

# SECURITIES AND EXCHANGE COMMISSION

## FORM 10-Q

Quarterly report pursuant to sections 13 or 15(d)

Filing Date: **2004-08-12** | Period of Report: **2004-06-30**  
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### FILER

#### LYNCH CORP

CIK: **61004** | IRS No.: **381799862** | State of Incorporation: **IN** | Fiscal Year End: **1231**  
Type: **10-Q** | Act: **34** | File No.: **001-00106** | Film No.: **04968740**  
SIC: **4213** Trucking (no local)

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**SECURITIES & EXCHANGE COMMISSION**

**WASHINGTON, D.C. 20549**

**FORM 10-Q**

(Mark One)

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

For the quarterly period ended June 30, 2004

or

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File No. 1-106

**LYNCH CORPORATION**

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(Exact name of Registrant as specified in its charter)

Indiana

38-1799862

(State or other jurisdiction of incorporation or organization)

I.R.S. Employer Identification No.)

50 Kennedy Plaza, Suite 1250, Providence, Rhode Island

02903

(Address of principal executive offices)

(Zip Code)

(401) 453-2007

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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 is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act).

Yes  No

Indicate the number of shares outstanding of each of the Registrant's classes of Common Stock, as of the latest practical date.

<u>Class</u>	<u>Outstanding at August 1, 2004</u>
Common Stock, \$0.01 par value	1,495,483

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**Part 1 - FINANCIAL INFORMATION -****Item 1 - Financial Statements****LYNCH CORPORATION AND SUBSIDIARIES****CONDENSED CONSOLIDATED BALANCE SHEETS - UNAUDITED**

(In thousands except share amounts)

	<b>June 30, 2004 (unaudited)</b>	<b>December 31, 2003 (A)</b>
<b>ASSETS</b>		
<b>CURRENT ASSETS</b>		
Cash and cash equivalents	\$ 3,055	\$ 3,981
Restricted cash (Note D)	1,125	1,125
Investments - Marketable Securities (Note E)	3,376	2,311
Trade accounts receivables, less allowances of \$96 and \$91, respectively	3,622	3,366
Unbilled accounts receivable	81	2,431
Inventories (Note F)	6,015	4,911
Deferred income taxes	57	57
Prepaid expenses	452	456
<b>TOTAL CURRENT ASSETS</b>	<b>17,783</b>	<b>18,638</b>
<b>PROPERTY, PLANT AND EQUIPMENT</b>		
Land	291	291
Buildings and improvements	4,198	4,198
Machinery and equipment	11,562	11,377
	16,051	15,866
Less: accumulated depreciation	(12,117)	(11,689)
	3,934	4,177
<b>OTHER ASSETS</b>	<b>81</b>	<b>204</b>
<b>TOTAL ASSETS</b>	<b>\$ 21,798</b>	<b>\$ 23,019</b>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>CURRENT LIABILITIES:</b>		
Notes payable to banks (Note G)	\$ 1,879	\$ 1,976
Trade accounts payable	2,290	2,054
Accrued warranty expense (Note H)	424	585
Accrued compensation expense	766	1,219
Accrued income taxes	862	716
Accrued professional fees	225	273
Accrued commissions	203	429
Margin liability on marketable securities	1,535	1,033
Other accrued expenses (Note L)	1,065	664
Customer advances	836	1,206
Current maturities of long-term debt (Note G)	331	998
<b>TOTAL CURRENT LIABILITIES</b>	<b>10,416</b>	<b>11,153</b>
<b>LONG-TERM DEBT (Note G)</b>	<b>1,438</b>	<b>833</b>
<b>TOTAL LIABILITIES</b>	<b>11,854</b>	<b>11,986</b>
<b>COMMITMENTS AND CONTINGENCIES (Note L)</b>		

SHAREHOLDERS' EQUITY

Common stock, \$0.01 par value - 10,000,000 shares authorized; 1,513,191 shares issued; 1,495,483 shares outstanding at June 30, 2004, 1,497,883 shares outstanding at December 31, 2003.	15	15
Additional paid-in capital	15,645	15,645
Accumulated deficit	(5,828 )	(4,460 )
Accumulated other comprehensive Income (Note J)	602	291
Treasury stock, at cost, of 17,708 shares at June 30, 2004, and 15,308 shares at December 31, 2003	(490 )	(458 )
TOTAL SHAREHOLDERS' EQUITY	<u>9,944</u>	<u>11,033</u>
<b>TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY</b>	<b>\$ <u>21,798</u></b>	<b>\$ <u>23,019</u></b>

(A) The Balance Sheet at December 31, 2003 has been derived from the audited financial statements at that date, but does not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements.

**See accompanying notes**

## PART I - FINANCIAL INFORMATION

Item 1 - Financial Statements**LYNCH CORPORATION AND SUBSIDIARIES****CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS - UNAUDITED**

(In Thousands, except share amounts)

	Three Months Ended June 30		Six Months Ended June 30	
	2004	2003	2004	2003
SALES AND REVENUES	\$ 6,736	\$ 6,714	\$ 13,548	\$ 11,458
Cost and expenses:				
Manufacturing cost of sales	4,750	4,982	10,050	8,933
Selling and administrative	2,028	2,010	4,303	3,843
Lawsuit settlement provision (Note L)	425	-	425	-
OPERATING LOSS	(467 )	(278 )	(1,230 )	(1,318 )
Other income (expense):				
Investment Income	4	153	8	168
Interest expense	(62 )	(93 )	(113 )	(162 )
Other income (expense)	(5 )	2	22	9
	(63 )	62	(83 )	15
LOSS BEFORE INCOME TAXES	(530 )	(216 )	(1,313 )	(1,303 )
(Provision for) benefit from income taxes	(30 )	43	(55 )	392
NET LOSS	\$ (560 )	\$ (173 )	\$ (1,368 )	\$ (911 )
Weighted average shares outstanding	1,495,500	1,497,900	1,496,300	1,497,900
BASIC AND DILUTED LOSS PER SHARE:	\$ (0.37 )	\$ (0.12 )	\$ (0.91 )	\$ (0.61 )

See accompanying notes

## PART I - FINANCIAL INFORMATION

ITEM 1 - Financial StatementsLYNCH CORPORATION AND SUBSIDIARIESCONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS - UNAUDITED  
(In Thousands)

	Six Months Ended	
	June 30,	
	2004	2003
<b>OPERATING ACTIVITIES</b>		
Net loss	\$ (1,368)	\$ (911 )
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation	428	483
Amortization of definite-lived intangible assets	123	134
Lawsuit settlement provision (Note L)	425	-
Gain realized on sale of marketable securities	-	(134 )
Changes in operating assets and liabilities:		
Receivables	2,094	(716 )
Inventories	(1,104)	(1,131)
Accounts payable and accrued liabilities	(98 )	1,363
Other assets/liabilities	3	(109 )
Net cash provided by (used in) operating activities	<u>503</u>	<u>(1,021)</u>
<b>INVESTING ACTIVITIES</b>		
Capital expenditures	(184 )	(108 )
Proceeds from sale of marketable securities	-	252
Purchase of marketable securities	(754 )	(113 )
Payment on margin liability on marketable securities	(300 )	(143 )
Cash (used in) investing activities	<u>(1,238)</u>	<u>(112 )</u>
<b>FINANCING ACTIVITIES</b>		
Net borrowings (repayments) of notes payable	(97 )	377
Repayment of long-term debt	(62 )	(109 )
Proceeds from long-term debt	-	296
Purchase of treasury stock	(32 )	-
Net cash (used in) provided by financing activities	<u>(191 )</u>	<u>564</u>
Increase (decrease) in cash and cash equivalents	(926 )	(569 )
Cash and cash equivalents at beginning of period	<u>3,981</u>	<u>5,986</u>
Cash and cash equivalents at end of period	<u>\$ 3,055</u>	<u>\$ 5,417</u>

See accompanying notes



NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

A. Subsidiaries of the Registrant

Lynch Corporation dissolved its 100 percent owned, inactive subsidiaries, Lynch International Holding Corporation and Lynch-AMAV in Delaware, their State of incorporation on June 30, 2004.

As of June 30, 2004, the Subsidiaries of the Registrant are as follows:

	<u>Owned By Lynch</u>
Lynch Systems, Inc.	100.0%
M-tron Industries, Inc.	100.0%
M-tron Industries, Ltd.	100.0%

B. Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three month and six month period ended June 30, 2004 are not necessarily indicative of the results that may be expected for the year ended December 31, 2004.

The balance sheet at December 31, 2003 has been derived from the audited financial statements at that date but does not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements.

For further information, refer to the consolidated financial statements and footnotes thereto included in the Registrant Company and Subsidiaries' annual report on Form 10-K for the year ended December 31, 2003.

C. Adoption of Accounting Pronouncements

In January 2003, the FASB issued Interpretation No. 46, "Consolidation of Variable Interest Entities, an Interpretation of ARB No 51" ("FIN 46"). FIN 46 clarifies the application of Accounting Research Bulletin No. 51, "Consolidated Financial Statements," to certain entities in which equity investors do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. The consolidation requirements of FIN 46, as revised, are required for periods ending after December 15, 2003 for interests in structures that are commonly referred to as special-purpose entities, while the application of this Interpretation for all other types of variable interest entities is required for periods ended March 15, 2004. The Company does not have any interests in variable interest entities.

D. Restricted Cash

At both June 30, 2004 and December 31, 2003, the Company had \$1.1 million of Restricted Cash that secures a Letter of Credit issued by Fleet Bank to the First National Bank of Omaha as collateral for its M-tron subsidiary's loans.

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### E. Investments

The following is a summary of marketable securities (investments) held by the Company (in Thousands):

<u>Equity Securities</u>	<u>Cost</u>	<u>Gross Unrealized Gains</u>	<u>Gross Unrealized Losses</u>	<u>Estimated Fair Value</u>
June 30, 2004	\$ 2,774	\$ 602	–	\$ 3,376
December 31, 2003	\$ 2,020	\$ 291	–	\$ 2,311

The Company has a margin liability against this investment of \$1,535,000 at June 30, 2004 and of \$1,033,000 at December 31, 2003 which must be settled upon the disposition of the related securities whose fair value is based on quoted market prices. The Company has designated these investments as available for sale pursuant to Statement of Financial Accounting Standards No. 115, "Accounting for Certain Investments in Debt and Equity Securities".

### F. Inventories

Inventories are stated at the lower of cost or market value. At June 30, 2004, inventories were valued by two methods: last-in, first-out (LIFO) 74%, and first-in, first-out (FIFO) 26%. At December 31, 2003, inventories were valued by the same two methods: LIFO - 73%, and FIFO - 27%.

	<u>June 30, 2004</u>	<u>December 31, 2003</u>
	<u>(In Thousands)</u>	
Raw materials	\$ 1,605	\$ 1,394
Work in process	2,066	1,641
Finished goods	2,344	1,876
Total Inventories	\$ <u>6,015</u>	\$ <u>4,911</u>

Current costs exceed LIFO value of inventories by \$1,031,000 and \$930,000 at June 30, 2004 and December 31, 2003 respectively.

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### G. Indebtedness

On a consolidated basis, at June 30, 2004, Lynch maintains short-term credit facilities totaling \$10.0 million, of which \$3.6 million was available for future borrowings, including up to \$3.6 million for working capital and/or up to \$2.4 million for Letters of Credit. These facilities generally limit the credit available under the lines of credit to certain variables, such as inventories and receivables, and are secured by the operating assets of the respective subsidiary borrower, and include various financial covenants, which currently restrict the transfer of substantially all the assets of the subsidiaries. Both M-tron and Lynch Systems renewed the credit agreements that expired on April 30, 2004 and May 30, 2004 respectively with the incumbent lenders for another year.

Lynch Systems, Inc. and M-tron Industries, Inc. maintain their own credit facilities. The Lynch Systems facilities includes an unsecured parent Company guarantee. M-tron's revolving credit agreement is supported by a \$1.0 million Letter of Credit that is secured by a \$1.1 million deposit in a Fleet Bank Treasury Fixed Income Fund (see Note D - "Restricted Cash").

In general, the credit facilities are secured by property, plant and equipment, inventory, receivables and common stock of certain subsidiaries and contain certain covenants restricting distributions to the Company.

Notes payable to banks and long-term debt consists of:

	<u>June 30,</u> <u>2004</u>	<u>December 31,</u> <u>2003</u>
	(In Thousands)	
Notes payable:		
M-tron bank revolving loan at variable interest rates (4.5% at June 30, 2004), due May 2005	\$ 1,879	\$ 1,976
Lynch Systems bank revolving loan at variable interest rates, due June, 2005	-	-
	<u>\$ 1,879</u>	<u>\$ 1,976</u>
Long-term debt:		
M-tron commercial bank term loan at variable interest rates (4.5% at June 30, 2004), due May, 2007	\$ 800	\$ 829
Yankton Area Progressive Growth loan at 0.0% interest, due April 2005	150	150
South Dakota Board of Economic Development at a fixed rate of 3%, due December , 2007	279	285
Yankton Areawide Business Council loan at a fixed interest rate of 5.5%, due November 2007	87	90
Lynch Systems term loan at a fixed interest rate of 5.5%, due August 2013	453	477
	<u>1,769</u>	<u>1,831</u>
Current maturities	<u>(331 )</u>	<u>(998 )</u>
	<u>\$ 1,438</u>	<u>\$ 833</u>

### H. Long-Term Contracts and Warranty Expense

Lynch Systems, a 100% wholly owned subsidiary of the Company, is engaged in the manufacture and marketing of glass-forming machines and specialized manufacturing machines. Certain sales contracts require an advance payment (usually 30% of the contract price) which is accounted for as a customer advance. The contractual sales prices are paid either (i) as the manufacturing process reaches specified levels of completion or (ii) based on the shipment date or (iii) negotiated terms of sale. Guarantees by letter of credit from a qualifying financial institution are required for most sales contracts. Because of the specialized nature of these machines and the period of time needed to complete production and shipping, Lynch Systems accounts for these contracts using the percentage-of-completion accounting method as costs are incurred compared to total estimated project costs (cost to cost basis). At June 30, 2004 and December 31, 2003, unbilled accounts receivable were \$0.1 million and \$2.4 million, respectively.

Lynch Systems provides a full warranty to world-wide customers who acquire machines. The warranty covers both parts and labor and normally covers a period of one year or thirteen months. Based upon experience, the warranty accrual is based upon three to five percent of the selling price of the machine. The Company periodically assesses the adequacy of the reserve and adjusts the amounts as necessary.

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Balance, December 31, 2003	\$ 585
Warranties issued during the period	162
Settlements made during the period	(272)
Changes in liabilities for pre-existing warranties during the period, including expirations	(51 )
Balance, June 30, 2004	\$ 424

### I. Earnings Per Share and Stockholders' Equity

The Company's basic and diluted earnings per share are equivalent as the options issued in May 2002 to purchase 228,000 shares of the Company's common stock were anti-dilutive throughout 2003 and throughout the first half of 2004.

On December 10, 2001, the Board of Directors approved, subject to shareholder approval at the May 2002 Annual Meeting, the 2001 Equity Incentive Plan and the issuance of up to 300,000 options to purchase shares of Company common stock to certain employees of the Company, of which 228,000 options were granted (subject to shareholder approval) at \$17.50 per share on December 10, 2001. Although the grants were approved by the shareholders on May 2, 2002, the shares are not considered issued until exercised or in the money, neither event having transpired to-date. 220,000 of these options are fully vested, with the remaining options vesting quarterly over the next two quarters.

The Company has a stock-based employee compensation plan. The Company accounts for the plan under the recognition and measurement principles of Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees," and related Interpretations. No stock-based employee compensation cost is reflected in net income, as all options granted under those plans had an exercise price equal to or above the market value of the underlying common stock on the date of grant. The Company provides pro forma disclosures of the compensation expense determined under the fair value provisions of Financial Accounting Standards Board Statement No. 123, "Accounting for Stock-Based Compensation" as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2004	2003	2004	2003
Net loss as reported	\$ (560 )	\$ (173 )	\$ (1,368 )	\$ (911 )
Deduct: Total stock based employee compensation expense determined under fair value based method for all awards, net of related tax effect	(38 )	(38 )	(77 )	(77 )
Pro forma net loss	\$ (598 )	\$ (211 )	\$ (1,445 )	\$ (988 )
Basic and diluted loss per share:				
As reported	\$ (0.37)	\$ (0.12)	\$ (0.91 )	\$ (0.61)
Pro forma	\$ (0.40)	\$ (0.14)	\$ (0.97 )	\$ (0.66)

The net loss as reported in each period did not include any stock-based compensation.

During the quarter, the Company paid \$382,000 to settle a previously recorded liability related to the stock appreciation rights for certain employees at Lynch Systems.

### J. Accumulated Other Comprehensive Income (Loss)

Total comprehensive loss was \$835,000 in the three months ended June 30, 2004, as opposed to a total comprehensive loss of \$140,000 in the second quarter of 2003. "Other" comprehensive loss, resulting from losses

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on available for sale securities, included in the total comprehensive loss was \$275,000 in the second quarter of 2004 as opposed to a gain of \$33,000 in the quarter ending June 30, 2003.

Total comprehensive loss was \$1,057,000 and \$903,000 for the six months ended 6/30/04 and 6/30/03 respectively, including other comprehensive income of \$311,000 in the first half of 2004 and other comprehensive income of \$8,000 in the first half of 2003 resulting from gains on available for sale securities.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2004	2003	2004	2003
Net loss as reported	\$ (560)	\$ (173)	\$ (1,368)	\$ (911)
Unrealized gain (loss) on available for sale securities	(275)	33	311	8
Total comprehensive loss	\$ (835)	\$ (140)	\$ (1,057)	\$ (903)

The components of accumulated other comprehensive income (loss), net of related tax, at June 30, 2004 and December 31, 2003, and June 30, 2003 are as follows:

	June 30, 2004	December 31, 2003	June 30, 2003
Balance beginning of period	\$ 291	\$ 302	\$ 302
Unrealized gain (loss) on available for-sale securities	311	(11)	8
Accumulated other comprehensive income	\$ 602	\$ 291	\$ 310

## K. Segment Information

The Company has two reportable business segments. The first segment is Lynch Systems' glass manufacturing equipment business. Frequency control devices (quartz crystals and oscillators) manufactured and sold by M-tron is the other segment. Except for M-tron's Hong Kong subsidiary which acts as a buying agent and sales representative, the businesses are located domestically.

Operating loss is equal to revenues less operating expenses, excluding investment income, interest expense and income taxes. The Company allocates a negligible portion of its general corporate expenses to its operating segments.

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	Three Months Ended		Six Months Ended	
	June 30,		June 30	
	2004	2003	2004	2003
	(In Thousands)		(In Thousands)	
<b>Revenues</b>				
Glass manufacturing equipment - USA	\$ 181	\$ 2,077	\$ 333	\$ 2,693
Glass manufacturing equipment - Foreign	970	1,105	3,117	1,972
Total Glass manufacturing equipment	1,151	3,182	3,450	4,665
Frequency control devices - USA	2,052	1,753	4,189	3,267
Frequency control devices - Foreign	3,533	1,779	5,909	3,526
Total Frequency control devices	5,585	3,532	10,098	6,793
Consolidated Total	\$ 6,736	\$ 6,714	\$ 13,548	\$ 11,458
<b>Operating Profit (Loss)</b>				
Glass manufacturing equipment	\$ (130 )	\$ 146	\$ (522 )	\$ (337 )
Frequency control devices	407	(6 )	469	(229 )
Total manufacturing	277	140	(53 )	(566 )
Unallocated Corporate expenses	(744 )	(418 )	(1,177)	(752 )
Consolidated Total	\$ (467 )	\$ (278 )	\$ (1,230)	\$ (1,318)
<b>Capital Expenditures</b>				
Glass manufacturing equipment	\$ 10	\$ 28	\$ 13	\$ 56
Frequency control devices	105	47	171	52
Consolidated Total	\$ 115	\$ 75	\$ 184	\$ 108
<b>Total Assets</b>				
Glass manufacturing equipment			\$ 9,902	\$ 12,481
Frequency control devices			9,018	8,383
General Corporate			2,878	3,416
Consolidated Total			\$ 21,798	\$ 24,280
Total operating loss of reporting segments	\$ (467 )	\$ (278 )	\$ (1,230)	\$ (1,318)
<b>Other profit or loss:</b>				
Investment income	4	155	8	177
Interest expense	(62 )	(93 )	(113 )	(162 )
Other income (expense)	(5 )	-	22	-
Loss before income taxes	\$ (530 )	\$ (216 )	\$ (1,313)	\$ (1,303)

L. Commitments and Contingencies

In the normal course of business, subsidiaries of the Registrant are defendants in certain product liability, worker claims and other litigation in which the amounts being sought may exceed insurance coverage levels. The resolution of these matters is not expected to have a material adverse effect on the Company's financial condition or operations. In addition, Registrant and/or one or more of its subsidiaries are parties to the following additional legal proceedings:

**1. In re: Spinnaker Coating, Inc., Debtor/PACE Local 1-1069 v. Spinnaker Coating, Inc., and Lynch Corporation, U.S. Bankruptcy Court, District of Maine, Chapter 11, Adv. Pro. No. 02-2007, and PACE Local 1-1069 v. Spinnaker Industries, Inc., Spinnaker Coating, Inc., and Spinnaker Coating-Maine, Inc., Cumberland County Superior Court, CV-2001-00352**

On or about June 26, 2001, in anticipation of the July 15, 2001 closure of Spinnaker's Westbrook, Maine facility, Plaintiff PACE Local 1-1069 ("PACE") filed a three count complaint in Cumberland County Superior Court, CV-2001-00352 naming the following defendants: Spinnaker Industries, Inc., Spinnaker Coating, Inc., and Spinnaker Coating-Maine, Inc. (collectively, the "Spinnaker Entities") and Lynch. The complaint alleged that under Maine's Severance Pay Act both the Spinnaker Entities and Lynch would be liable to pay approximately \$1,166,000 severance pay under Maine's Severance Pay Act in connection with the plant closure. The Defendants filed a notice of removal, thereby creating United States District Court Civil Action C.V. No. 01-236. The case was remanded to state court. The Spinnaker Entities also filed a separate complaint challenging the constitutionality of the Maine Severance Pay Act, United States District Court Civil Action No. 01-232 which later was dismissed by stipulation of the Spinnaker Entities. PACE also filed three separate Motions for Ex-Parte Attachment against the Spinnaker Entities and Lynch. PACE filed the First Motion for Attachment with its original Complaint. PACE sought to attach \$1,166,483.44, an amount large enough to cover the claims of all PACE's members seeking severance. The Court denied that Motion as being premature. PACE then filed a Second Motion against the Spinnaker Entities and Lynch for an attachment large enough to cover the claims of eight individual employees seeking severance pay in the amount of \$120,736.27. On August 20, 2001, the Court granted that Motion in the amount of \$118,500. On April 4, 2002, PACE subsequently recorded this attachment through UCC-1 filings with the Maine Secretary of State against Lynch Manufacturing and Lynch Corporation. PACE filed a Third Motion for Ex-Parte Attachment on August 29, 2001. This Motion sought an attachment large enough to cover the severance pay claimed by the remaining PACE members, \$1,048,003. The Court denied this Motion but permitted PACE the opportunity to obtain an attachment after all defendants had an opportunity to respond and after hearing.

Before any further action was taken with respect to PACE's Third Motion for Attachment, the Spinnaker Defendants filed for relief under Chapter 11 of the Bankruptcy Code. Following a series of filings in the United States District Court for the District of Maine and the United States Bankruptcy Court for the District of Maine which, like United States District Court Case No. 01-236, later were dismissed by the parties with prejudice and without costs, PACE's case continues to proceed against Lynch in Cumberland County Superior Court in Maine on the issue of whether Lynch has liability to PACE's members under the Maine Severance Pay Act.

On September 30, 2002, PACE requested a ruling from the Superior Court on its Third Motion for Attachment. On October 21, 2002, Lynch filed a Motion for Summary Judgment which incorporated its prior objection to any attachment. PACE filed an Opposition to Lynch's Motion for Summary Judgment, which included a request for summary judgment in its favor, and a Motion for Leave to Further Amend the Complaint on November 12, 2002. Lynch thereafter filed a Reply Memorandum in Support of its Motion for Summary Judgment on November 26, 2002 and an opposition to PACE's Motion for Leave to Further Amend the Complaint on December 3, 2002. On December 31, 2002, the Superior Court held a hearing on all pending Motions. The Superior Court requested that arguments focus on Lynch's Motion for Summary Judgment since the granting of that Motion would render PACE's Third Motion for Attachment and Motion to Further Amend the Complaint moot.

On July 28, 2003, the Superior Court issued an Order deciding both Lynch's and PACE's Motions for Summary Judgment. The Court denied Lynch's Motion for Summary Judgment, finding that there remained a disputed issue of material fact regarding one of Lynch's primary defenses. The Court granted partial summary judgment in favor of PACE to the extent that the Court found Lynch was an "employer" subject to potential liability under Maine's Severance Pay Act. The Court held, however, that PACE must still prove its entitlement to severance pay under the Act. In a separate ruling also issued on July 28, 2003, the Court denied PACE's Third Motion for Attachment.

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On March 8, 2004, Lynch filed a Motion for Summary Judgment on the issue of an exemption under the Maine Severance Pay Act, based upon the nexus between the plant closure in Westbrook, Maine and the Spinnaker defendants' bankruptcy filing. PACE concurrently filed a Motion for Summary Judgment on Count II of the complaint on March 8, 2004.

During a trial management conference on March 24, 2004, the parties agreed to submit a Stipulation of Facts to the Court in lieu of a trial on any remaining issues in the case. The Court has not yet scheduled oral arguments from the parties related to the pending motions for summary judgment and related to any remaining issues in the case.

At a Settlement Conference held in the Cumberland County Superior Court (Portland, Maine), the Company offered \$425,000 in full settlement of the PACE claim. Both parties have continued negotiations that could lead to a settlement. During the 2<sup>nd</sup> quarter of 2004, the Company has provided for this \$425,000 potential settlement.

Lynch believes that, in addition to other defenses, it is not subject to the Maine Severance Pay Act, as now in effect. Management does not believe that the resolution of this case will have a material adverse effect on the Registrant's consolidated financial condition and operations.

The Company does not believe that it has any other contingent liabilities related to Spinnaker.

## **2. Qui Tam Lawsuit**

There has been no material change in the status of this lawsuit as last reported in Registrant's Form 10-K for its fiscal year ended December 31, 2003.

### **M. Income Taxes**

The Company files consolidated federal income tax returns. The Company has a \$2,375,000 net operating loss ("NOL") carry-forward as of December 31, 2003. This NOL expires in 2024 if not utilized prior to that date.

### **N. Guarantees**

The Company presently guarantees (unsecured) the SunTrust Bank loans of its subsidiary, Lynch Systems, and has guaranteed a Letter of Credit issued to the First National Bank of Omaha on behalf of its subsidiary, M-tron Industries, Inc. (see Note G - "Indebtedness Debt"). As of June 30, 2004, there were no obligations to the SunTrust Bank. As of June 30, 2004, the \$1,000,000 Letter of Credit issued by Fleet Bank to The First National Bank of Omaha was secured by a \$1,125,000 deposit in a Fleet Bank Treasury Fixed Income Fund. (See Note D - "Restricted Cash").

There were no other financial, performance, indirect guarantees or indemnification agreements.

## **Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.**

### **Critical Accounting Policies**

The Company has identified the accounting policies listed below that we believe are most critical to our financial condition and results of operations, and that require management's most difficult, subjective and complex judgements in estimating the effect of inherent uncertainties. This section should be read in conjunction with Note 1 to the consolidated financial statements, included in the Company's Annual Report on Form 10K for the year ended December 31, 2003, which includes other significant accounting policies.

#### ***Accounts Receivable***

Accounts receivable on a consolidated basis consist principally of amounts due from both domestic and foreign customers. Credit is extended based on an evaluation of the customer's financial condition and collateral is not generally required except at Lynch Systems. The Company considers concentrations of credit risk to be minimal due to the Company's diverse customer base. In relation to export sales, the Company requires letters of credit



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supporting a significant portion of the sales price prior to production to limit exposure to credit risk. Certain subsidiaries and business segments have credit sales to industries that are subject to cyclical economic changes. The Company maintains an allowance for doubtful accounts at a level that management believes is sufficient to cover potential credit losses.

We maintain allowances for doubtful accounts for estimated losses resulting from the inability of our clients to make required payments. We base our estimates on our historical collection experience, current trends, credit policy and relationship of our accounts receivable and revenues. In determining these estimates, we examine historical write-offs of our receivables and review each client's account to identify any specific customer collection issues. If the financial condition of our customers were to deteriorate, resulting in an impairment of their ability to make payment, additional allowances may be required. Our failure to estimate accurately the losses for doubtful accounts and ensure that payments are received on a timely basis could have a material adverse effect on our business, financial condition, and results of operations.

### ***Inventory Valuation***

Inventories are stated at the lower of cost or market value. Inventories valued using the last-in, first-out (LIFO) method comprised approximately 74%, 73% and 63% of consolidated inventories at June 30, 2004, December 31, 2003 and 2002, respectively. The balance of inventories are valued using the first-in-first-out (FIFO) method. If actual market conditions are more or less favorable than those projected by management, including the demand for our products, changes in technology, internal labor costs and the costs of materials, adjustments may be required.

### ***Revenue Recognition and Accounting for Long-Term Contracts***

Revenues, with the exception of certain long-term contracts discussed below, are recognized upon shipment when title passes. Shipping costs are included in manufacturing cost of sales.

Lynch Systems, a 100% owned subsidiary of the Company, is engaged in the manufacture and marketing of glass-forming machines and specialized manufacturing machines. Certain sales contracts require an advance payment (usually 30% of the contract price) which is accounted for as a customer advance. The contractual sales prices are paid either (i) as the manufacturing process reaches specified levels of completion or (ii) based on the shipment date or (iii) negotiated terms of sale. Guarantees by letter of credit from a qualifying financial institution are required for most sales contracts. Because of the specialized nature of these machines and the period of time needed to complete production and shipping, Lynch Systems accounts for these contracts using the percentage-of-completion accounting method as costs are incurred compared to total estimated project costs (cost to cost basis). At June 30, 2004, and December 31, 2003, unbilled accounts receivable were \$0.1 and \$2.4 million respectively.

The percentage of completion method is used since reasonably dependable estimates of the revenues and costs applicable to various stages of a contract can be made, based on historical experience and milestones set in the contract. These estimates include current customer contract specifications, related engineering requirements and the achievement of project milestones. Financial management maintains contact with project managers to discuss the status of the projects and, for fixed-price engagements, financial management is updated on the budgeted costs and required resources to complete the project. These budgets are then used to calculate revenue recognition and to estimate the anticipated income or loss on the project. In the past, we have occasionally been required to commit unanticipated additional resources to complete projects, which have resulted in lower than anticipated profitability or losses on those contracts. Favorable changes in estimates result in additional profit recognition, while unfavorable changes in estimates result in the reversal of previously recognized earnings to the extent of the error of the estimate. We may experience similar situations in the future. Provisions for estimated losses on contracts are made during the period in which such losses become probable and can be reasonably estimated. To date, such losses have not been significant.

### ***Warranty Expense***

Lynch Systems provides a full warranty to world-wide customers who acquire machines. The warranty covers both parts and labor and normally covers a period of one year or thirteen months. Based upon experience, the warranty accrual is based upon three to five percent of the selling price of the machine. The Company periodically assesses the adequacy of the reserve and adjusts the amounts as necessary.

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Balance, December 31, 2003	\$585
Warranties issued during the period	162
Settlements made during the period	(272)
Changes in liabilities for pre-existing warranties during the period, including expirations	(51 )
Balance, June 30, 2004	<u>\$424</u>

### **Results of Operations**

#### ***Second Quarter 2004 and Six Months 2004 Compared to 2003***

##### Sales and Revenues/Gross Margin

Revenues for the second quarter of 2004 of \$6.7 million were equal to second quarter 2003 revenues. Improvements in M-tron' s sales were offset by reduced sales at Lynch Systems that was caused by Lynch Systems' low backlog at December 31, 2003 and the timing of deliveries for orders booked by Lynch Systems in April of 2004 that combined to depress System' s second quarter and first half 2004 revenue.

Six months 2004 sales of \$13.5 million were \$2.1 million greater than the \$11.4 million revenue recorded in the first six months of 2003 due to the low opening backlog and the delivery schedules for glass press machines that depressed Lynch Systems' first half 2004 sales by \$1.2 million that was overcome by improvements in the telecommunications market that resulted in \$3.3 million higher sales at M-tron.

Second quarter 2004 gross margin as a percent of sales was 29.5% or 3.7 points better than the 25.8% gross margin achieved in the second quarter of 2003 due to mainly (a) the 58% volume increase at M-tron, (b) additional absorption of fixed manufacturing costs at M-tron, and (c) efficiently producing Champion products that had caused unfavorable variances in the prior year.

Six month 2004 gross margin as a percent of revenues of 25.8% was 3.8% above the first half of 2003 due mainly to the higher level of sales at M-tron.

Revenues at M-tron increased by \$2.1 million, or 58.1%, to \$5.6 million for the second quarter of 2004 and by \$3.3 million, or 48.7%, to \$10.1 million for the six month period ending June 2004 due primarily (a) a stronger general economy, (b) improvements in the infrastructure segment of the telecommunications market; and (c) landing new customers.

Lynch Systems' second quarter 2004 revenue of \$1.2 million was \$2.0 million, or 63.8%, below the same period of 2003. Lynch Systems' revenues for the first six months of 2004 declined by \$1.2 million from the corresponding 2003 period to \$3.5 million due mainly to depressed bookings for glass press machines throughout the second half of 2003. However, order backlog of \$8.8 million at June 30, 2004 represented an improvement of \$6.0 million since December 31, 2003. The Company expects to recognize half of the \$6.6 million tableware order that was booked on April 27, 2004 in fiscal 2004, the gross margin on this contract may be less than historical rates.

M-tron' s gross margin as a percentage of net sales for the second quarter of 2004 improved over the same period of 2003 by 2.1% to 26.4%. M-tron' s gross margin of 25.0% for the six month period ending June 30, 2004 represented a 2.8% improvement over the 22.2% gross margin achieved in the first half of 2003. The sales improvement in the second quarter and six month period ending June 30, 2004 of 58.1% and 48.7% respectively combined with selective price increases and operational efficiencies caused the improved gross margin rates. M-tron achieved an incremental gross profit rate of 30.8% in the first half of 2004.

Lynch Systems' gross margin as a percentage of net sales for the second quarter of 2004 improved 17.0% to 44.4% compared to the same period of 2003. Lynch Systems' gross margin of 28.1% for the six month period ending June, 2004 was 6.3% better than the first half 2003 gross margin of 21.8 percent. These improvements in the second quarter and in the first half of 2004 were the result of high margin repair part sales that represented a much higher proportion of total sales (80% in 2Q 2004 versus 25% in 2Q 2003; 49% year-to-date versus 30% in first half 2003 at a gross margin rate of 49.6% in the second quarter and 38.5% in the period ending June 30, 2004).

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### Operating Loss

Operating loss for the second quarter 2004 including a \$425,000 expense provision for a potential legal settlement was \$0.5 million compared to the second quarter 2003 operating loss of \$0.3 million, representing an unfavorable variance of \$0.2 million on equal revenue.

Six months 2004 operating loss of \$1.2 million was \$0.1 million less than the first half 2003 loss of \$1.3 million because the gross margin on \$2.1 million additional revenue was virtually offset by the \$425,000 provision for a potential legal settlement.

For the second quarter of 2004, M-tron had an operating profit of \$407,000, an improvement of \$413,000 over the \$6,000 loss in the second quarter of 2003. M-tron's six month 2004 operating profit of \$469,000 represented a major improvement of \$698,000 when compared to M-tron's \$229,000 operating loss in the six month period ending June 30, 2003. The operating profit improvements were due mainly to the 58.1% sales increase in the second quarter and 48.7% six month increase mentioned above and better product mix.

For the 2004 second quarter, Lynch Systems had an operating loss of \$130,000 compared to an operating profit of \$146,000 in the second quarter of 2003. Lynch Systems' first half 2004 operating loss of \$522,000 was \$185,000 unfavorable to the six month 2003 operating loss of \$337,000. Although Lynch Systems second quarter and six months 2004 gross margin rate improved by 17.0% and 6.3% respectively, the company could not compensate for the volume decline mentioned above and higher variable selling and engineering expenses incurred in the first quarter of 2004.

Lynch's corporate headquarters incurred unallocated expenses of \$744,000 in the second quarter of 2004, bringing the six months 2004 headquarters expense to \$1,177,000. The second quarter and six month 2004 headquarters expenses exceeded the prior year by \$326,000 and \$425,000 respectively due to higher professional fees, liability insurance (D&O), directors fees, and a \$425,000 provision in second quarter 2004 for the potential settlement of the PACE suit as previously described in Note L.

### Other Income (Expense), Net

Second quarter and first half 2004 investment income was \$149,000 and \$160,000 respectively less than 2003 due to (a) lower average cash balances, (b) investment in non-dividend paying securities, and (c) a realized gain on sale of marketable securities in 2Q 2003 in the amount of \$134,000.

Second quarter interest expense of \$62,000 was less than 2003 by \$31,000 due to fewer and lower Letter of Credit fees and lower average borrowing to fund M-tron's losses.

Interest expense of \$113,000 for the first six months of 2004 was \$49,000 less than the \$162,000 incurred in the first half of 2003 due to fewer Letter of Credit fees, lower average borrowing to fund M-tron's losses, and lower interest rates.

Six month 2004 other income of \$22,000 was mainly the result of selling excess equipment that had no book value for \$27,000 in the first quarter.

### Income Taxes

The Company files consolidated federal income tax returns, which includes all subsidiaries.

First half 2004 income tax includes federal, state, local and foreign taxes. There was no state income tax benefit in first six months of 2004 because tax carry-back is not available to the Company's Georgia business. There was no federal tax benefit in the first half of 2004 as a result of net operating losses ("NOL's") because the Company had previously been refunded all taxes in its carry-back period and there is uncertainty regarding the utilization of the NOL carry-forward. The Company recorded a \$30,000 tax provision in second quarter 2004 and \$55,000 for the six month period ending June 30, 2004 for taxes at the Hong Kong tax rate on M-tron's foreign subsidiaries' earnings.

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The six month 2003 income tax benefit included federal, as well as state, local, and foreign taxes. The second quarter 2003 and six month 2003 net tax benefit of \$43,000 and \$392,000 respectively was the result of operating losses incurred which were expected to be realized during the remainder of 2003.

### Net Loss

Net loss for the second quarter of 2004 was \$560,000 compared to a net loss of \$173,000 in the quarter ending June 30, 2003. Six month 2004 net loss of \$1,368,000 was unfavorable to the \$911,000 net loss in the first six months of 2003 by \$457,000. The \$387,000 additional loss in the second quarter is primarily due to income tax expense of \$30,000 versus a \$43,000 tax benefit last year and the \$425,000 legal settlement provision recorded in the second quarter of 2004. As a result, fully diluted second quarter 2004 loss per share was \$0.37 compared to a loss of \$0.12 per share in the second quarter 2003.

First half 2004 fully diluted loss per share of \$0.91 was \$0.30 per share worse than the \$0.61 per share loss in the first half of 2003 due mainly to the 2004 sales increase of \$2.1 million that resulted in additional gross profit being more than offset by (a) the \$425,000 legal settlement provision in 2004; (b) a tax provision in 2004 of \$55,000 compared to a \$392,000 tax benefit in 2003; and (c) \$160,000 less investment income due mainly to a realized gain on sale of marketable securities in 2003 of \$134,000.

### Backlog/New Orders

Total backlog of manufactured products at June 30, 2004 was \$12.1 million, a \$6.5 million improvement over the backlog at December 31, 2003, and \$0.5 million less than the backlog at June 30, 2003.

M-tron's backlog improved by \$0.7 million since last June and \$0.5 since December 31, 2003, due mainly to increasing demand for telecommunications hardware.

Lynch Systems backlog has improved by \$6.0 million since December 31, 2003 as a result of a \$6.6 million order for tableware manufacturing equipment. First half 2004 bookings of \$9.5 million were \$1.8 million less than first half 2003 due to the lack of glass press machine orders in 2004.

### Financial Condition

At June 30, 2004, the Company has current assets of \$17.8 million and current liabilities of \$10.4 million. Working capital was therefore \$7.4 million as compared to \$7.5 million at December 31, 2003 and \$8.1 million at June 30, 2003. The ratio of current assets to current liabilities was 1.71 to 1.00 at June 30, 2004; 1.67 to 1.00 at December 31, 2003; and 1.71 to 1.00 ratio at June 30, 2003.

Cash provided in operating activities was approximately \$0.5 million in the first half of 2004 compared to cash used of approximately \$1.0 million in the first half of 2003. The year over year favorable change in operating cash flow of \$1.5 million was mainly the result of \$1.4 million less cash used in working capital. Capital expenditures were \$184,000 in the first half of 2004 compared to \$108,000 in the period ending June 30, 2003.

Total debt of \$3.6 million at June 30, 2004 was \$0.2 million less than the amount outstanding at December 31, 2003 and \$1.1 million less than the debt at June 30, 2003. The year over year reduction in debt is primarily due to M-tron's improved operating results that enabled it to reduce its revolving credit loan by \$735,000 while at the same time reducing its funded debt by \$305,000. Debt outstanding at June 30, 2004 included \$0.9 million of fixed rate debt at an average interest rate of 3.9%, and \$2.7 million of variable rate debt at a June 30, 2004 average interest rate of 4.5%.

Restrictions on dividends under the M-tron loan with First National Bank of Omaha disallow distributions to the parent company without consent of the bank. Lynch Systems, under its loan with Sun Trust Bank, may pay a cash dividend to the parent company equal to 50% of LS' s net income for the prior fiscal year, subject to the minimum net worth covenant in the loan agreement. Under the M-tron loan agreement, advances to the parent company are disallowed without the prior written consent of the lending bank. Under its loan agreement, LS may pay an annual management fee to the parent company in an amount not to exceed \$250,000. In addition, LS may reimburse the parent company for expenses and taxes paid by the parent on behalf of LS.

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At June 30, 2004, the Company's total cash, cash equivalents and investments in marketable securities total \$7.6 million (including \$1.1 million of restricted cash). In addition, the Company had a consolidated borrowing capacity of \$3.6 million under M-tron's and LS's revolving line of credit. Therefore, gross cash and securities and availability under the revolving credit loans total \$11.2 million and exceed the combined outstanding debt and margin liability on securities of \$5.2 million by \$6.0 million.

On May 29, 2004, Lynch Systems renewed its SunTrust Bank loan with a new maturity date of May 31, 2005. This long-time lender has provided a \$7 million line-of-credit which can be used entirely for stand-by Letters of Credit or up to \$4 million (formerly \$2 million) for domestic revolving credit within the credit line. This loan, as well as the previous loan, includes an unsecured parent company guarantee. At June 30, 2004, there were outstanding Letters of Credit of \$35,000 and no borrowings under the working capital line.

On April 30, 2004, M-tron's long-time lending bank, First National Bank of Omaha, renewed the \$3 million revolving credit loan that now matures on April 30, 2005. On May 14, 2004, M-tron and First National Bank of Omaha also entered into a new term loan arrangement in the amount of \$1,200,000. A portion of the proceeds from this new term loan were used to pay off the term loan that had a September 2004 maturity date. This new loan has an April 30, 2007 maturity date and bears interest at the bank's base rate plus 0.50%. \$800,000 is outstanding on the new loan as of June 30, 2004. This loan is secured by the August 31, 2001 loan agreement and \$1,000,000 Letter of Credit dated September 9, 2002 issued by Fleet Bank on behalf of Lynch.

The Company has guaranteed a Letter of Credit issued to the First National Bank of Omaha on behalf of its subsidiary, M-tron Industries, Inc. As of March 31, 2004, the \$1,000,000 Letter of Credit issued by Fleet Bank to The First National Bank of Omaha was secured by a \$1,125,000 deposit in a Fleet Bank Treasury Fixed Income Fund. The Company's outstanding Letter of Credit in the amount of \$1.0 million for the benefit of the bank can be reduced to \$500,000 when M-tron is profitable for 5 of 6 consecutive months and the cumulative after tax profit equals or exceeds \$500,000. The remaining \$500,000 Letter of Credit will be released when the earnings parameters are met for a second time. These thresholds were not met in 2003 or the first half of 2004 and there is no assurance they will be met in 2004.

The Company does not at present have credit facilities at the parent company level. The Company believes that existing cash and cash equivalents, cash generated from operations and available borrowings under its subsidiaries lines of credit will be sufficient to meet its on-going working capital and capital expenditure requirements for the foreseeable future.

### Adoption of Accounting Pronouncements

In January 2003, the FASB issued Interpretation No. 46, "Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51" ("FIN 46"). Fin 46 clarifies the application of Accounting Research Bulletin No. 51, "Consolidated Financial Statements," to certain entities in which equity investors do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. The consolidation requirements of FIN 46, as revised, are required to be applied for periods ending after December 15, 2003 for interests in structures that are commonly referred to as special-purpose entities, while the application of this Interpretation for all other types of variable interest entities is required for periods ending after March 15, 2004. The Company does not have any interests in variable interest entities.

### **Off-Balance Sheet Arrangements**

Aside from the Company's stand-by Letter of Credit in the amount of \$1,000,000, the Company does not have any off-balance sheet arrangements.

### **Aggregate Contractual Obligations**

Details of the Company's contractual obligations for short-term debt, long-term debt, leases, purchases and other long term obligations are as follows:

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Contractual Obligations	Payments Due by Period - Including Interest (in 000' s)				
	Total	Less Than 1 Year	1 - 3 Years	3 - 5 Years	More Than 5 Years
Short-term Debt	\$ 1,942	\$ 1,942	—	—	—
Long-term Debt Obligations	2,003	521	\$ 1,187	\$ 125	\$ 170
Capital Lease Obligations	—	—	—	—	—
Operating Lease Obligations	493	250	243	—	—
Purchase Obligations	—	—	—	—	—
Other Long-term Liabilities Reflected on the Registrant' s Balance Sheet under GAAP	—	—	—	—	—
<b>TOTAL</b>	<b>\$ 4,438</b>	<b>\$ 2,713</b>	<b>\$ 1,430</b>	<b>\$ 125</b>	<b>\$ 170</b>

### Market Risk

The Company is exposed to market risk relating to changes in the general level of U.S. interest rates. Changes in interest rates affect the amounts of interest earned on the Company' s cash equivalents and short-term investments (approximately \$4.2 million at June 30, 2004). The Company generally finances the debt portion of the acquisition of long-term assets with fixed rate, long-term debt. The Company does not use derivative financial instruments for trading or speculative purposes. Management does not foresee any significant changes in the strategies used to manage interest rate risk in the near future, although the strategies may be reevaluated as market conditions dictate. There has been no significant change in market risk since June 30, 2004.

Since the Company' s international sales are in U.S. Dollars, there is no monetary risk.

At June 30, 2004, approximately \$2.7 million of the Company' s debt bears interest at variable rates. Accordingly, the Company' s earnings and cash flows are only slightly affected by changes in interest rates. Assuming the current level of borrowings for variable rate debt, and assuming a two percentage point increase in the 2004 average interest rate under these borrowings, it is estimated that the Company' s interest expense would change by less than \$0.1 million. In the event of an adverse change in interest rates, management would take actions to further mitigate its exposure.

### Risk Factors

Certain subsidiaries and business segments of the Company sell to industries that are subject to cyclical economic changes. Any downturns in the economic environment would have a financial impact on the Company and its consolidated subsidiaries and may cause the reported financial information herein not to be indicative of future operating results, financial condition or cash flows.

Future activities and operating results may be adversely affected by fluctuating demand for capital goods such as large glass presses, delay in the recovery of demand for components used by telecommunications infrastructure manufacturers, disruption of foreign economies and the inability to renew or obtain new financing for expiring loans.

Financial instruments that potentially subject the Company to significant concentrations of credit risk consist principally of cash investments, and trade accounts receivable.

The Company maintains cash and cash equivalents and short-term investments with various financial institutions. These financial institutions are located throughout the country and the Company' s policy is designed to limit exposure to any one institution. The Company performs periodic evaluations of the relative credit standing of those financial institutions that are considered in the Company' s investment strategy. Other than certain accounts receivable, the Company does not require collateral on these financial instruments. In relation to export sales, the Company requires letters of credit supporting a significant portion of the sales price prior to production to limit exposure to credit risk. The Company maintains an allowance for doubtful accounts at a level that management believes is sufficient to cover potential credit losses.

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### Forward Looking Information

Included in this Management Discussion and Analysis of Financial Condition and Results of Operations are certain forward looking financial and other information, including without limitation matters relating to “Risks”. It should be recognized that such information are projections, estimates or forecasts based on various assumptions, including without limitation, meeting its assumptions regarding expected operating performance and other matters specifically set forth, as well as the expected performance of the economy as it impacts the Company’ s businesses, government and regulatory actions and approvals, and tax consequences, and the risk factors and cautionary statements set forth in reports filed by the Company with the Securities and Exchange Commission. As a result, such information is subject to uncertainties, risks and inaccuracies, which could be material.

The Registrant makes available, free of charge, its annual report on Form 10-K, Quarterly Reports on Form 10-Q, and current reports, if any, on Form 8-K.

The Registrant also makes this information available on its website, who’ s internet address is [www.lynchcorp.com](http://www.lynchcorp.com).

### **Item 3. Quantitative and Qualitative Disclosure About Market Risk**

See “Market Risk” under Item 2 above.

### **Item 4. Controls and Procedures**

The Chief Executive Officer and Chief Financial Officer have concluded that the Company’ s disclosure controls and procedures were effective as of the end of the period covered by this report based on the evaluation of these controls and procedures required by Exchange Act Rule 13a-15.

There have been no changes in the Registrant’ s internal control over financial reporting that occurred during the Registrant’ s last fiscal quarter that has materially affected, or is reasonably likely to materially affect, the Registrant’ s internal control over financial reporting.

## **PART II. OTHER INFORMATION**

### **Item 1. Legal Proceedings**

**In re Spinnaker Coating, Inc., Debtor/PACE Local I-1069 v. Spinnaker Coating, Inc., and Lynch Corporation, U.S. Bankruptcy 1. Court, District of Maine, Chapter 11, Adv. Pro. No. 02-2007; and PACE Local 1-1069 v. Spinnaker Industries, Inc., Spinnaker Coating, Inc., and Spinnaker Coating-Maine, Inc., Cumberland County Superior Court, CV-2001-00352:**

On or about June 26, 2001, in anticipation of the July 15, 2001 closure of Spinnaker’ s Westbrook, Maine facility, Plaintiff PACE Local 1-1069 (“PACE”) filed a three count complaint in Cumberland County Superior Court, CV-2001-00352 naming the following defendants: Spinnaker Industries, Inc., Spinnaker Coating, Inc., and Spinnaker Coating-Maine, Inc. (collectively, the “Spinnaker Entities”) and Lynch. The complaint alleged that under Maine’ s Severance Pay Act both the Spinnaker Entities and Lynch would be liable to pay approximately \$1,166,000 severance pay under Maine’ s Severance Pay Act in connection with the plant closure. The Defendants filed a notice of removal, thereby creating United States District Court Civil Action C.V. No. 01-236. The case was remanded to state court. The Spinnaker Entities also filed a separate complaint challenging the constitutionality of the Maine Severance Pay Act, United States District Court Civil Action No. 01-232 which later was dismissed by stipulation of the Spinnaker Entities. PACE also filed three separate Motions for Ex-Parte Attachment against the Spinnaker Entities and Lynch. PACE filed the First Motion for Attachment with its original Complaint. PACE sought to attach \$1,166,483.44, an amount large enough to cover the claims of all PACE’ s members seeking severance. The Court denied that Motion as being premature. PACE then filed a Second Motion against the Spinnaker Entities and Lynch for an attachment large enough to cover the claims of eight individual employees seeking severance pay in the amount of \$120,736.27. On August 20, 2001, the Court granted that Motion in the amount of \$118,500. On April 4, 2002, PACE subsequently recorded this attachment through UCC-1 filings with the Maine Secretary of State

against Lynch Manufacturing and Lynch Corporation. PACE filed a Third Motion for Ex-Parte Attachment on August 29, 2001. This Motion sought an attachment large enough to cover the severance pay claimed by the



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remaining PACE members, \$1,048,003. The Court denied this Motion but permitted PACE the opportunity to obtain an attachment after all defendants had an opportunity to respond and after hearing.

Before any further action was taken with respect to PACE' s Third Motion for Attachment, the Spinnaker Defendants filed for relief under Chapter 11 of the Bankruptcy Code. Following a series of filings in the United States District Court for the District of Maine and the United States Bankruptcy Court for the District of Maine which, like United States District Court Case No. 01-236, later were dismissed by the parties with prejudice and without costs, PACE' s case continues to proceed against Lynch in Cumberland County Superior Court in Maine on the issue of whether Lynch has liability to PACE' s members under the Maine Severance Pay Act.

On September 30, 2002, PACE requested a ruling from the Superior Court on its Third Motion for Attachment. On October 21, 2002, Lynch filed a Motion for Summary Judgment which incorporated its prior objection to any attachment. PACE filed an Opposition to Lynch' s Motion for Summary Judgment, which included a request for summary judgment in its favor, and a Motion for Leave to Further Amend the Complaint on November 12, 2002. Lynch thereafter filed a Reply Memorandum in Support of its Motion for Summary Judgment on November 26, 2002 and an opposition to PACE' s Motion for Leave to Further Amend the Complaint on December 3, 2002. On December 31, 2002, the Superior Court held a hearing on all pending Motions. The Superior Court requested that arguments focus on Lynch' s Motion for Summary Judgment since the granting of that Motion would render PACE' s Third Motion for Attachment and Motion to Further Amend the Complaint moot.

On July 28, 2003, the Superior Court issued an Order deciding both Lynch' s and PACE' s Motions for Summary Judgment. The Court denied Lynch' s Motion for Summary Judgment, finding that there remained a disputed issue of material fact regarding one of Lynch' s primary defenses. The Court granted partial summary judgment in favor of PACE to the extent that the Court found Lynch was an "employer" subject to potential liability under Maine' s Severance Pay Act. The Court held, however, that PACE must still prove its entitlement to severance pay under the Act. In a separate ruling also issued on July 28, 2003, the Court denied PACE' s Third Motion for Attachment.

On March 8, 2004, Lynch filed a Motion for Summary Judgment on the issue of an exemption under the Maine Severance Pay Act, based upon the nexus between the plant closure in Westbrook, Maine and the Spinnaker defendants' bankruptcy filing. PACE concurrently filed a Motion for Summary Judgment on Count II of the complaint on March 8, 2004.

During a Trial Management Conference on March 24, 2004, the parties agreed to submit a Stipulation of Facts to the Court in lieu of a trial on any remaining issues in the case. The Court has not yet scheduled oral arguments from the parties related to the pending motions for summary judgment and related to any remaining issues in the case.

At a settlement conference held in the Cumberland County Superior Court (Portland, Maine), the Company offered \$425,000 in full settlement of the PACE claim. Both parties have continued negotiations that could lead to a settlement. During the 2<sup>nd</sup> quarter of 2004, the Company has provided for this \$425,000 potential settlement.

Lynch believes that, in addition to other defenses, it is not subject to the Maine Severance Pay Act, as now in effect. Management does not believe that the resolution of this case will have a material adverse effect on the Registrant' s consolidated financial condition and operations.

The Company does not believe that it has any other contingent liabilities related to Spinnaker.

## **2. Qui Tam Lawsuit**

There has been no material change in the status of this lawsuit as last reported in Registrant' s Form 10-K for its fiscal year ended December 31, 2002.

**Item 2. Issuer Purchase of Its Equity Securities**

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number (or Approximate Dollar Value) of Shares that May Yet Be Purchased Under the Plans or Programs
February 4, 2004 To February 29, 2004	400	\$ 12.5125	400	49,600 Shares
March 1, 2004 - March 31, 2004	2,000	\$ 13.5000	2,000	47,600 Shares
April 1, 2004 - June 30, 2004	–	–	–	47,600 Shares
Total	2,400	\$ 13.3770	2,400	47,600 Shares

On February 4, 2004, Lynch announced that on January 23, 2004, the Board of Directors authorized the repurchase of up to 50,000 shares of the Company's outstanding common stock. The timing of the buy-back and the exact number of shares purchased will depend on market conditions; this program does not have an expiration date. The Company will buy back shares through both public and private channels at prices believed to be appropriate and in the best interest of shareholders.

As of June 30, 2004, the Company has repurchased 2,400 shares in the amount of \$32,105, at an average price of \$13.377 per share. 47,600 shares may yet be purchased under this program.

**Item 4. Submission of Matters to a Vote of Security Holders**

At the Annual Meeting of Stockholders of the Registrant held on May 6, 2004:

The following persons were elected as Directors with the following votes:

Name	Votes For	Votes Withheld
Val Cerutti	1,399,589	5,291
Mario J. Gabelli	1,399,589	5,291
Avrum Gray	1,402,289	2,591
Ralph R. Papitto	1,401,637	3,243
Anthony R. Pustorino	1,399,589	5,291

**Item 6. Exhibits and Reports on Form 8-K**

(a) Exhibits filed herewith:

- 10(nn) Third Amendment to Restated Loan and Security Agreement dated April 30, 2004 between M-tron Industries, Inc. and First National Bank of Omaha.
- 10(oo) Second Amendment to Amended and Restated Credit Agreement between Lynch Systems, Inc. and SunTrust Bank dated May 29, 2004.
- 10(pp) Term Loan Note between M-tron Industries, Inc. and First National Bank of Omaha dated May 14, 2004.
- 31 Certifications of Registrant's principal executive and principal chief financial officer required by Exchange Act Rule 13a-14(a).
- 32 Section 1350 Certifications of Registrant's principal executive and principal financial officer's required by Exchange Act Rule 13a-14(b).



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(b) Reports on Form 8-K:

1. Registrant' s press release announcing its results of operations for the first quarter ending March 31, 2004 was filed with a Form 8-K on May 13, 2004.
2. Registrant' s press release announcing its results of operations for the fourth quarter and year-ending December 31, 2003 was filed with a Form 8-K on April 14, 2004.

SIGNATURES

Pursuant to the requirements of the Securities and Exchange Act of 1934, the Company has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

LYNCH CORPORATION  
(Registrant)

By:

August 11, 2004

/s/ RAYMOND H. KELLER \_\_\_\_\_  
Raymond H. Keller  
Chief Financial Officer

**EXHIBIT INDEX**

<b>Exhibit No.</b>	<b>Description</b>
10(nn)	Third Amendment to Restated Loan and Security Agreement dated April 30, 2004 between M-tron Industries, Inc. and First National Bank of Omaha. ††
10(oo)	Second Amendment to Amended and Restated Credit Agreement between Lynch Systems, Inc. and SunTrust Bank dated May 29, 2004. ††
10(pp)	Term Loan Note between M-tron Industries, Inc. and First National Bank of Omaha dated May 14, 2004. ††
31	Certifications of Registrant' s principal executive and principal financial officers required by Exchange Act Rule 13a-14(a). ††
32	Section 1350 Certifications of Registrant' s principal executive and principal financial officers required by Exchange Act Rule 13a-14(b). ††

†† Filed herewith.

The Exhibits listed above have been filed separately with the Securities and Exchange Commission in conjunction with this Quarterly Report on Form 10-Q or have been incorporated by reference into this Quarterly Report on Form 10-Q. Upon request, Lynch Corporation will furnish to each of its shareholders a copy of any such Exhibit. Requests should be addressed to the Office of the Secretary, Lynch Corporation, 50 Kennedy Plaza, Suite 1250, Providence, RI 02903.

[FIRST NATIONAL BANK LOGO]

<TABLE>

<CAPTION>

LOAN NUMBER	LOAN NAME	ACCT. NUMBER	NOTE DATE	INITIALS
<S> 2000001751/5 Renewal	<C> M-Tron Industries, Inc.	<C>	<C> 04/30/04	<C> JRK
NOTE AMOUNT	INDEX (w/Margin)	RATE	MATURITY DATE	LOAN PURPOSE
\$3,000, 000.00	FNBO National Base Rate	4.5%	04/30/05	Commercial
Creditor Use Only				

</TABLE>

PROMISSORY NOTE  
(Commercial - Revolving Draw - Variable Rate)

DATE AND PARTIES. The date of this Promissory Note (Note) is April 30, 2004. The parties and their addresses are:

LENDER:

FIRST NATIONAL BANK OF OMAHA  
Stop Code 1030  
1620 Dodge St  
Omaha, Nebraska 68197  
Telephone: (402) 633-3555

BORROWER:

M-TRON INDUSTRIES, INC.  
a Delaware Corporation  
100 Douglas Avenue  
Yankton, South Dakota 57078

1. DEFINITIONS. As used in this Note, the terms have the following meanings:

A. PRONOUNS. The pronouns "I," "me," and "my" refer to each Borrower signing this Note, individually and together with their heirs, successors and assigns, and each other person or legal entity (including guarantors, endorsers, and sureties) who agrees to pay this Note. "You" and "Your" refer to the Lender, with its participants or syndicators, successors and assigns, or any person or company that acquires an interest in the Loan.

B. NOTE. Note refers to this document, and any extensions, renewals, modifications and substitutions of this Note.

C. LOAN. Loan refers to this transaction generally, including obligations and duties arising from the terms of all documents prepared or submitted for this transaction such as applications, security agreements, disclosures or notes, and this Note.

D. PROPERTY. Property is any property, real, personal or intangible, that secures my performance of the obligations of this Loan.

E. PERCENT. Rates and rate change limitations are expressed as annualized percentages.

2. PROMISE TO PAY. For value received, I promise to pay you or your order, at your address, or at such other location as you may designate, amounts advanced from time to time under the terms of this Note up to the maximum outstanding principal balance of \$3,000,000.00 (Principal), plus interest from the date of disbursement, on the unpaid outstanding Principal balance until this Note matures or this obligation is accelerated.

I may borrow up to the Principal amount more than one time.

3. ADVANCES. Advances under this Note are made according to the following terms and conditions.

A. REQUESTS FOR ADVANCES. My requests are a warranty that I am in compliance with all the Loan documents. When required by you for a particular method of advance, my requests for an advance must specify the requested amount and the date and be accompanied with any agreements, documents, and instruments that you require for the Loan. Any payment by you of any check, share draft or other charge may, at your option, constitute an advance on the Loan to me. All advances will be made in United States dollars. I will indemnify you and hold you harmless for your reliance on any request for advances that you reasonably believe to be genuine. To the extent permitted by law, I will indemnify you and hold you harmless when the person making any request represents that I authorized this person to request an advance even when this person is unauthorized or this person's signature is not genuine.

I or anyone I authorize to act on my behalf may request advances by the following methods.

- (1) I make a request in person.
- (2) I make a request by phone.
- (3) I make a request by mail.
- (4) I write a check or share draft.

B. ADVANCE LIMITATIONS. In addition to any other Loan conditions, requests for, and access to, advances are subject to the following limitations.

- (1) Obligatory Advances. You will make all Loan advances subject to this Agreement's terms and conditions.
- (2) Advance Amount. Subject to the terms and conditions contained in this Note, advances will be made in exactly the amount I request.
- (3) Disbursement of Advances. On my fulfillment of this Note's terms and conditions, you will disburse the advance in any manner as you and I agree.
- (4) Credit Limit. I understand that you will not ordinarily grant a request for an advance that would cause the unpaid principal of my Loan to be greater than the Principal limit. You may, at your option, grant such a request without obligating yourselves to do so in the future.
- (5) Records. Your records will be conclusive evidence as to the amount of advances, the Loan's unpaid principal balances and the accrued interest.

4. INTEREST. Interest will accrue on the unpaid Principal balance of this Note at the rate of 4.5 percent (Interest Rate) until May 1, 2004, after which time it may change as described in the Variable Rate subsection.

A. INTEREST AFTER DEFAULT. If you declare a default under the terms of this

Loan, including for failure to pay in full at maturity, you may increase the Interest Rate payable on the outstanding Principal balance of this Note. In such event, interest will accrue on the outstanding Principal balance at the variable Interest Rate in effect from time to time, plus an additional 6.000 percent, until paid in full.

B. MAXIMUM INTEREST AMOUNT. Any amount assessed or collected as interest under the terms of this Note or obligation will be limited to the Maximum Lawful Amount of interest allowed by state or federal law. Amounts collected in excess of the Maximum Lawful Amount will be applied first to the unpaid Principal balance. Any remainder will be refunded to me.

M-Tron Industries, Inc.  
Nebraska Promissory Note  
NE/4XX270735007252000043  
64005051404N

(c)1996 Bankers Systems, Inc.,  
St. Cloud, MN [ILLEGIBLE] (TM)

Initials \_\_\_\_\_  
Page 1

C. STATUTORY AUTHORITY. The amount assessed or collected on this Note is authorized by the Nebraska usury laws under Neb. Rev. Stat. S 45.101.03.

D. ACCRUAL. During the scheduled term of this Loan interest accrues using an Actual/360 days counting method.

E. VARIABLE RATE. The Interest Rate may change during the term of this transaction.

(1) Index. Beginning with the first Change Date, the Interest Rate will be based on the following index: the base rate in effect from time to time and designated by First National Bank of Omaha as its National Base Rate.

The Current Index is the most recent index figure available on each Change Date. You do not guaranty by selecting this index, or the margin, that the interest Rate on this Note will be the same rate you charge on any other loans or class of loans you make to me or other borrowers. If this Index is no longer available, you will substitute a similar index. You will give me notice of your choice.

(2) Change Date. Each date on which the Interest Rate may change is called a Change Date. The Interest Rate may change May 15, 2004 and daily thereafter.

(3) Calculation Of Change. On each Change Data, you will calculate the Interest Rate, which will be the Current Index plus 0.500 percent. The result of this calculation will be rounded to the nearest .001 percent. Subject to any limitations, this will be the Interest Rate until the next Change Date. The new Interest Rate will become effective on each Change Date. The Interest Rate and other charges on this Note will never exceed the highest rate or charge allowed by law for this Note.

(4) Limitations. The Interest Rate changes are subject to the following limitations:

(a) Lifetime. The Interest Rate will never be less than 4.500 percent.

(5) Effect Of Variable Rate. A change in the Interest Rate will have the following effect on the payments: The amount of the final payment will change.

5. PAYMENT. I agree to pay this Note as follows: I agree to pay this Note in 36 payments. This Note is amortized over 60 payments. A payment of \$22,369.76 will be due May 31, 2004. and on the last day of each month thereafter. A final



payment of the entire unpaid balance of Principal and interest will be due April 30, 2007. Any changes in the Interest Rate will affect the amount of this payment.

Payments will be rounded to the nearest \$.01. With the final payment I also agree to pay any additional fees or charges owing and the amount of any advances you have made to others on my behalf. Payments scheduled to be paid on, the 29th, 30th or 31st day of a month that contains no such day will, instead, be made on the last day of such month.

Each payment I make on this Note will be applied first to interest that is due then 10 principal that is due, and finally to any charges that I owe other than principal and interest If you and I agree to a different application of payments, we will describe our agreement on this Note. The actual amount of my final payment will depend on my payment record.

6. PREPAYMENT. I may prepay this Loan in full or in part at any time. Any partial prepayment will not excuse any later scheduled payments until I pay in full.

7. LOAN PURPOSE. The purpose of this Loan is to fund the purchase of new and used equipment.

8. SECURITY. This Loan is secured by the following, previously executed, security instruments or agreements: Restated Loan/Security Agreement dated August 31, 2001. Letter of Credit #RS1361047 issued by Fleet National Bank on behalf of Lynch Corporation in the amount of \$1,000,000.00 dated September 9, 2002.

9. DEFAULT. I will be in default if any of the following occur:

A. PAYMENTS. I fail to make a payment in full when due.

B. INSOLVANCY OR BANKRUPTCY. I make an assignment for the benefit of creditors or become Insolvent, either because my liabilities exceed my assets or I am unable to pay my debts as they become due; or I petition for protection under federal, state or local bankruptcy, insolvency or debtor relief laws, or am the subject of a petition or action under such laws and fail to have the petition of action dismissed within a reasonable period of time not to exceed 60 days.

C. BUSINESS TERMINATION. I merge, dissolve, reorganize, and my business or existence, or a partner or majority owner dies or is declared legally incompetent.

D. FAILURE TO PERFORM. I fail to perform any condition or to keep any promise or covenant of this Note.

E. OTHER DOCUMENTS. A default occurs under the terms of any other transaction document.

F. OTHER AGREEMENTS. I am in default or any other debt or agreement I have with you.

G. MISREPRESENTATION. I make any verbal Of written statement or provide any financial information that is untrue, inaccurate, or conceals a material fact at the time it is made or provided.

H. JUDGMENT. I fail to satisfy or appeal any judgment against me.

I. FORFEITURE. The Property is used in a manner or for a purpose that threatens confiscation by a legal authority.

J. NAME CHANGE. I change my name or assume an additional name without notifying you before making such a change.

K. PROPERTY TRANSFER. I transfer all or a substantial part of my money or property.

L. PROPERTY VALUE. The value of the Property declines or is impaired.

M. MATERIAL CHANGE. Without first notifying you, there is a material change in my business, including ownership, management, and financial conditions.

N. INSECURITY. You reasonably believe that you are insecure.

10. ASSUMPTIONS. Someone buying the Property cannot assume the obligation. You may declare the entire balance of the Note to be immediately due and payable upon the creation of, or contract for the creation of, any lien, encumbrance, or transfer of the property.

11. WAIVERS AND CONSENT. To the extent not prohibited by law, I waive protest, presentment for payment, demand, notice of acceleration, notice of intent to accelerate and notice of dishonor.

A. ADDITIONAL WAIVERS BY BORROWER. In addition, I, and any party to this Note and Loan, to the extent permitted by law, consent to certain actions you may take, and generally waive defenses that may be available based on these actions or based on the status of a party to this Note.

(1) You may renew or extend payments on this Note, regardless of the number of such renewals or extensions.

(2) You may release any Borrower, endorser, guarantor, surety, accommodation maker or any other co-signer.

(3) You may release, substitute or impair any Property securing this Note.

(4) You, or any institution participating in this Note, may invoke your right of set-off.

(5) You may enter into any sales, repurchases or participations of this Note to any person in any amounts and I waive notice of such sales, repurchases or participations.

(6) I agree that any of us signing this Note as a Borrower is authorized to modify the terms of this Note or any instrument securing, guarantying or relating to this Note.

B. NO WAIVER BY LENDER. Your course of dealing, or your forbearance from, or delay in, the exercise of any of your rights, remedies, privileges or right to insist upon my strict performance of any provisions contained in this Note, or other Loan documents, shall not be construed as a waiver by you, unless any such waiver is in writing and is signed by you.

12. REMEDIES, After I default, and after you give any legally required notice and opportunity to cure the default, you may at your option do any one or more of the following.

A. ACCELERATION. You may make all or any part of the amount owing by the terms of this Note immediately due.

B. SOURCES. You may use any and all remedies you have under state or federal law or in any instrument securing this Note.

C. INSURANCE BENEFITS. You may make a claim for any and all insurance benefits or refunds that may be available on my default.

D. PAYMENTS MADE ON MY BEHALF. Amounts advanced on my behalf will be immediately due and may be added to the balance owing under the terms of this Note, and accrue interest at the highest post-maturity interest rate.

E. TERMINATION. You may terminate my right to obtain advances and may refuse to make any further extensions of credit.

F. SET-OFF. You may use the right of set-off. This means you may set-off any amount due and payable under the terms of this Note against any right I have to receive money from you.

My right to receive money from you includes any deposit or share account balance I have with you: any money owed to me on an item presented to you or in your possession for collection or exchange; end any repurchase agreement or other non-deposit obligation, "Any amount due and payable under the terms of this Note" means the total amount to which you are entitled to demand payment under the terms of this Note at the time you set-off.

Subject to any other written contract, if my right to receive money from you is also owned by someone who has not agreed to pay this Note, your right of set-off will apply to my interest in the obligation and to any other amounts I could withdraw on my sole request or endorsement.

Your right of set-off does not apply to an account or other obligation where my rights arise only in a representative capacity, It also does not apply to any individual Retirement Account or other tax-deferred retirement account.

You will not be liable for the dishonor of any check when the dishonor occurs because you set-off against any of my accounts. I agree to hold you harmless from any such claims arising as a result of your exercise of your right of set-off.

G. WAIVER. Except as otherwise required by law. by choosing any one or more of these remedies you do not give up your right to use any other remedy. You do not waive a default if you choose not to use a remedy. By electing not to use any remedy, you do not waive your right to later consider the event a default and to use any remedies if The default continues or occurs again.

13. COLLECTION EXPENSES AND ATTORNEYS' FEES. On or after Default, to the extent permitted by law, I agree to pay all expenses of collection, enforcement or protection of your rights and remedies under this Note. Expenses include, but are not limited to, attorneys' fees, court costs and other legal expenses. These expenses are due and payable immediately, If not paid immediately, these expenses will bear interest from the date of payment until paid in full at the highest interest rate In effect as provided for in the terms of this Note. All fees and expenses will be secured by the Property I have granted to you, if any. To the extent permitted by the United States Bankruptcy Code. I agree to pay the reasonable attorneys' fees you incur to collect this Debt as awarded by any court exercising jurisdiction under the Bankruptcy Code.

14. WARRANTIES AND REPRESENTATIONS. I make to you the following warranties and

representations which will continue as long as this Note is in effect:

A. POWER. I am duly organized, and validly existing and in good standing in all jurisdictions in which I operate. I have the power and authority to enter into this transaction and to carry on my business or activity as it is now being conducted and, as applicable, am qualified to do so in each jurisdiction in which I operate.

B. AUTHORITY. The execution, delivery and performance of this Note and the obligation evidenced by this Note are within my powers, have been duly authorized, have received all necessary governmental approval, will not violate any provision of law, or order of court or governmental agency, and will not violate any agreement to which I am a party or to which I am or any of my Property is subject.

C. NAME AND PLACE OF BUSINESS. Other than previously disclosed in writing to you I have not changed my name or principal place of business within the last 10 years and have not used any other trade or fictitious name. Without your prior written consent, I do not and will not use any other name and will preserve my existing name, trade names and franchises.

15. APPLICABLE LAW. This Note is governed by the laws of Nebraska, the United States of America and to the extent required, by the laws of the jurisdiction where the Property is located. In the event of a dispute, the exclusive forum, venue and place of jurisdiction will be in Nebraska, unless otherwise required by law.

16. JOINT AND INDIVIDUAL LIABILITY AND SUCCESSORS. My obligation to pay this Loan is independent of the obligation of any other person who has also agreed to pay it, You may sue me alone, or anyone else who is obligated on this Loan, or any number of us together, to collect this Loan, Extending this Loan or new obligations under this Loan, will not affect my duty under this Loan and I will still be obligated to pay this loan. The duties and benefits of this Loan will bind and benefit the successors and assigns of you and me.

17. AMENDMENT, INTEGRATION AND SEVERABILITY. This Note may not be amended or modified by oral agreement. No amendment or modification of this Note is effective unless made in writing and executed by you and me. This Note is the complete and final expression of the agreement. If any provision of this Note is unenforceable, then the unenforceable provision will be severed and the remaining provisions will still be enforceable.

18. INTERPRETATION. Whenever used, the singular includes the plural and the plural includes the singular. The section headings are for convenience only and are not to be used to interpret or define the terms of this Note.

19. NOTICE, FINANCIAL REPORTS AND ADDITIONAL DOCUMENTS. Unless otherwise required by law, any notice will be given by delivering it or mailing it by first class mail to the appropriate party's address listed in the DATE AND PARTIES section, or to any other address designated in writing. Notice to one party will be deemed to be notice to all parties. I will inform you in writing of any change in my name, address or other application information. I will provide you any financial statement or information you request. All financial statements and information I give you will be correct and complete. I agree to sign, deliver, and file any additional documents or certifications that you may consider necessary to perfect, continue, and preserve my obligations under this Loan and to confirm your lien status on any Property. Time is of the essence.

20. CREDIT INFORMATION. I agree to supply you with whatever information you reasonably request. You will make requests for this information without undue frequency, and will give me reasonable time in which to supply the Information.

21. ERRORS AND OMISSIONS. I agree, if requested by you, to fully cooperate in the correction, if necessary, in the reasonable discretion of you of any and all loan closing documents so that all documents accurately describe the loan between you and me. I agree to assume all costs including by way of illustration and not limitation, actual expenses, legal fees and marketing losses for failing to reasonably comply with your requests within thirty (30) days.

M-Tron Industries, Inc.  
Nebraska Promissory Note  
NE/4XX270735007252000043  
64003051404N

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St. Cloud, MN [ILLEGIBLE] (TM)

Initials\_\_\_\_\_  
Page 3

A CREDIT AGREEMENT MUST BE IN WRITING TO BE ENFORCEABLE UNDER NEBRASKA LAW. TO PROTECT YOU AND US FROM ANY MISUNDERSTANDINGS OR DISAPPOINTMENTS, ANY CONTRACT, PROMISE, UNDERTAKING, OR OFFER TO FOREBEAR REPAYMENT OF MONEY OR TO MAKE ANY OTHER FINANCIAL ACCOMMODATION IN CONNECTION WITH THIS LOAN OF MONEY OR GRANT OR EXTENSION OF CREDIT, OR ANY AMENDMENT OF CANCELLATION OF, WAIVER OF, OR SUBSTITUTION FOR ANY OR ALL OF THE TERMS OR PROVISIONS OF ANY INSTRUMENT OR DOCUMENT EXECUTED IN CONNECTION WITH THIS LOAN OF MONEY OR GRANT OR EXTENSION OF CREDIT, MUST BE IN WRITING TO BE EFFECTIVE.

BORROWER:

M-Tron Industries, Inc.

By /s/ DAVID L. REIN

-----  
Authorized Signer

22. SIGNATURES. By signing. I agree to the terms contained in this Note. I also acknowledge receipt of copy of this Note.

BORROWER:

M-Tron Industries, Inc.

By /s/ DAVID L. REIN

-----  
Authorized Signer

LENDER:

First National Bank of Omaha

By /s/ James R. Kamm

-----  
James R. Kamm, Vice President

M-Tron Industries, Inc.  
Nebraska Promissory Note  
NE/4XX270735007252000043  
64005051404N

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St. Cloud, MN EXPERTS(TM)

Initials\_\_\_\_\_  
Page 4

SECOND AMENDMENT AND WAIVER TO AMENDED AND RESTATED CREDIT AGREEMENT

THIS SECOND AMENDMENT TO AMENDED AND RESTATED CREDIT AGREEMENT (this "AMENDMENT") made and entered into as of May 29, 2004 (the "EFFECTIVE DATE"), by and among LYNCH SYSTEMS, INC., a South Dakota corporation (the "BORROWER"), and SUNTRUST BANK, a Georgia banking corporation (the "LENDER").

W I T N E S S E T H:

WHEREAS, the Borrower and the Lender are parties to a certain Amended and Restated Credit Agreement, dated as of June 10, 2002, as amended by that certain First Amendment to Amended and Restated Credit Agreement, dated as of May 30, 2003 (as the same may be further amended from time to time, the "CREDIT AGREEMENT"; capitalized terms used herein and not otherwise defined herein shall have the meanings given such terms in the Credit Agreement as amended by this Amendment), whereby the Lender has agreed to make certain loans to the Borrower, subject to the terms, covenants and conditions contained in the Credit Agreement; and

WHEREAS, the Borrower has requested that the Lender amend the Credit Agreement as set forth in this Amendment, and the Lender is willing to agree to such modifications subject to the terms and conditions of this Amendment.

NOW THEREFORE, in consideration of the premises and mutual covenants contained herein, and other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, the parties hereto agree as follows:

1. RESERVED.

2. AMENDMENTS TO CREDIT AGREEMENT. Subject to the terms and conditions of this Amendment, the Credit Agreement is hereby amended as follows:

(a) by deleting the definition of the term "Maturity Date" from Section 1.01 thereof, and by substituting, in lieu thereof, the following new definition of such term:

"Maturity Date" shall mean May 31, 2005, as such date may be extended, accelerated or amended from time to time pursuant to this Agreement.

(b) by deleting the language "Two Million Dollars (\$2,000,000)" from Section 2.01(a)(i) thereof, and by substituting, in lieu thereof, the following new language: "Four Million Dollars (\$4,000,000)."

3. NO OTHER WAIVERS OR AMENDMENTS; CONDITIONS SUBSEQUENT. Except for the

amendment expressly set forth and referred to in Section 2 above, the Credit Agreement shall remain unchanged and in full force and effect. Nothing in this Amendment is intended, or shall be construed, to constitute a novation or an accord and satisfaction of any of the Borrower's Obligations under or in connection with the Credit Agreement or to modify, affect or impair the

1

perfection or continuity of Lender's security interests in, security titles to or other liens on any Collateral for the Obligations.

4. CONDITIONS TO EFFECTIVENESS. This Amendment shall become effective, upon the Effective Date, subject to the satisfaction of the following conditions on or prior to such date:

(1) the receipt by the Lender of this Amendment, duly executed, completed and delivered by the Lender and the Borrower;

(2) the receipt by the Lender of the fully-executed promissory note, in the form of Exhibit A attached hereto (the "NEW NOTE"), to replace the promissory note previously delivered under the Credit Agreement;

(3) the receipt by Lender of a non-refundable extension fee in the amount of \$8,750 (representing 0.125% of the Non-Guaranteed Loan Maximum Availability), which extension fee shall be deemed fully earned upon the parties' execution and delivery of this Amendment; and

(4) the receipt by the Lender of such other documents, certificates, lien searches and instruments as the Lender may reasonably request.

5. REPRESENTATIONS AND WARRANTIES. The Borrower hereby represents and warrants to the Lender that (a) this Amendment and the New Note have been duly authorized, executed and delivered by it, (b) no Default or Event of Default has occurred and is continuing as of this date after giving effect to the waiver granted in Section 1 hereof, and (c) all of the representations and warranties made by it in the Credit Agreement are true and correct in all material respects on and as of the date of this Amendment (except to the extent that any such representations or warranties expressly referred to a specific prior date). Any breach the Borrower of its representations and warranties contained in this Section 5 shall be an Event of Default for all purposes of the Credit Agreement.

6. RATIFICATION. The Borrower hereby ratifies and reaffirms each and every term, covenant and condition set forth in the Credit Agreement and all other documents delivered by the Borrower in connection therewith (including without limitation the other Credit Documents to which the Borrower is a party), effective as of the date hereof.

7. ESTOPPEL. To induce the Lender to enter into this Amendment, the Borrower hereby acknowledges and agrees that, as of the date hereof, there exists no right of offset, defense or counterclaim in favor of the Borrower as against the Lender with respect to the obligations of the Borrower to the Lender under the Credit Agreement or the other Credit Documents, either with or without giving effect to this Amendment.

8. REIMBURSEMENT OF EXPENSES. The Borrower hereby agrees that it shall reimburse the Lender on demand for all costs and expenses (including without limitation reasonable attorney's fees) actually incurred by such parties in connection with the negotiation, documentation and consummation of this Amendment and the other documents executed in connection herewith and therewith and the transactions contemplated hereby and thereby.

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9. GOVERNING LAW. THIS AGREEMENT SHALL BE GOVERNED BY, AND CONSTRUED IN ACCORDANCE WITH, THE LAWS OF THE STATE OF GEORGIA FOR CONTRACTS TO BE PERFORMED ENTIRELY WITHIN SAID STATE.

10. SEVERABILITY OF PROVISIONS. Any provision of this Amendment which is prohibited or unenforceable in any jurisdiction shall, as to such jurisdiction, be ineffective to the extent of such prohibition or unenforceability without invalidating the remaining provisions hereof or affecting the validity or enforceability of such provision in any other jurisdiction. To the extent permitted by applicable law, the Borrower hereby waives any provision of law that renders any provision hereof prohibited or unenforceable in any respect.

11. COUNTERPARTS. This Amendment may be executed in any number of counterparts, all of which shall be deemed to constitute but one original and shall be binding upon all parties, their successors and permitted assigns.

12. ENTIRE AGREEMENT. The Credit Agreement as amended by this Agreement embodies the entire agreement between the parties hereto relating to the subject matter hereof and supersedes all prior agreements, representations and understandings, if any, relating to the subject matter hereof.

[remainder of page intentionally left blank]

3

IN WITNESS WHEREOF, the parties hereto have caused this Amendment to be duly executed and delivered on their behalf and the Borrower has caused its corporate seal to be hereunto affixed, all as of the date first above stated.

BORROWER:

(CORPORATE SEAL)

LYNCH SYSTEMS, INC.

Attest:

By: /s/ A. BOWLING



/s/ JANET T. GRIMSLEY

-----  
Title: President

-----  
Title: Secretary

LENDER:

SUNTRUST BANK

By: /s/ CATHERINE M. MATHIS

-----  
Title: Group Vice President

4

PARENT GUARANTOR ACKNOWLEDGMENT AND CONSENT

The undersigned hereby acknowledges and consents to, and agree to the terms of, the foregoing Second Amendment to Amended and Restated Credit Agreement, and ratifies and confirms its obligations under the Parent Guaranty (as defined in the Amended and Restated Credit Agreement).

This 29th day of May, 2004.

LYNCH CORPORATION

By: /s/ Raymond H. Keller

-----  
Name: Raymond H. Keller  
Title: VP/CFO

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EXHIBIT A

FORM OF PROMISSORY NOTE

PROMISSORY NOTE

U.S. \$7,000,000

MAY 29, 2004

FOR VALUE RECEIVED, the undersigned LYNCH SYSTEMS, INC., a South Dakota corporation (the "Borrower"), hereby promises to pay to the order of SUNTRUST BANK (herein, together with any subsequent holder hereof, called the "Lender"), the lesser of SEVEN MILLION AND NO/100 U.S. DOLLARS (U.S. \$7,000,000.00) or the aggregate outstanding principal amount of the Loans made to the Borrower by Lender pursuant to the terms of the Credit Agreement referred to below, which principal sum shall be payable on the earlier of (i) the Maturity Date specified in the Credit Agreement or (ii) the date on which all amounts outstanding under this Promissory Note (this "Note") have become due and payable pursuant to the

provisions of Article IX of the Credit Agreement (as defined below). The Borrower likewise promises to pay interest on the outstanding principal balance of each Loan made by the Lender to the Borrower, at such interest rates, payable at such times, and computed in such manner, as are specified in the Credit Agreement in strict accordance with the terms thereof.

This Note is issued pursuant to, and is the "Note" referred to in, the Amended and Restated Credit Agreement dated as of June 10, 2002, between Borrower and Lender, as amended by that certain First Amendment to Amended and Restated Credit Agreement dated as of May 30, 2003, and as amended by that certain Second Amendment to Amended and Restated Credit Agreement dated as the date hereof (as the same may be further amended, modified or replaced from time to time, the "Credit Agreement"), and the Lender is and shall be entitled to all benefits thereof and of all the Credit Documents executed and delivered to the Lender in connection therewith. Terms defined in the Credit Agreement are used herein with the same meaning. The Credit Agreement, among other things, contains provisions for acceleration of the maturity hereof upon the happening of certain Events of Default, provisions relating to prepayments on account of principal hereof prior to the maturity hereof, and provisions for post-default interest rates.

This Note is issued in replacement of and substitution for that certain Promissory Note, dated as of May 30, 2003, issued by the Borrower in favor of the Lender (the "PRIOR NOTE"). This Note is not intended nor shall it be construed as a novation or an accord and satisfaction of the indebtedness evidenced by the Prior Note.

The Borrower agrees to make payments of principal and interest hereon on the dates and in the amounts specified in the Credit Agreement in strict accordance with the terms thereof.

In case an Event of Default shall occur and be continuing, the principal and all accrued interest of this Note may automatically become, or may be declared, immediately due

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and payable in the manner and with the effect provided in the Credit Agreement. The Borrower agrees to pay, and save the Lender harmless against any liability for the payment of, all costs and expenses, including reasonable attorneys' fees, in connection with the enforcement by the Lender of any of its rights or remedies under this Note or the Credit Agreement.

This Note has been delivered in Atlanta, Georgia, and the rights and obligations of the Lender and the Borrower hereunder shall be construed in accordance with and governed by the laws of the State of Georgia (without giving effect to its conflicts of law rules).

The Borrower expressly waives any presentment, demand, protest or notice in connection with this Note, whether now or hereafter required by

applicable law. This Note is intended to be an instrument under seal.

IN WITNESS WHEREOF, the Borrower has caused this Note to be executed, sealed and delivered by its duly authorized officers as of the date first above written.

(CORPORATE SEAL)

LYNCH SYSTEMS, INC.

By: /s/ A. Bowling

-----  
Title: President

Attest:

/s/ JANET T. GRIMSLEY

-----  
Secretary

[FIRST NATIONAL BANK LOGO]

<S>	<C>	<C>	<C>	<C>
LOAN NUMBER	LOAN NAME	ACCT, NUMBER	NOTE DATE	INITIALS
2000001751/6	M-Tron Industries, Inc.		06/14/04	JRK
Renewal Plus	INDEX (w/Margin)			
NOTE AMOUNT	FNBO National	RATE	MATURITY DATE	LOAN PURPOSE
\$1, 200,000, 00	Base Rate plus 0.500%	4.5%	04/30/07	Commercial

Creditor Use Only

</TABLE>

PROMISSORY NOTE  
(Commercial-Draw-Variable Rate)

DATE AND PARTIES. The date of this Promissory Note (Note) is May 14, 2004. The parties and their addresses are:

LENDER:

FIRST NATIONAL BANK OF OMAHA  
STOP CODE 1030  
1620 Dodge St  
Omaha, Nebraska 68197  
Telephone: (402) 633-3555

BORROWER:

M-TRON INDUSTRIES, INC.  
a Delaware Corporation  
100 Douglas Avenue  
Yankton, South Dakota 57078

1. DEFINITIONS. As used in this Note, the terms have the following meanings;

A. PRONOUNS. The pronouns "I," "me," and "my" refer to each Borrower signing this Note, individually and together with their heirs, successors and assigns, and each other person of legal entity (including guarantors, endorsers, and sureties) who agrees to pay this Note. "You" and "Your" refer to the Lender, with its participants or syndicators, successors and assigns, or any person or company that acquires an interest in the Loan.

B. NOTE. Note refers to this document, and any extensions, renewals, modifications and substitutions of this Note.

C. LOAN. Loan refers to this transaction generally, including obligations and duties arising from the terms of all documents prepared or submitted for this transaction such as applications, security agreements, disclosures or notes, and this Note.

D. PROPERTY. Property is any property, real, personal or intangible, that secures my performance of the obligations of this Loan,

E. PERCENT. Rates and rate change limitations are expressed as annualized percentages.

2. PROMISE TO PAY. For value received I promise to pay you or your order, at your address, or at such other location as you may designate, amount advanced from time to time under the terms of this Note up to the maximum total principal balance of \$1,200,000.00 [Principal]. plus interest from the date of

disbursement, on the unpaid outstanding Principal balance until this Note matures or this obligation is accelerated.

3. ADVANCES. Advances under this Note are made according to the following terms and conditions.

A. REQUESTS FOR ADVANCES. My requests are a warranty that I am in compliance with all the Loan documents. When required by you for a particular method of advance, my requests for an advance must specify the requested amount and the date and be accompanied with any agreements, documents, and instruments that you require for the Loan. Any payment by you of any check, share draft or other charge may, at your option, constitute an advance on the Loan to me. All advances will be made in United States dollars. I will indemnify you and hold you harmless for your reliance on any request for advances that you reasonably believe to be genuine. To the extent permitted by law, I will indemnify you and hold you harmless when the person making any request represents that I authorized this person to request an advance even when this person is unauthorized or this person's signature is not genuine.

I or anyone I authorize to act on my behalf may request advances by the following methods.

- (1) I make a request in person.
- (2) I make a request by phone.
- (3) I make a request by mail.
- (4) I write a check or share draft.

B. ADVANCE LIMITATIONS. In addition to any other Loan conditions, requests for, and access to, advances are subject to the following limitations.

- (1) OBLIGATORY ADVANCES. You will make all Loan advances subject to this Agreement's terms and conditions. :
- (2) ADVANCE AMOUNT. Subject to the terms and conditions contained in this Note, advances will be made in exactly the amount I request.
- (3) DISBURSEMENT OF ADVANCES. On my fulfilment of this Note's terms and conditions, you will disburse the advance in any manner as you and I agree.
- (4) CREDIT LIMIT. I understand that you will not ordinarily grant a request for an advance that would cause the unpaid principal of my Loan to be greater than the Principal limit. You may, at your option, grant such a request without obligating yourselves to do so in the future.
- (5) RECORDS. Your records will be conclusive evidence as to the amount of advances, the Loan's unpaid principal balances and the accrued interest.

4. INTEREST. interest will accrue on the unpaid Principal balance of this Note at the rate of 4.5 percent (Interest Rate) until May 15, 2004. after which time it may change as described in the Variable Rate subsection.

A. INTEREST AFTER DEFAULT. If you declare a default under the terms of this Loan, including for failure to pay in full at maturity, you may increase the Interest Rate payable on the outstanding Principal balance of this Note. In such event, interest will accrue on the outstanding Principal balance at the variable Interest Rate in effect from time to time, plus an additional 6.000 percent, until paid in full.

B. MAXIMUM INTEREST AMOUNT. Any amount assessed or collected as interest under the terms of this Note or obligation will be limited to the Maximum Lawful Amount of interest allowed by state or federal law. Amounts

collected in excess of the Maximum Lawful Amount will be applied first to the unpaid Principal balance. Any remainder will be refunded to me,

<TABLE>  
<S> <C> Initials \_\_\_\_\_  
M-Tron Industries, Inc. NE/4XX27073500725200004364003051404N (c) (1996) Bankers Systems, Inc., St. Cloud, MN [ILLEGIBLE] Page 1  
Nebraska Promissory Note  
</TABLE>

C. STATUTORY AUTHORITY. The amount assessed or collected on this Note is authorized by the Nebraska usury laws under Neb, Rev. Stat. ! 45.101.03.

D. ACCRUAL. During the scheduled term of this Loan Interest accrues using an Actual/360 days counting method.

E. VARIABLE RATE. The Interest Rate may change during the term of this transaction.

(1) INDEX. Beginning with the first Change Date, the Interest Rate will be based on the following index: the base rate in effect from time to time and designated by First National Bank of Omaha [ILLEGIBLE] its National Base Rate.

The Current Index is the most recent index figure available on each Change Date. You do not guaranty by selecting this Index, or the margin, that the Interest Rate on this Note will be the same rate you charge on any other loans or class of loans you make to me or other borrowers. If this Index is no longer available, you will substitute a similar index. Yog will give me notice of your choice.

(2) CHANGE DATE. Each date on which the Interest Rate may change is called a Change Date. The Interest Rate may change May 15, 2004 and daily thereafter.

(3) CALCULATION OF CHANGE. On each Change Date, you will calculate the Interest Rate, which will be the Current Index plus 0.500 percent. The result of this calculation will be rounded to the nearest .001 percent. Subject to any limitations, this will be the Interest Rate until the next Change Date. The new Interest Rate will become effective on each Change Date. The Interest Rate and other charges on this Note will never exceed the highest rate or charge allowed by law for this Note.

(4) LIMITATIONS. The Interest Rate change\* era subject to the following limitations.

(a) LIFETIME. The Interest Rate will never be less than 4.500 percent.

5. EFFECT OF VARIABLE RATE. A change in the Interest Rate will have the following effect on the payments: The amount of the final payment will change.

5. PAYMENT. I agree to pay this Note as follows: I agree to pay this Note in 36 payments. This Note is amortized over 60 payments. A payment of 422,369.76 will be due May 31, 2004, and on the last day of each month thereafter. A final payment of the entire unpaid balance of Principal and interest will be due April 30, 2007. Any changes in the Interest Rate will affect the amount of this payment.

Payment will be rounded to the nearest 4.01. With the final payment I also agree to pay any additional fees or charges owing and the amount of any advances you have made to others on my behalf. Payments scheduled to be paid on the 29th, 30th or 31st day of a month that contains no such day will, instead, be made on the last day of such month.

Each payment I make on this Note will be applied first to interest that is due then to principal that is due, and finally to any charges that I owe other than principal and interest. If you and I agree to a different application of payments, we will describe our agreement on this Note. The actual amount of my final payment will depend on my payment record,

6. PREPAYMENT. I may prepay this Loan in full or in part at any time. Any partial prepayment will not excuse any later scheduled payments until I pay in full.

7. LOAN PURPOSE. The purpose of this Loan is to fund the purchase of new and used equipment.

8. SECURITY. This Loan is secured by the following, previously executed, security instruments or agreements: Restated Loan/Security Agreement dated August 31, 2001. Letter of Credit IRS1351047 issued by Fleet National Bank on behalf of Lynch Corporation in the amount of \$ 1,000,000.00 dated September 9, 2002.

9. DEFAULT. I will be in default if any of the following occur:

A. PAYMENT. I fail to make a payment in full when due.

B. INSOLVENCY OR BANKRUPTCY. I make an assignment for the benefit of creditors or become insolvent, either because my liabilities exceed my assets or I am unable to pay my debts as they become due; or I petition for protection under federal, state or local bankruptcy, insolvency or debtor relief laws, or am the subject of a petition or action under such laws and fail to have the petition or action dismissed within a reasonable period of time not to exceed 60 days.

C. BUSINESS TERMINATION. I merge, dissolve, reorganize, end my business or existence, or a partner or majority owner dies or is declared legally incompetent.

D. FAILURE TO PERFORM. I fail to perform any condition or to keep any promise or covenant of this Note.

E. OTHER DOCUMENTS. A default occurs under the terms of any other transaction document.

F. OTHER AGREEMENTS. I am in default on any other debt or agreement I have with you.

G. MISREPRESENTATION. I make any verbal or written statement or provide any financial information that is untrue, inaccurate, or conceals a material fact at the time it is made or provided.

H. JUDGMENT. I fail to satisfy or appeal any judgment against me.

I. [ILLEGIBLE] The Property is used in a manner or for a purpose that threatens confiscation by a legal authority.

J. NAME CHANGE. I change my name or assume an additional name without notifying you before making such a change.

K. PROPERTY TRANSFER. I transfer all or a substantial part of my money or property.

L. PROPERTY VALUE. The value of the Property declines or is impaired.

M. MATERIAL CHANGE. Without first notifying you, there is a material change in my business, including ownership, management, and financial conditions.

N. INSECURITY. You reasonably believe that you are insecure.

10. ASSUMPTIONS. Someone buying the Property cannot assume the obligation. You

may declare the entire balance of the Note to be immediately due and payable upon the creation of, or contract for the creation of, any lien, encumbrance, or transfer of the Property.

11. WAIVERS AND CONSENT. To the extent not prohibited by law, I waive protest, presentment for payment, demand, notice of acceleration, notice of intent to accelerate and notice of dishonor.

A. Additional Waivers By Borrower. In addition, I, and any party to this Note and Loan, to the extent permitted by law, consent to certain actions you may take, and generally waive defenses that may be available based on these actions or based on the status of a party to this Note.

(1) You may renew or extend payments on this Note, regardless of the number of such renewals or extensions.

(2) You may release any Borrower, endorser, guarantor, surety, accommodation maker or any other co-signer.

(3) You may release, substitute or impair any Property securing this Note.

(4) You, or any institution participating in this Note, may invoke your right of set-off.

(5) You may enter into any sales, repurchases or participations of this Note to any person in any amounts and I waive notice of such sales, repurchases or participations.

(6) I agree that any of us signing this Note as a Borrower is authorized to modify the terms of this Note or any instrument securing, guarantying or relating to this Note.

B. NO WAIVER BY LENDER. Your course of dealing, or your forbearance from, or delay in, the exercise of any of your rights, remedies, prevelages or right to insist upon my strict performance of any provisions contained in this Note, or other Loan documents, shall not be construed as a waiver by you, unless any such waiver is in writing and is signed by you.

12. REMEDIES. After I default, and after you give any legally required notice and opportunity to cure the default, you may at your option do any one or more of the following.

A. Acceleration. You may make all or any part of the amount owing by the terms of this Note immediately due.

B. Sources. You may use any and all remedies you have under state or federal law or in any instrument securing this Note.

<TABLE>  
<S> M-Tron Industries, Inc. Nebraska Promissory Note NE/4XX27073500725200004364003051404N (c)1996, Bankers Systems, Inc., St. Cloud, MN [ILLEGIBLE] Page 2  
<C> Initials\_\_\_\_\_  
</TABLE>

C. INSURANCE BENEFITS. You may make a claim for any and all insurance benefits or refunds that may be available on my default.

D. PAYMENTS MADE ON MY BEHALF. Amounts advanced on my behalf will be immediately due and may be added to the balance owing under the terms of this Note, and accrue interest at the highest post-maturity interest rate.

E. TERMINATION. You may terminate my right to obtain advances and may refuse to make any further extensions of credit.



F. SET-OFF. You may use the right of set-off. This means you may set-off any amount due and payable under the terms of this Note against any right I have to receive money from you.

My right receive money from you includes any deposit or share account balance I have with you; any money owed to me on an item presented to you or in your possession for collection or exchange; and any repurchase agreement or other non-deposit obligation. "Any amount due and payable under the terms of this Note" means the total amount to which you are entitled to demand payment under the terms of this Note at the time you set-off.

Subject to any other written contract, if my right to receive money from you is also owned by someone who has not agreed to pay this Note, your right of set-off will apply to my interest in the obligation and to any other amounts I could withdraw on my sole request or endorsement.

Your right of set-off does not apply to an account or other obligation where my rights arise only in a representative capacity. It also does not apply to any individual Retirement Account or other tax-deferred retirement account.

You will not be liable for the dishonor of any check when the dishonor occurs because you set-off against any of my account. I agree to hold you harmless from any such claims arising as a result of your exercise of your right of set-off.

G. WAIVER. Except as otherwise required by law, by choosing any one or more of these remedies you do not give up your right to use any other remedy. You do not waive a default if you choose not to use a remedy. By electing not to use any remedy, you do not waive your right to later consider the event a default and to use any remedies if the default continues or occurs again.

13. COLLECTION EXPENSES AND ATTORNEYS' FEES. On or after Default, to the extent permitted by law, I agree to pay all expenses of collection, enforcement or protection of your rights and remedies under this Note. Expenses include, but are not limited to, attorneys' fees, court costs and other legal expenses. These expenses are due and payable immediately. If not paid immediately, these expenses will bear interest from the date of payment until paid in full at the highest interest rate in effect as provided for in the terms of this Note. All fees and expenses will be secured by the Property I have granted to you, if any. To the extent permitted by the United States Bankruptcy Code. I agree to pay the reasonable attorneys' fees you incur to collect this Debt as awarded by any court exercising jurisdiction under the Bankruptcy Code.

14. WARRANTIES AND REPRESENTATIONS. I make to you the following warranties and representations which will continue as long as this Note is in effect:

A. POWER. I am duly organized, and validly existing and in good standing in all jurisdictions in which I operate. I have the power and authority to enter into this transaction and to carry on my business or activity as it is now being conducted and, as applicable, am qualified to do so in each jurisdiction in which I operate.

B. AUTHORITY. The execution, delivery and performance of this Note and the obligation evidenced by this Note are within my powers, have been duly authorized, have received all necessary governmental approval, will not violate any provision of law, or order of court or governmental agency, and will not violate any agreement to which I am a party or to which I am or any of my Property is subject.

C. NAME AND PLACE OF BUSINESS. Other than previously disclosed in writing to you I have not changed my name or principal place of business within the last 10 years and have not used any other trade or fictitious name. Without your prior written consent, I do not and will not use any other name and will preserve my existing name, trade names and franchises.

15. APPLICABLE LAW. This Note is governed by the laws of Nebraska, the United States of America and to the extent required, by the laws of the jurisdiction where the Property is located. In the event of a dispute, the exclusive forum, venue and place of jurisdiction will be in Nebraska, unless otherwise required by law.

16. JOINT AND INDIVIDUAL LIABILITY AND SUCCESSORS. My obligation to pay this Loan is independent of the obligation of any other person who has also agreed to pay it. You may sue me alone, or anyone else who is obligated on this Loan, or any number of us together, to collect this Loan. Extending this Loan or new obligations under this Loan, will not affect my duty under this Loan and I will still be obligated to pay this Loan. The duties and benefits of this Loan will bind and benefit the Successors and assigns of you and me.

17. AMENDMENT, INTEGRATION AND SEVERABILITY. This Note may not be amended or modified by oral agreement. No amendment or modification of this Note is effective unless made in writing and executed by you and me. This Note is the complete and final expression of the agreement. If any provision of this Note is unenforceable, then the unenforceable provision will be severed and the remaining provisions will still be enforceable.

18. INTERPRETATION. Whenever used, the singular includes the plural and the plural includes the singular. The section headings are for convenience only and are not to be used to interpret or define the terms of this Note.

19. NOTICE, FINANCIAL REPORTS AND ADDITIONAL DOCUMENTS. Unless otherwise required by law, any notice will be given by delivering it or mailing it by first class mail to the appropriate party's address listed in the DATE AND PARTIES section, or to any other address designated in writing. Notice to one party will be deemed to be notice to all parties. I will inform you in writing of any change in my name, address or other application information. I will provide you any financial statement or information you request. All financial statements and information I give You will be correct and complete. I agree to sign, deliver, and file any additional documents or certifications that you may consider necessary to perfect, continue, and preserve my obligations under this Loan and to confirm your lien status on any Property. Time is of the essence.

20. CREDIT INFORMATION. I agree to supply you with whatever information you reasonably request. You will make requests for this information without undue frequency, and will give me reasonable time in which to supply the information.

21. ERRORS AND OMISSIONS. I agree, if requested by you, to fully cooperate in the correction, if necessary, in the reasonable discretion of you of any and all loan closing documents so that all documents accurately describe the loan between you and me. I agree to assume all costs including by way of illustration and not limitation, actual expenses, legal fees and marketing losses for failing to reasonably comply with your requests within thirty (30) days.

<TABLE>  
<S> <C> <C>  
M-Tron Industries, Inc. Initials \_\_\_\_\_  
Nebraska Promissory Note  
NE/4XX27073500725200004364003051404N (c)1996, Bankers Systems, Inc., St. Cloud, MN [ILLEGIBLE] Page 3  
</TABLE>

A CREDIT AGREEMENT MUST BE IN WRITING TO BE ENFORCEABLE UNDER NEBRASKA LAW. TO PROTECT YOU AND US FROM ANY MISUNDERSTANDINGS OR DISAPPOINTMENTS, ANY CONTRACT, PROMISE, UNDERTAKING, OR OFFER TO FOREBEAR REPAYMENT OF MONEY OR TO MAKE ANY OTHER FINANCIAL ACCOMMODATION IN CONNECTION WITH THIS LOAN OF MONEY OR GRANT OR EXTENSION OF CREDIT, OR ANY AMENDMENT OF, CANCELLATION OF, WAIVER OF, OR SUBSTITUTION FOR ANY OR ALL OF THE TERMS OR PROVISIONS OF ANY INSTRUMENT OR DOCUMENT EXECUTED IN CONNECTION WITH THIS LOAN OF MONEY OR GRANT OR EXTENSION OF CREDIT, MUST BE IN WRITING TO BE EFFECTIVE.

BORROWER:

M-Tron Industries, Inc.

By DAVID L. REIN

-----  
Authorized Signer

22. SIGNATURES. By signing, I agree to the terms contained in this Note. I also acknowledge receipt of a copy of this Note.

BORROWER:

M-Tron Industries, Inc.

By DAVID L. REIN

-----  
Authorized Signer

LENDER:

First National Bank of Omaha

By: /s/ James R. Kamm

-----  
James R. Kamm, Vice President

<TABLE>

<S>

<C>

<C>

M-Tron Industries, Inc.

Nebraska Promissory Note

NE/4XX27073500725200004364003051404N

(c) (1996) Bankers Systems, Inc., St. Cloud, MN [ILLEGIBLE]

Initials \_\_\_\_\_

Page 4

</TABLE>

## CERTIFICATIONS

I, Ralph R. Papitto, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Lynch Corporation;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operation and cash flows of the Registrant as of, and for, the periods presented in this quarterly report;
4. The Registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15e) and 15d-15(e)), (inapplicable language intentionally omitted) for the Registrant and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this quarterly report is being prepared;
  - (b) [Intentionally omitted]
  - (c) Evaluated the effectiveness of the Registrant's disclosure requirements and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) Disclosed in this report any change in the Registrant's internal control over financial reporting that occurred during the Registrant's most recent fiscal quarter that has materially affected, or is reasonable likely to materially affect, the registrant's internal control over financial reporting; and
5. The Registrant's other certifying officer and I have disclosed, based

on our most recent evaluation of internal control over financial reporting, to the Registrant's auditors and the audit committee of Registrant's board of directors (or persons performing the equivalent function):

- (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Registrant's ability to record, process, summarize and report financial information; and
- (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the Registrant's internal controls over financial reporting.

Date: August 11, 2004

/s/ Ralph R. Papitto

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RALPH R. PAPITTO

Chairman and Chief Executive Officer

EXHIBIT 31

#### CERTIFICATIONS

I, Raymond H. Keller, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Lynch Corporation;
2. Based on my knowledge, this quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in this quarterly report, fairly present in all material respects the financial condition, results of operation and cash flows of the Registrant as of, and for, the periods presented in this report;
4. The Registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15e) and 15d-15(e)) (inapplicable language intentionally omitted) for the Registrant and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the Registrant, including its consolidated subsidiaries, is made known

to us by others within those entities, particularly during the period in which this quarterly report is being prepared;

- (b) [Intentionally omitted]
- (c) Evaluated the effectiveness of the Registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
- (d) Disclosed in this report any change in the Registrant's internal control over financial reporting that occurred during the Registrant's most recent fiscal quarter that has materially affected, or is reasonable likely to materially affect, the registrant's internal control over financial reporting; and

5. The Registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Registrant's auditors and the audit committee of Registrant's board of directors (or persons performing the equivalent function):

- (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the Registrant's ability to record, process, summarize and report financial information; and
- (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the Registrant's internal controls over financial reporting.

Date: August 11, 2004

/s/ Raymond H. Keller

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RAYMOND H. KELLER

Vice President and Chief Financial Officer

CERTIFICATION PURSUANT TO  
18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report of Lynch Corporation (the "Company") on Form 10-Q for the period ending June 30, 2004, as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Ralph R. Papitto, Chief Executive Officer of the Company, and I, Raymond H. Keller, Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

- (1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and result of operations of the Company.

/s/ RALPH R. PAPITTO  
/s/ RAYMOND H. KELLER

Ralph R. Papitto  
Chief Executive Officer  
August 11, 2004

Raymond H. Keller  
Chief Financial Officer  
August 11, 2004

A signed original of this written statement required by Section 906 has been provided to Lynch Corporation and will be retained by Lynch Corporation and furnished to the Securities and Exchange Commission or its staff upon request.