under the financing agreement with the Bank, prepayment of the mortgage note up to \$100,000 per year is allowed without penalty so long as these funds are generated through internal cash flow and not borrowed from a separate financial institution. The mortgage note is cross collateralized and cross defaulted with all other credit facilities of Torotel Products and is secured by a first real estate mortgage on the property located at 620 North Lindenwood Drive in Olathe, Kansas.

Two separate promissory notes have been delivered by Torotel Products under the working capital line of credit, and amounts under this working capital revolving line of credit are available for working capital purposes. As of January 31, 2018 Torotel Products has only drawn upon the promissory note that matures on October 20, 2018 and no amounts had been borrowed under the promissory note scheduled to mature on April 30, 2018. The working capital revolving line of credit is renewable annually. The associated interest rate of both promissory notes is equal to the greater of the floating Commerce Bank Prime Rate (currently 4.25%) or a floor of 4% (as listed above). Monthly repayments of interest only are required under both promissory notes with the principal due at maturity. The maximum borrowing of this line of credit is \$1,250,000. This revolving line of credit is cross collateralized and cross defaulted with all other credit facilities and arrangements of Torotel Products with the Bank and is secured by a first lien on all business assets of Torotel Products.

On March 31, 2017, Torotel Products entered into a \$500,000 building revolving line of credit, which is available for working capital purposes and is renewable annually. The associated interest rate is equal to the greater of the floating Commerce Bank Prime Rate (currently 4.25%) or a floor of 4% (as listed above). Monthly repayments of interest only are required with the principal due at maturity. The maximum borrowing of this line of credit is \$500,000. This facility is cross collateralized and cross defaulted with all other facilities and is secured by a first lien on the building located at 620 North Lindenwood Drive in Olathe, Kansas. This revolving line of credit is scheduled to mature on March 31, 2018, and Torotel Products expects to negotiate an extension of that maturity date.

The equipment note is a guidance line of credit to be used for equipment purchases. Monthly repayments consisting of both interest and principal are required. This note is cross collateralized and cross defaulted with all other facilities of Torotel Products and is secured by a purchase money security interest in the assets purchased as well as a first lien on all business assets of Torotel Products. The maximum borrowing of this line of credit is \$500,000.

Torotel Products is required to comply with specified financial covenants of the financing agreement with Commerce Bank. As of January 31, 2018, Torotel Products was not in compliance with the covenant in such financing agreement that requires a ratio of EBITDA (as defined in the financing agreement) to fixed charge coverage (as defined in the financing agreement) in excess of 1.100 to 1.000. A waiver for non-compliance with this covenant was received from Commerce Bank for the period ending January 31, 2018.

Irrevocable Standby Letter of Credit

Under the terms of a lease amendment for its manufacturing facility located in Olathe, Kansas (see Note 11), Torotel provided the landlord an irrevocable standby letter of credit in the original amount of \$350,000 as additional security. The balance under the letter of credit will automatically reduce in accordance with the below schedule if not drawn upon:

Date of Reduction	Amount of Reduction	Balance of Letter of Credit
January 1, 2020	\$ 75,000	\$ 275,000
January 1, 2021	75,000	200,000
January 1, 2022	75,000	125,000
January 1, 2023	75,000	50,000
January 1, 2024	50,000	-

NOTE 5—INCOME TAXES

As of January 31, 2018, the federal tax returns for the fiscal years ended 2015 through 2017 are open to audit until the statute of limitations closes for the years in which our net operating losses are utilized. We would recognize interest and penalties accrued on unrecognized tax benefits as well as interest received from favorable tax settlements within income tax expense.

The Tax Cuts and Jobs Act (the “Tax Act”) was enacted on December 22, 2017. The Tax Act makes broad and complex changes to the U.S. tax code, including, but not limited to, (1) reducing the U.S. federal corporate tax rate from 35% to 21% effective January 31, 2018; (2) extending bonus depreciation that will allow for full expensing of qualified property; and (3) eliminating the corporate alternative minimum tax (AMT) and changing how existing AMT credits can be realized.

In the third quarter of the 2018 fiscal year, we revised our estimated annual effective rate to reflect a change in the federal statutory rate from 34% to 21%. The rate change is administratively effective at the beginning of our fiscal year,

using a blended rate for the annual period. As a result, the blended statutory tax rate for the year is 30.40%, resulting in \$198,000 of current income tax benefit.

In addition, we recognized tax expense in our tax provision for the period related to adjusting our existing deferred tax balance to reflect the new corporate tax rate, resulting in \$283,000 of current income tax expense. As a result, our total income tax expense reported for the first nine months of the 2018 fiscal year was an overall increase in income tax expense of \$85,000 during the third quarter.

We remeasured certain deferred tax assets and liabilities based on the rates at which they are expected to reverse in the future, which is generally 21%. However, we are still analyzing certain aspects of the Act and refining our calculations, which would potentially affect the measurement of these balances or potentially give rise to new deferred tax amounts.

The SEC issued Staff Accounting Bulletin No. 118 ('SAB 118') to address the application of accounting for the tax effects of the Tax Act. SAB 118 provides a measurement period that should not extend beyond one year from the Tax Act enactment date for companies to complete the accounting under ASC 740. In accordance with SAB 118, a company must reflect the income tax effects of those aspects of the Act for which the accounting under ASC 740 is complete. To the extent that a company's accounting for certain income tax effects of the Tax Act is incomplete but it is able to determine a reasonable estimate, it must record a provisional estimate in the financial statements.

Pursuant to the guidance within SAB 118, at January 31, 2018, we recognized the provisional effects of the enactment of the Tax Act for which measurement could be reasonably determined. As we continue to analyze certain aspects of the Tax Act and refine our assessment, the ultimate impact of the Tax Act may differ from these estimates due to our continued analysis or further regulatory guidance that may be issued as a result of the Tax Act. Pursuant to SAB 118, adjustments to the provisional amounts recorded at December 31, 2017 that are identified within a subsequent measurement period of up to one year from the enactment date will be included as an adjustment to tax expense from continuing operations in the period the amounts are determined.

NOTE 6—RESTRICTED STOCK AGREEMENTS

Restricted Stock Agreements, and stock awards thereunder, are authorized by the Compensation and Nominating Committee (the "Committee") and the Board of Directors of Torotel (the "Board"). The terms of the Restricted Stock Agreements afford the grantees all of the rights of a stockholder with respect to the award shares, including the right to vote such shares and to receive dividends and other distributions payable with respect to such shares since the date of award. Under the terms of each agreement, the non-vested shares are restricted as to disposition and subject to forfeiture under certain circumstances. The Restricted Stock Agreements further provide, subject to certain conditions, that if prior to all of the restricted shares having vested, we undergo a change in control, then all of the restricted shares shall be vested and no longer subject to restrictions under the Restricted Stock Agreements. The restricted shares are treated as non-vested stock; accordingly, the fair value of the restricted stock at the date of award is offset against capital in excess of par value in the accompanying consolidated balance sheets under stockholders' equity.

Restricted Stock Grants

On September 21, 2016, we entered into Restricted Stock Agreements ("2016 Agreements") with three key employees for the grant of an aggregate total of 730,000 restricted shares of the Company's common stock (the "Shares"). The Shares were granted, and the 2016 Agreements were entered into, pursuant to the Company's Stock Award Plan (the "Plan"). The award of the Shares was authorized by both the Committee and the Board as a whole on September 19, 2016. Except for the number of shares granted to each recipient, the terms of each of the 2016 Agreements are identical. In fiscal year 2017, 350,000 shares of restricted common stock granted under the Plan in 2013 were reverted to treasury shares because it was determined that it was unlikely that the requisite financial performance metrics for the restrictions on such shares to lapse would be achieved.

The Shares were granted subject to restrictions that prohibit them from being sold, assigned, pledged or otherwise disposed of until the restrictions lapse. The restrictions will lapse on the fifth anniversary of the date of grant if during the five year restriction period, (1) the Company's cumulative annual growth in revenue is at least 10%, and (2) the average economic value added as a percentage of revenue is at least 2%. The economic value added, which attempts to capture the true economic profit, will be calculated as the operating profit less the cost of capital with adjustments made for taxes. The restrictions will also lapse, if prior to the fifth anniversary of the date of grant, (1) the grantee's employment with the Company is terminated by reason of disability, (2) the grantee dies, or (3) the Committee, in its sole discretion, terminates the restrictions. If the restrictions on the Shares have not lapsed by the fifth anniversary of the date of grant, the Shares will be forfeited to the Company.

Stock Compensation Costs and Restricted Stock Activity

Total stock compensation cost for the nine months ended January 31, 2018 and 2017 was \$81,000 and \$33,000, respectively.

Restricted stock activity for each nine month period through January 31 is summarized as follows:

	2018		2017	
	Restricted Shares Under Option	Weighted Average Grant Price	Restricted Shares Under Option	Weighted Average Grant Price
Outstanding at May 1	730,000	\$ 0.740	350,000	\$ 0.500
Granted	—	—	730,000	0.740
Vested	—	—	—	—
Forfeited	—	—	(350,000)	0.500
Outstanding at January 31	730,000	\$ 0.740	730,000	\$ 0.740

NOTE 7—STOCKHOLDERS' EQUITY

The shares of common stock outstanding as of January 31 of each year are summarized as follows:

	2018	2017
Balance, May 1	5,995,750	5,615,750
Shares released from treasury for restricted stock grants	—	717,795
Newly issued shares for restricted stock grants	—	12,205
Shares reverted to treasury for restricted stock forfeitures	—	(350,000)
Balance, January 31	5,995,750	5,995,750

NOTE 8—EARNINGS PER SHARE

Basic and diluted earnings per share are computed using the two-class method. The two-class method is an earnings allocation formula that determines net income per share for each class of common stock and participating security according to dividends declared and participation rights in undistributed earnings. Per share amounts are computed by dividing net income attributable to common shareholders by the weighted average shares outstanding during each period.

The basic earnings per common share were computed as follows:

	Three Months Ended		Nine Months Ended	
	January 31, 2018	January 31, 2017	January 31, 2018	January 31, 2017
Net earnings (loss)	\$ (307,000)	\$ (191,000)	\$ (671,000)	\$ (176,000)
Amounts allocated to participating securities (nonvested restricted shares)	—	—	—	—
Net earnings (loss) attributable to common shareholders	\$ (307,000)	\$ (191,000)	\$ (671,000)	\$ (176,000)
Basic weighted average common shares	5,265,750	4,915,750	5,265,750	5,077,171
Earnings per share attributable to common shareholders:				
Basic earnings (loss) per share	\$ (0.06)	\$ (0.04)	\$ (0.13)	\$ (0.03)

ASC 260, Earnings per Share, provides that unvested share-based payment awards that contain non-forfeitable rights to dividends are considered to be participating securities and must be considered in the computation of earnings per share pursuant to the two-class method. Diluted earnings per share is not presented as we do not have any shares considered incremental and dilutive.

NOTE 9—CUSTOMER DEPOSITS

For certain customers, we collect payment at the time the order is placed. These deposits are classified as a liability and will be recognized as revenue at the time of shipment in accordance with our revenue recognition policy. As of January 31, 2018 we had approximately \$23,000 in customer deposits related to these arrangements.

NOTE 10 — CONCENTRATIONS OF CREDIT RISK

Financial instruments that potentially subject us to concentrations of credit risk consist principally of cash and accounts receivable. We grant unsecured credit to most of our customers. We do not believe that we are exposed to any extraordinary credit risk as a result of this policy. At various times cash balances exceeded federally insured limits. However, we have incurred no losses in the cash accounts and we do not believe we are exposed to any significant credit risk with respect to our cash.

NOTE 11 — COMMITMENTS AND CONTINGENCIES

Torotel is obligated under several capital leases for the lease of various information technology and production equipment that expire at various dates during the next three years. All of these leases are non-cancellable and are presented in the accompanying consolidated financial statements as long-term debt. At January 31, 2018 and 2017, the gross amount of equipment under capital lease was \$225,000 and \$0, respectively. Related accumulated depreciation recorded under capital lease were \$23,000 and \$0, respectively.

Amortization of assets held under capital lease is included with depreciation expense.

On August 30, 2017, Torotel entered into a Third Amendment (“Amendment”) to the lease for its manufacturing facility located in Olathe, Kansas. The Amendment reconfigured the Suite 520 entry design, and granted Torotel a \$37,500 lump sum net base rent abatement, to be applied at \$18,750 per month from September 1, 2017 through October 31, 2017. The Amendment also reduced the current letter of credit requirement from \$350,000 to \$300,000. The Amendment did not change the term of the lease, which continues through December 31, 2026 (subject to early termination options and two separate options to extend the lease term for additional five year periods).

Future minimum lease payments on the amended operating lease and future minimum capital lease payments as of January 31, 2018 are as follows:

Fiscal Years Ending April 30,	Capital Leases	Operating Leases
2018	\$ 27,000	\$ 81,000
2019	90,000	329,000
2020	75,000	362,000
2021	37,000	402,000
2022	—	427,000
2023	—	442,000
2024	—	452,000
2025	—	456,000
2026	—	467,000
2027	—	350,000
	229,000	3,768,000
Less: Amounts representing interest	(30,000)	—
Total	\$ 199,000	\$ 3,768,000

Forward-Looking Information

This report, as well as our other reports filed with or furnished to the Securities and Exchange Commission (the "SEC"), contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). The words "believe," "estimate," "anticipate," "project," "intend," "expect," "plan," "outlook," "forecast," "may," "should," "predict," and similar expressions are intended to identify forward-looking statements. Statements regarding expectations, including performance assumptions and estimates relating to capital requirements, as well as other statements that are not historical facts, are forward-looking statements. This report contains forward-looking statements regarding, among other topics, our expected financial position, results of operations, cash flows, strategy, budgets and management's plans and objectives. Accordingly, these forward-looking statements are based on management's judgments based on currently available information and assumptions about a number of important factors. While we believe that our assumptions about such factors are reasonable, such factors involve risks and uncertainties that could cause actual results to differ materially from those in the forward-looking statements. These factors include, without limitation:

- *economic, political and legislative factors that could impact defense spending;*
- *continued production of the Hellfire II missile system for which we supply parts;*
- *loss of key customers and our relatively concentrated customer base;*
- *risks in fulfilling military subcontracts;*
- *our ability to finance operations;*
- *ability to adequately pass through to customers unanticipated future increases in raw material and labor costs;*
- *delays in developing new products;*
- *markets for new products and the cost of developing new markets;*
- *expected orders that do not occur;*
- *our ability to adequately protect and safeguard our network infrastructure from cyber security vulnerabilities;*
- *our on-going ability to satisfy our debt covenant requirements;*
- *our ability to generate sufficient taxable income to realize the amount of our deferred tax assets; and*
- *the impact of competition and price erosion as well as supply and manufacturing constraints;*

In light of these risks and uncertainties, there can be no assurance that the forward-looking information contained in this report will prove accurate, and actual results may differ materially from these forward-looking statements. We assume no obligation to update any forward-looking statements made herein.

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

Overview

Torotel, Inc. ("Torotel") conducts business primarily through its wholly owned subsidiary, Torotel Products, Inc. ("Torotel Products"). Torotel Products is engaged in the custom design and manufacture of a wide variety of precision magnetic components consisting of transformers, inductors, reactors, chokes, toroidal coils, high voltage transformers, dry-type transformers and electro-mechanical assemblies for use in military, commercial aerospace and industrial electronic applications. These products are used to modify and control electrical voltages and currents in electronic devices. Torotel Products sells these products to original equipment manufacturers, which use them in applications such as:

- aircraft navigational equipment;
- digital control devices;
- airport runway lighting devices;
- medical equipment;
- avionics systems;
- radar systems;
- down-hole drilling;
- conventional missile guidance systems; and
- other commercial aerospace and defense applications.

Torotel Products markets its components primarily through an internal sales force and independent manufacturers’ representatives paid on a commission basis. These commissions are earned when a product is sold and/or shipped to a customer within the representative’s assigned territory. Torotel Products also utilizes its engineering department in its direct sales efforts for the purpose of expanding its reach into new markets and/or customers.

The industry mix of the customers that accounted for Torotel Products’ net sales for the first nine months of the fiscal year ending April 30, 2018 (“fiscal year 2018”) was 51% defense, 44% commercial aerospace, and 5% industrial compared to 52% defense, 42% commercial aerospace, and 6% industrial for the same period in the fiscal year ending April 30, 2017 (“fiscal year 2017”). Approximately 88% of Torotel Products’ sales during the first nine months of fiscal year 2018 have been derived from domestic customers.

Torotel Products is an approved source for magnetic components used in numerous military and commercial aerospace systems, which means Torotel Products is automatically solicited for any procurement needs for such applications. The magnetic components manufactured by Torotel Products are sold primarily in the United States, and most sales are awarded on a competitive bid basis. The markets in which Torotel Products competes are highly competitive. A substantial number of companies sell components of the type manufactured and sold by Torotel Products. In addition, Torotel Products sells to a number of customers who have the capability of manufacturing their own electronic components. The principal methods of competition for electronic products in the markets served by Torotel Products include, among other factors, price, on-time delivery performance, lead times, customized product engineering and technical support, marketing capabilities, quality assurance, manufacturing efficiency, and existing relationships with customers’ engineers. While we believe magnetic components are generally not susceptible to rapid technological change, Torotel Products’ sales, which do not represent a significant share of the industry’s market, are susceptible to decline given the competitive nature of the market.

Business and Industry Considerations

Defense Markets

During the first nine months of fiscal years 2018 and 2017, the amount of consolidated revenues derived from contracts with prime contractors of the U.S. Department of Defense (“DoD”) was approximately 51% and 52% respectively. As a result, our financial results in any period could be impacted substantially by spending cuts or increases in the DoD budget and the funds appropriated for certain military programs.

Despite ongoing uncertainty associated with the DoD budget, we believe our overall defense business outlook remains favorable due to the present demand for the potted coil assembly and other existing orders from major defense contractors. As of January 31, 2018, our consolidated order backlog for the defense market was nearly \$7.4 million, which included \$5.6 million for the potted coil assembly.

Commercial Aerospace and Industrial Markets

We provide magnetic components and electro-mechanical assemblies for a variety of applications in the commercial aerospace and industrial markets. The primary demand drivers for these markets include commercial aircraft orders, oil and gas drilling exploration activity, and general economic growth. While domestic economic growth remains positive, the above demand drivers could be impacted by short-term changes in the economy such as spikes or declines in the price of oil, war, terrorism, or changes in regulation. Other threats to our anticipated positive near-term and long-term market outlook include delays on the development and production of new commercial aircraft and competition from international suppliers. As of January 31, 2018, our consolidated order backlog for the aerospace and industrial markets was \$2.6 million.

Business Outlook

Our non-headcoil backlog as of January 31, 2018 as compared to January 31, 2017 increased from \$3.2 million to \$4.5 million, a 41% increase. This was due primarily to an increase in magnetics orders. We anticipate that net sales for fiscal year 2018 will improve from net sales for fiscal year 2017. This is primarily due to the timing of newer program revenue that is projected to ship in fiscal year 2018.

Consolidated Results of Operations

The following management comments regarding Torotel's results of operations and outlook should be read in conjunction with the Consolidated Condensed Financial Statements and Notes to the Consolidated Condensed Financial Statements included in Part I, Item 1 of this Quarterly Report.

This discussion and analysis of the results of operations include the operations of Torotel and its subsidiary Torotel Products as of January 31, 2018.

Net Sales

	Three Months Ended		Nine Months Ended	
	January 31, 2018	January 31, 2017	January 31, 2018	January 31, 2017
Torotel Products:				
Magnetic components	\$ 2,428,000	\$ 1,621,000	\$ 7,070,000	\$ 5,465,000
Potted coil assembly	1,465,000	1,307,000	4,278,000	3,843,000
Electro-mechanical assemblies	617,000	774,000	2,310,000	2,349,000
Large transformers	19,000	—	84,000	—
Total Torotel Products	\$ 4,529,000	\$ 3,702,000	\$ 13,742,000	\$ 11,657,000

Consolidated net sales in the three and nine months ended January 31, 2018 increased 22% or \$827,000 and 18% or \$2,085,000, respectively compared to the three and nine months ended January 31, 2017. Torotel Products' net sales increased primarily because of increased demand in magnetics. The increase in magnetics was expected as a number of products had an increase in demand from customers.

Gross Profit

	Three Months Ended		Nine Months Ended	
	January 31, 2018	January 31, 2017	January 31, 2018	January 31, 2017
Torotel Products:				
Gross profit	\$ 1,438,000	\$ 1,045,000	\$ 4,056,000	\$ 3,737,000
Gross profit % of net sales	32 %	28 %	30 %	32 %

Consolidated gross profit increased in the three and nine months ended January 31, 2018 by 38% or \$393,000 and by 9% or \$319,000 respectively, compared to the three and nine months ended January 31, 2017. The gross profit of Torotel Products increased during each of the three and nine month periods ended January 31, 2018 compared to the comparable periods in fiscal year 2017 primarily due to higher magnetics revenue volume during each period.

Operating Expenses

	Three Months Ended		Nine Months Ended	
	January 31, 2018	January 31, 2017	January 31, 2018	January 31, 2017
Engineering	\$ 267,000	\$ 215,000	\$ 806,000	\$ 662,000
Selling, general and administrative	1,140,000	1,146,000	3,783,000	3,353,000
Total	\$ 1,407,000	\$ 1,361,000	\$ 4,589,000	\$ 4,015,000

Engineering expenses increased 24%, or \$52,000 and 22%, or \$144,000, respectively in the three and nine months ended January 31, 2018 compared to the three and nine months ended January 31, 2017. The increase primarily resulted from an increase in engineering headcount.

Selling, general and administrative expenses decreased 1%, or \$6,000 and increased 13%, or \$430,000 in the three and nine months ended January 31, 2018 compared to the three and nine months ended January 31, 2017. The three month decrease resulted primarily from a decrease in consulting and professional fees, and the nine month increase was primarily due to an increase in headcount and higher personnel costs, as well as an increase in occupancy costs associated with the facility located at 520 N. Rogers Road in Olathe, Kansas.

Earnings (loss) from Operations

	Three Months Ended		Nine Months Ended	
	January 31, 2018	January 31, 2017	January 31, 2018	January 31, 2017
Torotel Products	\$ 142,000	\$ (172,000)	\$ (117,000)	\$ 289,000
Torotel	(111,000)	(144,000)	(416,000)	(567,000)
Total	\$ 31,000	\$ (316,000)	\$ (533,000)	\$ (278,000)

For the reasons discussed under each of the Gross Profit, and Operating Expenses headings above, consolidated earnings from operations increased by 110%, or \$347,000 and decreased by 92% or \$255,000 for the three and nine months ended January 31, 2018 when compared to the three and nine months ended January 31, 2017.

Other Earnings Items

	Three Months Ended		Nine Months Ended	
	January 31, 2018	January 31, 2017	January 31, 2018	January 31, 2017
Earnings (loss) from operations	\$ 31,000	\$ (316,000)	\$ (533,000)	\$ (278,000)
Interest expense	28,000	5,000	53,000	16,000
Earnings (loss) before income taxes	3,000	(321,000)	(586,000)	(294,000)
Provision (credit) for income taxes	310,000	(130,000)	85,000	(118,000)
Net earnings (loss)	\$ (307,000)	\$ (191,000)	\$ (671,000)	\$ (176,000)

For additional discussion related to Income Taxes, see Note 5 of Notes to Consolidated Financial Statements.

Financial Condition and Liquidity

Cash generated by operations together with the borrowing under our lines of credit are our primary sources of liquidity. The following table highlights the sources of liquidity available to us as of January 31, 2018 and 2017, and compares net cash provided by operating activities during the nine months ended January 31, 2018 compared to the nine months ended January 31, 2017.

	2018	2017
Cash	\$ 409,000	\$ 875,000
Amount available under our building line of credit	35,000	-
Amount available under our equipment loan	400,000	309,000
Amount available under our working capital line of credit	655,000	500,000
Total funds available	\$ 1,499,000	\$ 1,684,000

Operating Activities

	2018	2017
Net cash used in operating activities	\$ (462,000)	\$ (691,000)

Net cash used in operating activities decreased \$229,000 during the nine months ended January 31, 2018 versus the comparable period of the 2017 fiscal year primarily due to decreases in inventory purchases, as well as an increase in accrued liabilities.

Investing Activities

	2018	2017
Net cash used in investing activities	\$ (52,000)	\$ (338,000)

The decrease of \$286,000 in net cash used in investing activities during the nine months ended January 31, 2018 compared to the comparable period of fiscal year 2017 was due to lower capital expenditures, as well as financing capital expenditures through capital leases. Capital expenditures during each of the nine months ended January 31, 2018 and January 31, 2017 were primarily related to purchases of new information technology and production equipment. We expect capital expenditure spending to rise moderately during the remainder of fiscal year 2018 which is consistent with the anticipated needs of our business.

Financing Activities

	2018	2017
Net cash provided by (used in) financing activities	\$ 625,000	\$ 58,000

The change of \$567,000 for the nine month period of fiscal year 2018 from the comparable period in fiscal year 2017 is due primarily to additional borrowings under our working capital line of credit.

Capital Resources

We believe that the projected cash flow from operations, combined with existing cash balances and available borrowings under our existing financing arrangements to supplement our working capital needs, will be sufficient to meet our anticipated funding requirements for the foreseeable future, based on historical levels. As of January 31, 2018, we had \$750,000 drawn on the \$1,250,000 working capital line of credit. During fiscal year 2017, we entered into a \$500,000 building revolving line of credit with \$465,000 drawn down as of January 31, 2018. As of January 31, 2018 our total borrowing capacity is approximately \$935,000 under our existing financing arrangements, plus \$409,000 of cash on hand. Torotel Products is required to comply with specified financial covenants of the financing agreement with Commerce Bank. As of January 31, 2018, Torotel Products was not in compliance with the covenant in such financing agreement, that requires a ratio of EBITDA (as defined in the financing agreement) to fixed charge coverage (as defined in the financing agreement) in excess of 1.100 to 1.000. A waiver for non-compliance with this covenant was received from Commerce Bank for the period ending January 31, 2018.

Our building revolving line of credit and the promissory note upon which we have borrowed funds under our working capital line of credit described in Note 4 of the Consolidated Financial Statements are scheduled to mature on March 31, 2018 and October 20, 2018, respectively. If our property located at 620 N. Lindenwood Drive in Olathe, Kansas is not sold prior to the maturity date of our building revolving line of credit, we expect to refinance this line of credit prior to the maturity date. Additionally, we expect to refinance our second working capital line of credit, if deemed necessary, prior to the maturity date.

We believe that inflation will have only a minimal effect on future operations since such effects are expected to be offset by sales price increases, which are not expected to have a significant effect upon demand.

Critical Accounting Policies

We discuss our critical accounting policies and estimates in Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations," in our Annual Report on Form 10-K for the year ended April 30, 2017 filed with the SEC on July 28, 2017. We have made no significant change in our critical accounting policies since April 30, 2017.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Not Applicable

Item 4. Controls and Procedures*Evaluation of Disclosure Controls and Procedures*

Torotel's management, with the participation of its Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of Torotel's disclosure controls and procedures, as such term is defined in Rule 13a-15(e) under the Securities Exchange Act of 1934, as amended, as of the end of the period covered by this report. Based on such evaluation, the Chief Executive Officer and the Chief Financial Officer have concluded that Torotel's disclosure controls and procedures are effective as of the end of the period covered by this report.

Changes in Internal Control

There were no significant changes in Torotel's internal control over financial reporting or in other factors that in management's estimates have materially affected, or are reasonably likely to materially affect, Torotel's internal control over financial reporting during the fiscal quarter covered by this Quarterly Report on Form 10-Q.

Item 5. Other Information

On February 26, 2018, the Board approved and adopted Amended and Restated By-Laws of Torotel (the "New Bylaws"). The adoption of the New Bylaws was reported in a Current Report on Form 8-K dated February 26, 2018 (and filed on March 2, 2018), and the New Bylaws were filed as Exhibit 3.1 to that report. The New Bylaws are being filed as Exhibit 3.2 to this Quarterly Report on form 10-Q to correct an immaterial clerical error in the form of the New Bylaws previously filed.

PART II. OTHER INFORMATION

Item 6. Exhibits

a) Exhibits

Exhibit 3.1	Articles of Incorporation, as amended (incorporated by reference to Exhibit 3.1 of Form 8-K filed with the SEC on September 25, 2009)
Exhibit 3.2*	Amended and Restated By-laws
Exhibit 31.1*	Officer Certification
Exhibit 31.2*	Officer Certification
Exhibit 32.1*	Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
Exhibit 32.2*	Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
Exhibit 101.INS	XBRL Instance Document
Exhibit 101.SCH	XBRL Taxonomy Extension Schema Document
Exhibit 101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
Exhibit 101.DEF	XBRL Taxonomy Extension Definition Linkbase Document
Exhibit 101.LAB	XBRL Taxonomy Extension Label Linkbase Document
Exhibit 101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document

* Filed herewith

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.

March 13, 2018

Date

Torotel, Inc.

/s/ Heath C. Hancock

Heath C. Hancock

Chief Financial Officer

Principal Financial Officer