



Nortech Systems

**ANNUAL REPORT
2009**

COMPANY PROFILE

Nortech Systems Inc. is a full-service electronics manufacturing services (EMS) provider of wire and cable assemblies, printed circuit board assemblies and higher-level complete box build assemblies for a wide range of industries. Markets served include industrial equipment, military/defense, medical and transportation. The company has manufacturing capabilities and operating partners in the U.S., Asia and Latin America. Nortech Systems is traded on the NASDAQ Stock Market under the symbol NSYS and appears in most stock listings as “NorSys.”

VISION

“To be the best”

OUR PURPOSE

To be the preferred electronics manufacturing services provider that builds long-term relationships and creates value-added solutions for our customers.

OUR VALUES

- ▶ Respect
- ▶ Customer-Focused
- ▶ Committed to Success
- ▶ Sense of Urgency
- ▶ Great Communication
- ▶ No One Does It Alone

ANNUAL MEETING

The annual meeting of shareholders will be held at 3:00 p.m. on May 12, 2010, at the Wayzata Country Club, 200 West Wayzata Boulevard, Wayzata, Minnesota.

To Our Shareholders

Last year we faced challenges unprecedented in our company's history. I am proud of how everyone at Nortech Systems met these challenges head-on with courage, determination and optimism. The valuable lessons we learned and adjustments we made will serve us well going forward. Along with weeding out weaker competition, difficult times also make strong companies stronger.

Fortunately Nortech, our industry and the economy are all in a much better place today than this time last year. While some challenges will always remain – inherent to any business – there are more positive signs today that indicate 2010 will be a year of recovery and modest growth.



Looking Back: Restructuring Necessary, Effective

A year ago, during the first quarter of 2009, we responded to dramatically lower customer demand with significant cost-reduction and cash-management initiatives. These included staffing reductions, wage freezes and cuts, and curtailing discretionary spending across the board.

As the recession persisted, further actions were needed to better align our capacity with the continued decreases in customer demand. Our restructuring efforts involved consolidating operations by closing three of our nine manufacturing facilities – two buildings in Fairmont, Minnesota, and one in Garner, Iowa.

By September, these initiatives started providing the benefits and savings we anticipated, resulting in improved financial performance by year-end.

Sales: Broad-Based Declines with Encouraging Trends Late

Our fiscal 2009 sales declined 34 percent to \$79.9 million, with all three of our primary markets impacted. In aerospace/defense, we experienced a 42 percent decline due to several major contracts being completed and delays in securing new ones. Our industrial customers were hardest hit by the poor economy, with sales down 34 percent from 2008 levels. Although the medical market felt the least economic impact, our sales to these customers still declined by 18 percent.

While all of these revenue declines were significant, we take some gratification in our customers' loyalty. Throughout difficult times we did not lose any major strategic accounts.

Late in the year our sales began to stabilize and we were encouraged by the six percent sequential increase from the third to fourth quarters. Our 90-day backlog increased 25 percent during the same period. These positive indicators give us greater confidence about the future. Instead of the order move-outs and cancellations we experienced in 2009, today we are seeing more move-ins and accelerated delivery requests.

Income, Balance Sheet: Improvements Take Hold in Fourth Quarter

As we restructured our capacity during 2009, our gross profits as a percentage of sales improved sequentially, reaching 11.3 percent in the fourth quarter when we returned to operating profitability. All of the \$5.5 million fiscal-year operating loss was booked in the first three quarters; this includes one-time restructuring charges of approximately \$1.0 million.

For the 2009 fiscal year, our net loss was \$3.8 million, or \$1.40 per diluted common share. The restructuring charge equated to \$.22 cents per diluted common share. As with our sales, earnings picked up later in 2009 – the fourth quarter loss was reduced to \$.05 cents a share as our restructuring efforts began gaining traction.

In response to the economic downturn, we've aggressively managed those areas we can control – our cash and asset management. In the last ten months of 2009 we generated positive operating cash flow of \$3.4 million by reducing inventory, collecting receivables faster and improving our partnerships with suppliers.

The new banking agreement we signed with Wells Fargo in August includes covenants and performance requirements better suited to our current business and financial position. It was also an important step instilling confidence in our suppliers and customers.

Market Strategy: Attracting Business with Flexibility, Customer Service

Serving a diverse customer base has been a key strength throughout Nortech's history. Our three largest markets – industrial, aerospace/defense and medical – are also the three largest EMS industry segments in North America, accounting for more than 70 percent of sales.

These customers are showing signs of rebounding in 2010, with EMS industry revenue expected to grow between three and seven percent according to industry analyst forecasts.

For industrial customers, the health of the semiconductor business is a bellwether; Gartner Group forecasts 20 percent worldwide growth this year. Ongoing U.S. military activity around the globe helps drive demand for new and replacement military-spec cables and assemblies. Technological advances and the aging population are factors positively impacting medical-market demand.

Along with this expected organic growth, there are opportunities for Nortech Systems to increase sales when our key markets expand their levels of electronics outsourcing, levels currently much lower than in other sectors like computers and telecommunications.

We also look to boost our market share by winning new business from domestic and international competitors. Many original equipment manufacturers (OEMs) that tried off-shoring are now finding the cost and logistical factors increasingly prohibitive.

Our flexibility and expertise with full-service, quick-turn capabilities makes Nortech increasingly more attractive. We can offer cradle-to-grave solutions – from product design and engineering support to procurement and supply chain management.

Employee Engagement: Driving Innovation, Supporting Corporate Goals

Providing world-class manufacturing services for our customers depends upon all Nortech employees working to their full potential. This is only possible when each employee has the ability to improve his or her own workplace and job processes. The resulting innovations – and positive changes they drive through every aspect of our company – are the primary objectives of Nortech's lean initiative, called FOCUS.

During 2010 we're committed to further engraining the FOCUS philosophy into all aspects of our business, aided by additional training and joint projects with customers.

Due to FOCUS and our restructuring efforts, we are in a much stronger position than a year ago. Our industry's outlook and customer demand are also improving.

However, we remain cautiously optimistic while concentrating on providing outstanding quality, delivery performance and customer service. Prudence dictates we maintain our successful efforts in returning to profitability, conserving cash and investing wisely.

Going forward, Nortech Systems' management team remains committed to our long-standing corporate goals: sales growth outpacing the industry average in the markets we serve, and profits increasing at a higher rate than sales.

My confidence in our ability to deliver on these goals is grounded in my trust in the dedication, skill and intelligence of our entire Nortech Systems team. I join them in thanking you for your support.

Sincerely,



Michael J. Degen
President & Chief Executive Officer

CORPORATE INFORMATION

Registrar and Transfer Agent

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Nortech Systems' Manufacturing and Service Locations

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