

SIGMATRON INTERNATIONAL INC

Form 10-Q

December 12, 2017

UNITED STATES

SECURITIES AND 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 October 31, 2017

OR

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

EXCHANGE ACT OF 1934

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For the transition period from to

Commission File Number 0-23248

SIGMATRON INTERNATIONAL, INC.

(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	36-3918470 (I.R.S. Employer Identification No.)
2201 Landmeier Road Elk Grove Village, Illinois (Address of principal executive offices)	60007 (Zip Code)

Registrant's telephone number, including area code: (847) 956-8000

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

SigmaTron International, Inc.

October 31, 2017

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

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

Large accelerated filer Accelerated filer

Non-accelerated filer (Do not check if a smaller reporting company) Smaller reporting company

Emerging growth company

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

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

Indicate the number of shares outstanding of the registrant’s common stock, \$0.01 par value, as of December 8, 2017:
4,210,563

SigmaTron International, Inc.

Index

PART 1. FINANCIAL INFORMATION:	Page No.
Item	
1 <u>Condensed Consolidated Financial Statements</u>	
<u>Condensed Consolidated Balance Sheets – October 31, 2017 (Unaudited) and April 30, 2017</u>	4
<u>Condensed Consolidated Statements of Income – (Unaudited)</u>	
<u>Three and Six Months Ended October 31, 2017 and 2016</u>	6
<u>Condensed Consolidated Statements of Cash Flows – (Unaudited)</u>	
<u>Six Months Ended October 31, 2017 and 2016</u>	7
<u>Notes to Condensed Consolidated Financial Statements – (Unaudited)</u>	9
Item	
2 <u>Management’s Discussion and Analysis of Financial Condition and Results of Operations</u>	24
Item	
3 <u>Quantitative and Qualitative Disclosures About Market Risks</u>	32
Item	
4 <u>Controls and Procedures</u>	32
 PART II OTHER INFORMATION:	
Item	
1 <u>Legal Proceedings</u>	33
Item	
1 <u>Risk Factors</u>	33
Item	
2 <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	33
Item	
3 <u>Defaults Upon Senior Securities</u>	33
Item	
4 <u>Mine Safety Disclosures</u>	33
Item	
5 <u>Other Information</u>	33
Item	
6 <u>Exhibits</u>	34
<u>Signatures</u>	35

SigmaTron International, Inc.

Condensed Consolidated Balance Sheets

	October 31, 2017 (Unaudited)	April 30, 2017
Current assets:		
Cash and cash equivalents	\$ 2,443,852	\$ 3,493,324
Accounts receivable, less allowance for doubtful accounts of \$100,000 at October 31, 2017 and April 30, 2017, respectively	26,614,409	26,656,871
Inventories, net	80,955,631	73,571,238
Prepaid expenses and other assets	1,725,393	2,971,087
Refundable income taxes	559,341	339,791
Notes receivable	1,202,531	887,531
Other receivables	1,319,273	1,112,071
Total current assets	114,820,430	109,031,913
Property, machinery and equipment, net	35,765,579	33,008,714
Intangible assets, net of amortization of \$4,918,840 and \$4,698,765 at October 31, 2017 and April 30, 2017, respectively	3,993,160	4,213,235
Goodwill	3,222,899	3,222,899
Deferred income taxes	554,658	236,087
Other assets	1,102,564	1,472,816
Total other long-term assets	8,873,281	9,145,037
Total assets	\$ 159,459,290	\$ 151,185,664
Liabilities and stockholders' equity:		
Current liabilities:		
Trade accounts payable	\$ 45,468,809	\$ 44,859,344
Accrued wages	5,051,594	4,489,602
Accrued expenses	1,995,953	3,623,106
Income taxes payable	253,405	69,868
Current portion of long-term debt	1,560,190	351,562
Current portion of capital lease obligations	2,151,333	1,711,204
Current portion of contingent consideration	251,756	286,240
Current portion of deferred rent	238,853	220,288

Total current liabilities	56,971,893	55,611,214
Long-term debt, less current portion	32,350,865	27,192,246
Capital lease obligations, less current portion	4,043,264	3,364,825
Contingent consideration, less current portion	192,112	237,578
Deferred rent, less current portion	418,863	555,348
Other long-term liabilities	1,016,002	991,017
Deferred income taxes	1,348,550	1,361,291
Total long-term liabilities	39,369,656	33,702,305
Total liabilities	96,341,549	89,313,519

Commitments and contingencies

Stockholders' equity:

Preferred stock, \$.01 par value; 500,000 shares authorized, none issued or outstanding	-	-
Common stock, \$.01 par value; 12,000,000 shares authorized, 4,202,813 and 4,195,813 shares issued and outstanding at October 31, 2017 and April 30, 2017, respectively	41,772	41,702
Capital in excess of par value	23,079,064	22,952,535
Retained earnings	39,996,905	38,877,908
Total stockholders' equity	63,117,741	61,872,145
Total liabilities and stockholders' equity	\$ 159,459,290	\$ 151,185,664

The accompanying notes to the condensed consolidated financial statements are an integral part of these statements.

SigmaTron International, Inc.

Condensed Consolidated Statements of Income

	Three Months Ended October 31, 2017 (Unaudited)	Three Months Ended October 31, 2016 (Unaudited)	Six Months Ended October 31, 2017 (Unaudited)	Six Months Ended October 31, 2016 (Unaudited)
Net sales	\$ 72,959,074	\$ 66,159,586	\$ 144,183,367	\$ 125,344,917
Cost of products sold	65,855,506	60,340,917	130,322,745	113,755,658
Gross profit	7,103,568	5,818,669	13,860,622	11,589,259
Selling and administrative expenses	5,642,273	5,555,385	11,554,419	10,915,276
Operating income	1,461,295	263,284	2,306,203	673,983
Other income	(35,815)	(39,870)	(80,166)	(99,272)
Interest expense	345,656	276,538	654,070	519,781
Income from operations before income tax expense	1,151,454	26,616	1,732,299	253,474
Income tax expense (benefit)	415,339	(6,679)	613,302	73,582
Net income	\$ 736,115	\$ 33,295	\$ 1,118,997	\$ 179,892
Earnings per share - basic	\$ 0.18	\$ 0.01	\$ 0.27	\$ 0.04
Earnings per share - diluted	\$ 0.17	\$ 0.01	\$ 0.26	\$ 0.04
Weighted average shares of common stock outstanding				
Basic	4,201,442	4,185,752	4,198,714	4,184,854
Weighted average shares of common stock outstanding				
Diluted	4,326,854	4,225,874	4,302,977	4,225,844

The accompanying notes to the condensed consolidated financial statements are an integral part of these statements.

6

SigmaTron International, Inc.

Condensed Consolidated Statements of Cash Flows

	Six Months Ended October 31, 2017 (Unaudited)	Six Months Ended October 31, 2016 (Unaudited)
Cash flows from operating activities		
Net income	\$ 1,118,997	\$ 179,892
Adjustments to reconcile net income to net cash used in operating activities:		
Depreciation and amortization	2,560,202	2,515,400
Stock-based compensation	83,659	169,963
Restricted stock expense	-	10,274
Deferred income tax expense (benefit)	(331,312)	152
Amortization of intangible assets	220,075	244,280
Amortization of financing fees	23,757	22,475
Fair value adjustment of contingent consideration	32,201	(96,627)
Loss from disposal or sale of machinery and equipment	191	29,819
Changes in assets and liabilities		
Accounts receivable	42,462	(3,396,989)
Inventories	(7,384,393)	(2,305,356)
Prepaid expenses and other assets	1,458,244	820,534
Refundable income taxes	(219,550)	(118,820)
Income taxes payable	183,537	55,496
Trade accounts payable	609,465	1,308,064
Deferred rent	(117,920)	(100,509)
Accrued expenses and wages	(1,089,676)	(651,825)
Net cash used in operating activities	(2,810,061)	(1,313,777)
Cash flows from investing activities		

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Purchases of machinery and equipment	(3,232,111)	(1,901,654)
Net cash used in investing activities	(3,232,111)	(1,901,654)
Cash flows from financing activities		
Advances on notes receivable	(315,000)	-
Proceeds from the exercise of common stock options	42,940	4,320
Proceeds from Employee stock purchases	-	8,347
Proceeds under equipment note	943,136	-
Payments of contingent consideration	(112,151)	(144,154)
Payments under capital lease and sale leaseback agreements	(966,579)	(815,127)
Payments under equipment note	(125,085)	-
Payments under building notes payable	(82,500)	(82,500)
Borrowings under lines of credit	9,298,262	41,780,402
Payments under lines of credit	(3,675,691)	(38,540,132)
Payments of financing fees	(14,632)	-
Net cash provided by financing activities	4,992,700	2,211,156

7

Change in cash and cash equivalents	(1,049,472)	(1,004,275)
Cash and cash equivalents at beginning of period	3,493,324	4,325,268
Cash and cash equivalents at end of period	\$ 2,443,852	\$ 3,320,993
Supplementary disclosures of cash flow information		
Cash paid for interest	\$ 571,537	\$ 520,012
Cash paid for income taxes	987,734	212,592
Purchase of machinery and equipment financed under capital leases	2,085,149	1,159,851
Financing of insurance policy	49,500	271,113

SigmaTron International, Inc.

October 31, 2017

Notes to Condensed Consolidated Financial Statements

(Unaudited)

Note A - Basis of Presentation

The accompanying unaudited condensed consolidated financial statements of SigmaTron International, Inc. (“SigmaTron”), SigmaTron’s wholly-owned subsidiaries Standard Components de Mexico S.A., AbleMex, S.A. de C.V., Digital Appliance Controls de Mexico, S.A. de C.V., Spitfire Controls (Vietnam) Co. Ltd., Spitfire Controls (Cayman) Co. Ltd. and wholly-owned foreign enterprises Wujiang SigmaTron Electronics Co., Ltd. and SigmaTron Electronic Technology Co., Ltd. (“SigmaTron China”) and international procurement office SigmaTron Taiwan branch (collectively, the “Company”) have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X.

Accordingly, the condensed consolidated financial statements do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring adjustments) considered necessary for a fair presentation have been included. Operating results for the three and six month periods ended October 31, 2017 are not necessarily indicative of the results that may be expected for the year ending April 30, 2018. For further information, refer to the condensed consolidated financial statements and footnotes thereto included in the Company’s Annual Report on Form 10-K for the year ended April 30, 2017.

Note B - Inventories, net

The components of inventory consist of the following:

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	October 31, 2017	April 30, 2017
Finished products	\$ 21,213,051	\$ 20,291,768
Work-in-process	1,642,188	1,795,852
Raw materials	59,342,433	52,748,542
	82,197,672	74,836,162
Less excess and obsolescence reserve	(1,242,041)	(1,264,924)
	\$ 80,955,631	\$ 73,571,238

9

SigmaTron International, Inc.

October 31, 2017

Notes to Condensed Consolidated Financial Statements

(Unaudited)

Note C - Earnings Per Share and Stockholders' Equity

The following table sets forth the computation of basic and diluted earnings per share:

	Three Months Ended		Six Months Ended	
	October 31, 2017	2016	October 31, 2017	2016
Net income	\$ 736,115	\$ 33,295	\$ 1,118,997	\$ 179,892
Weighted-average shares				
Basic	4,201,442	4,185,752	4,198,714	4,184,854
Effect of dilutive stock options	125,412	40,122	104,263	40,990
Diluted	4,326,854	4,225,874	4,302,977	4,225,844
Basic earnings per share	\$ 0.18	\$ 0.01	\$ 0.27	\$ 0.04
Diluted earnings per share	\$ 0.17	\$ 0.01	\$ 0.26	\$ 0.04

Options to purchase 359,763 and 366,763 shares of common stock were outstanding at October 31, 2017 and 2016, respectively. There were no options granted during the six month periods ended October 31, 2017 and 2016, respectively. The Company recognized \$0 and \$82,731 in stock option expense for the three month periods ended October 31, 2017 and 2016, respectively. The Company recognized \$83,659 and \$166,404 in stock option expense for the six month periods ended October 31, 2017 and 2016, respectively. The balance of unrecognized compensation expense related to the Company's stock option plans was \$0 and \$246,479 at October 31, 2017 and 2016, respectively. There were no anti-dilutive common stock equivalents outstanding during the three and six month periods ended October 31, 2017. There were 35,067 and 29,500 anti-dilutive common stock equivalents outstanding during the three and six month periods ended October 31, 2016 which were excluded from the calculation of diluted earnings per share.

On October 1, 2016, the Company issued 11,250 shares of restricted stock pursuant to the 2013 Non-Employee Director Restricted Stock Plan, which fully vested on April 1, 2017. The Company recognized no compensation expense with respect to such shares for the three and six month periods ended October 31, 2017. The Company recognized \$10,274 in compensation expense for the three and six month periods ended October 31, 2016.

The Company implemented an employee stock purchase plan (“ESPP”) for all eligible employees on February 1, 2014. The ESPP reserved 500,000 shares of common stock for issuance to employees. In addition, the number of shares of common stock reserved for issuance under the plan automatically increases on the first day of the Company’s fiscal years by 25,000 shares. The ESPP was terminated effective August 15, 2016. Final purchases under the ESPP were completed on August 31, 2016. The Company recorded \$0 and \$1,677 in compensation expense for the three months ended October 31, 2017 and 2016 respectively. The Company recorded \$0 and \$3,559 in compensation expense for the six months ended October 31, 2017 and 2016 respectively. During the three months ended October 31, 2017 and 2016, the Company recorded \$0 and \$1,472, respectively, to stockholders’

SigmaTron International, Inc.

October 31, 2017

Notes to Condensed Consolidated Financial Statements

(Unaudited)

Note C - Earnings Per Share and Stockholders' Equity - Continued

equity relating to purchases under the ESPP. During the six months ended October 31, 2017 and 2016, the Company recorded \$0 and \$8,347, respectively, to stockholders' equity relating to purchases under the ESPP.

Note D - Long-term Debt

Notes Payable – Banks

On March 31, 2017, the Company entered into a \$35,000,000 senior secured credit facility with U.S. Bank, N.A., which expires on March 31, 2022. The credit facility is collateralized by substantially all of the Company's domestically located assets. The facility allows the Company to choose among interest rates at which it may borrow funds: the fixed rate of four percent or LIBOR plus one and one half percent (effectively 2.775% at October 31, 2017). Interest is due monthly. Under the senior secured credit facility, the Company may borrow up to the lesser of (i) \$35,000,000 or (ii) an amount equal to a percentage of the eligible receivable borrowing base plus a percentage of the inventory borrowing base. Deferred financing costs of \$14,632 and \$207,647 were capitalized in the first quarter of fiscal 2018 and the fourth quarter of fiscal 2017, respectively, which are amortized over the term of the agreement. There were no deferred financing costs capitalized in the second quarter of fiscal 2018. As of October 31, 2017 and April 30, 2017 the unamortized amount included in other assets was \$196,346 and \$204,186, respectively. As of October 31, 2017, there was \$28,801,000 outstanding and \$6,199,000 of unused availability under the credit facility agreement compared to an outstanding balance of \$23,178,429 and \$11,821,571 of unused availability at April 30, 2017. At October 31, 2017, the Company was in compliance with its financial covenant and other restricted covenants under the credit facility.

On August 4, 2015, the Company's wholly-owned subsidiary, Wujiang SigmaTron Electronics Co., Ltd., entered into a credit facility with China Construction Bank. Under the agreement Wujiang SigmaTron Electronics Co., Ltd. could borrow up to 5,000,000 Renminbi and the facility was collateralized by Wujiang SigmaTron Electronics Co., Ltd.'s manufacturing building. Interest was payable monthly and the facility had a fixed interest rate of 6.67%. The facility was due to expire on August 3, 2017. The credit facility was closed as of March 1, 2017. There was no outstanding

balance under the facility at October 31, 2017 or April 30, 2017.

On March 24, 2017, the Company's wholly-owned subsidiary, SigmaTron Electronic Technology Co., Ltd., entered into a credit facility with China Construction Bank. Under the agreement SigmaTron Electronic Technology Co., Ltd. can borrow up to 9,000,000 Renminbi and the facility is collateralized by Wujiang SigmaTron Electronics Co., Ltd.'s manufacturing building. Interest is payable monthly and the facility bears a fixed interest rate of 6.09%. The term of the facility extends to February 7, 2018. There was no outstanding balance under the facility at October 31, 2017 or April 30, 2017.

Notes Payable – Buildings

The Company entered into a mortgage agreement on January 8, 2010, in the amount of \$2,500,000, with Wells Fargo, N.A. to refinance the property that serves as the Company's corporate headquarters and its Illinois manufacturing facility. On November 24, 2014, the Company refinanced the mortgage

SigmaTron International, Inc.

October 31, 2017

Notes to Condensed Consolidated Financial Statements

(Unaudited)

Note D - Long-term Debt - Continued

agreement with Wells Fargo, N.A. The note requires the Company to pay monthly principal payments in the amount of \$9,500, bears an interest rate of LIBOR plus two and one-quarter percent (effectively 3.625% at October 31, 2017) and is payable over a sixty month period. A final payment of approximately \$2,289,500 is due on or before November 8, 2019. The outstanding balance was \$2,517,500 and \$2,574,500 at October 31, 2017 and April 30, 2017, respectively.

The Company entered into a mortgage agreement on October 24, 2013, in the amount of \$1,275,000, with Wells Fargo, N.A. to finance the property that serves as the Company's engineering and design center in Elgin, Illinois. The Wells Fargo, N.A. note requires the Company to pay monthly principal payments in the amount of \$4,250, bears interest at a fixed rate of 4.5% per year and is payable over a sixty month period. A final payment of approximately \$1,030,000 is due on or before October 2018. The outstanding balance was \$1,071,000 and \$1,096,500 at October 31, 2017 and April 30, 2017, respectively.

Note Payable – Equipment

On November 1, 2016, the Company entered into a secured note agreement with Engencap Fin S.A. DE C.V. to finance the purchase of equipment in the amount of \$596,987. The term of the agreement extends to November 1, 2021 with average quarterly payments of \$35,060 beginning on February 1, 2017 and a fixed interest rate of 6.65%. The balance outstanding under this note agreement was \$507,439 and \$567,138 at October 31, 2017 and April 30, 2017, respectively.

On February 1, 2017, the Company entered into a secured note agreement with Engencap Fin S.A. DE C.V. to finance the purchase of equipment in the amount of \$335,825. The term of the agreement extends to February 1, 2022 with average quarterly payments of \$20,031 beginning on May 1, 2017 and a fixed interest rate of 7.35%. The balance outstanding under this note agreement was \$302,243 and \$335,825 at October 31, 2017 and April 30, 2017, respectively.

On June 1, 2017, the Company entered into a secured note agreement with Engencap Fin S.A. DE C.V. to finance the purchase of equipment in the amount of \$636,100. The term of the agreement extends to June 1, 2022 with average quarterly payments of \$37,941 beginning on September 1, 2017 and a fixed interest rate of 7.35%. The balance outstanding under this note agreement was \$604,295 at October 31, 2017.

On October 1, 2017, the Company entered into a secured note agreement with Engencap Fin S.A. DE C.V. to finance the purchase of equipment in the amount of \$307,036. The term of the agreement extends to November 1, 2022 with average quarterly payments of \$18,314 beginning on February 1, 2018 and a fixed interest rate of 7.35%. The balance outstanding under this note agreement was \$307,036 at October 31, 2017.

Capital Lease and Sales Leaseback Obligations

From October 2013 through June 2017, the Company entered into various capital lease and sales leaseback agreements with Associated Bank, National Association to purchase equipment totaling \$6,893,596. The terms of the lease agreements extend to September 2018 through May 2022 with monthly installment payments ranging from \$1,455 to \$40,173 and a fixed interest rate ranging from

SigmaTron International, Inc.

October 31, 2017

Notes to Condensed Consolidated Financial Statements

(Unaudited)

Note D - Long-term Debt - Continued

3.75% to 4.90%. The balance outstanding under these capital lease agreements was \$3,612,558 and \$3,627,760 at October 31, 2017 and April 30, 2017, respectively. The net book value of the equipment under these leases was \$5,083,596 and \$4,713,044 at October 31, 2017 and April 30, 2017, respectively.

From April 2014 through July 2015, the Company entered into various capital lease agreements with CIT Finance LLC to purchase equipment totaling \$2,512,051. The terms of the lease agreements extend to March 2019 through July 2020 with monthly installment payments ranging from \$1,931 to \$12,764 and a fixed interest rate ranging from 5.65% through 6.50%. The balance outstanding under these capital lease agreements was \$1,219,552 and \$1,448,269 at October 31, 2017 and April 30, 2017, respectively. The net book value of the equipment under these leases was \$1,841,357 and \$1,946,026 at October 31, 2017 and April 30, 2017, respectively.

From September 2017 through October 2017, the Company entered into various capital sales leaseback agreements with First American Equipment Finance to purchase equipment totaling \$1,432,114. The terms of the lease agreements extend to August 2021 through September 2021 with monthly installment payments ranging from \$12,912 to \$20,093 and a fixed interest rate ranging from 5.82% through 6.37%. The balance outstanding under these capital lease agreements was \$1,362,487 at October 31, 2017. The net book value of the equipment under these leases was \$1,374,731 at October 31, 2017.

SigmaTron International, Inc.

October 31, 2017

Notes to Condensed Consolidated Financial Statements

(Unaudited)

Note E - Goodwill and Other Intangible Assets

Goodwill

There were no changes in the carrying amount of tax-deductible goodwill in the amount of \$3,222,899 for the three and six months ended October 31, 2017 and 2016, respectively.

Other Intangible Assets

Intangible assets subject to amortization are summarized as of October 31, 2017 as follows:

	Weighted Average Remaining Amortization Period (Years)	Gross Carrying Amount	Accumulated Amortization
Other intangible assets – Able	-	\$ 375,000	\$ 375,000
Customer relationships – Able Spitfire:	-	2,395,000	2,395,000
Non-contractual customer relationships	9.58	4,690,000	1,422,770
Backlog	-	22,000	22,000
Trade names	14.58	980,000	265,395
Non-compete agreements	1.58	50,000	38,675
Patents	-	400,000	400,000
Total		\$ 8,912,000	\$ 4,918,840

SigmaTron International, Inc.

October 31, 2017

Notes to Condensed Consolidated Financial Statements

(Unaudited)

Note E - Goodwill and Other Intangible Assets - Continued

Intangible assets subject to amortization are summarized as of April 30, 2017, as follows:

	Weighted Average Remaining Amortization Period (Years)	Gross Carrying Amount	Accumulated Amortization
Other intangible assets – Able	-	\$ 375,000	\$ 375,000
Customer relationships – Able	-	2,395,000	2,395,000
Spitfire:			
Non-contractual customer relationships	10.08	4,690,000	1,237,410
Backlog	-	22,000	22,000
Trade names	15.08	980,000	240,897
Non-compete agreements	2.08	50,000	35,105
Patents	0.08	400,000	393,353
Total		\$ 8,912,000	\$ 4,698,765

Estimated aggregate amortization expense for intangible assets, which becomes fully amortized in 2032, for the remaining periods is as follows:

For the remaining 6 months of the fiscal year ending April 30:	2018	\$ 214,968
For the fiscal years ending April 30:	2019	423,721

2020	411,406
2021	403,199
2022	395,578
Thereafter	2,144,288
	\$ 3,993,160

Amortization expense was \$107,484 and \$122,865 for the three months ended October 31, 2017 and 2016, respectively. Amortization expense was \$220,075 and \$244,280 for the six months ended October 31, 2017 and 2016, respectively.

SigmaTron International, Inc.

October 31, 2017

Notes to Condensed Consolidated Financial Statements

(Unaudited)

Note E - Goodwill and Other Intangible Assets - Continued

In conjunction with the May 2012 acquisition of Spitfire, an estimate of the fair value of the contingent consideration, \$2,320,000, was recorded based on expected operating results through fiscal 2019 and the specific terms of when such consideration would be earned. Those terms provide for additional consideration to be paid based on a percentage of sales and pre-tax profits over those years in excess of certain minimums. Payments are made quarterly each year and adjusted after each year-end audit. The Company made payments totaling \$342,162 during fiscal year 2016. The Company made payments totaling \$273,672 during fiscal year 2017. During fiscal year 2017 the Company decreased the estimated remaining payments expected to be paid under the agreement, which resulted in a decrease of \$353,591 to the contingent consideration liability. Any change in the Company's estimate is reflected as a change in the contingent consideration liability and as additional charges or credits to selling and administrative expenses. The Company made one payment in the quarter ended July 31, 2017 in the amount of \$45,875 and one payment in the quarter ended October 31, 2017 in the amount of \$66,276. As of October 31, 2017, the contingent consideration liability was \$443,868 compared to \$523,818 at April 30, 2017.

Note F - Commitments and Contingencies

From time to time the Company is involved in legal proceedings, claims or investigations that are incidental to the conduct of the Company's business. In future periods, the Company could be subjected to cash cost or non-cash charges to earnings if any of these matters are resolved on unfavorable terms. However, although the ultimate outcome of any legal matter cannot be predicted with certainty, based on present information, including management's assessment of the merits of any particular claim, the Company does not expect that these legal proceedings or claims will have any material adverse impact on its future consolidated financial position or results of operations.

Note G - Critical Accounting Policies

Management Estimates and Uncertainties - The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America ("GAAP") requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets

and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Significant estimates made in preparing the consolidated financial statements include depreciation and amortization periods, the allowance for doubtful accounts, reserves for inventory and valuation of long-lived assets and goodwill, deferred taxes, contingent consideration and other commitments and litigation. Actual results could materially differ from these estimates.

Revenue Recognition - Revenues from sales of the Company's electronic manufacturing services business are recognized when the finished good product is shipped to the customer. In general, and except for consignment inventory, it is the Company's policy to recognize revenue and related costs when the finished goods have been shipped from its facilities, which is also the same point in time that title passes under the terms of the purchase order and control passes to the customer. Finished goods inventory for certain customers is shipped from the Company to an independent warehouse for storage or shipped directly to the customer and stored in a segregated part of the customer's own facility.

SigmaTron International, Inc.

October 31, 2017

Notes to Condensed Consolidated Financial Statements

(Unaudited)

Note G - Critical Accounting Policies - Continued

Upon the customer's request for finished goods inventory, the inventory is shipped to the customer if the inventory was stored off-site, or transferred from the segregated part of the customer's facility for consumption or use by the customer. The Company recognizes revenue upon such shipment or transfer. The Company does not earn a fee for such arrangements. The Company from time to time may ship finished goods from its facilities, which is also the same point in time that title passes under the terms of the purchase order, and invoice the customer at the end of the calendar month. This is done only in special circumstances to accommodate a specific customer. Further, from time to time customers request the Company hold finished goods after they have been invoiced to consolidate finished goods for shipping purposes. The Company generally provides a warranty for workmanship, unless the assembly was designed by the Company, in which case it warrants assembly/design. The Company does not have any installation, acceptance or sales incentives (although the Company has negotiated longer warranty terms in certain instances). The Company assembles and tests assemblies based on customers' specifications. Historically, the amount of returns for workmanship issues has been de minimis under the Company's standard or extended warranties.

Inventories - Inventories are valued at cost. Cost is determined by an average cost method and the Company allocates labor and overhead to work-in-process and finished goods. In the event of an inventory write-down, the Company records expense to state the inventory at lower of cost or market. The Company establishes inventory reserves for valuation, shrinkage, and excess and obsolete inventory. The Company records provisions for inventory shrinkage based on historical experience to account for unmeasured usage or loss. The Company records provisions for excess and obsolete inventories for the difference between the cost of inventory and its estimated realizable value based on assumptions about future product demand and market conditions. For convenience, the Company records these inventory reserves against the inventory cost through a contra asset rather than through a new cost basis. Upon a subsequent sale or disposal of the impaired inventory, the corresponding reserve is relieved to ensure the cost basis of the inventory reflects any reductions. Actual results differing from these estimates could significantly affect the Company's inventories and cost of products sold as the inventory is sold or otherwise relieved.

Goodwill - Goodwill represents the purchase price in excess of the fair value of assets acquired in business combinations. Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") 350, "Intangibles – Goodwill and Other," requires the Company to assess goodwill and other indefinite-lived intangible assets for impairment at least annually in the absence of an indicator of possible impairment and immediately upon an indicator of possible impairment. The Company is permitted the option to first assess qualitative factors to determine whether the existence of events and circumstances indicates that it is more likely than not that the fair value of any

reporting unit is less than its corresponding carrying value. If, after assessing the totality of events and circumstances, the Company concludes that it is not more likely than not that the fair value of any reporting unit is less than its corresponding carrying value, then the Company is not required to take further action. However, if the Company concludes otherwise, then it is required to perform a quantitative impairment test, including computing the fair value of the reporting unit and comparing that value to its carrying value. If the fair value is less than its carrying value, a second step of the test is required to determine if recorded goodwill is impaired. The Company also has the option to bypass the qualitative assessment for goodwill in any period and proceed directly to performing the quantitative impairment test. The Company will be able to resume performing the qualitative assessment in any subsequent period. The Company performed its annual goodwill impairment test as

17

SigmaTron International, Inc.

October 31, 2017

Notes to Condensed Consolidated Financial Statements

(Unaudited)

Note G - Critical Accounting Policies - Continued

of February 1, 2017 and determined no impairment existed as of that date. The step one analysis was performed using a combination of a market approach and an income approach based on a discounted cash flow approach. The Company did not note any triggering events that might indicate an impairment during the three and six month periods ended October 31, 2017.

Intangible Assets - Intangible assets are comprised of finite life intangible assets including patents, trade names, backlog, non-compete agreements, and customer relationships. Finite life intangible assets are amortized on a straight line basis over their estimated useful lives of 5 years for patents, 20 years for trade names, 1 year for backlog and 7 years for non-compete agreements except for customer relationships which are amortized on an accelerated basis over their estimated useful life of 15 years.

Impairment of Long-Lived Assets - The Company reviews long-lived assets, including amortizable intangible assets, for impairment. Property, machinery and equipment and finite life intangible assets are reviewed whenever events or changes in circumstances occur that indicate possible impairment. If events or changes in circumstances occur that indicate possible impairment, the Company first performs an impairment review based on an undiscounted cash flow analysis at the lowest level at which cash flows of the long-lived assets are largely independent of other groups of its assets and liabilities. This analysis requires management judgment with respect to changes in technology, the continued success of product lines, and future volume, revenue and expense growth rates. If the carrying value exceeds the undiscounted cash flows, the Company records an impairment, if any, for the difference between the estimated fair value of the asset group and its carrying value. The Company further conducts annual reviews for idle and underutilized equipment, and reviews business plans for possible impairment. As of October 31, 2017, there were no indicators of possible impairment of long-lived assets.

Income Tax - The Company's income tax expense, deferred tax assets and liabilities and reserves for unrecognized tax benefits reflect management's best assessment of estimated future taxes to be paid. The Company is subject to income taxes in both the U.S. and several foreign jurisdictions. Significant judgments and estimates by management are required in determining the consolidated income tax expense assessment.

Deferred income tax assets and liabilities are determined based on differences between financial reporting and tax basis of assets and liabilities, and are measured using the enacted tax rates and laws that are expected to be in effect when the differences are expected to reverse. In evaluating the Company's ability to recover its deferred tax assets within the jurisdiction from which they arise, the Company considers all available positive and negative evidence, including scheduled reversals of deferred tax liabilities, projected future taxable income, tax planning strategies and recent financial operations. In projecting future taxable income, the Company begins with historical results and changes in accounting policies, and incorporates assumptions including the amount of future state, federal and foreign pre-tax operating income, the reversal of temporary differences, and the implementation of feasible and prudent tax planning strategies. These assumptions require significant judgment and estimates by management about the forecasts of future taxable income and are consistent with the plans and estimates the Company uses to manage the underlying businesses. In evaluating the objective evidence that historical results provide, the Company considers three years of cumulative operating income and/or loss. Valuation allowances are established when necessary to reduce deferred

SigmaTron International, Inc.

October 31, 2017

Notes to Condensed Consolidated Financial Statements

(Unaudited)

Note G - Critical Accounting Policies - Continued

income tax assets to an amount more likely than not to be realized. The Company established a valuation allowance of \$78,100 related to its foreign tax credit carry-forward at April 30, 2017. The Company did not change the previous valuation allowance or establish any new valuation allowances at October 31, 2017.

The calculation of the Company's tax liabilities involves dealing with uncertainties in the application of complex tax laws and regulations in a multitude of jurisdictions across its global operations. Changes in tax laws and rates could also affect recorded deferred tax assets and liabilities in the future. Management is not aware of any such changes that would have a material effect on the Company's results of operations, cash flows or financial position.

A tax benefit from an uncertain tax position may only be recognized when it is more likely than not that the position will be sustained upon examination, including resolutions of any related appeals or litigation processes, based on the technical merits.

The Company adjusts its tax liabilities when its judgment changes as a result of the evaluation of new information not previously available. Due to the complexity of some of these uncertainties, the ultimate resolution may result in a payment that is materially different from its current estimate of the tax liabilities. These differences will be reflected as increases or decreases to income tax expense in the period in which they are determined.

Reclassifications - Certain reclassifications have been made to the previously reported 2017 financial statements to conform to the 2018 presentation. There was no change to net income.

New Accounting Standards:

In May 2014, the FASB issued Accounting Standards Update (“ASU”) No. 2014-09, "Revenue from Contracts with Customers" (Topic 606) which supersedes the revenue recognition requirements in ASC 605, “Revenue Recognition”. This ASU is based on the principle that revenue is recognized to depict the transfer of goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The ASU also requires additional disclosure about the nature, amount, timing and uncertainty of revenue. In August 2015, the FASB amended the effective date to be annual reporting periods beginning after December 15, 2017, including interim periods within that year (effective the first quarter of the Company’s fiscal year ending April 30, 2019), with early adoption permitted for annual reporting periods beginning after December 15, 2016 including the interim period within that year. The FASB issued several amendments clarifying various aspects of the ASU, including revenue transactions that involve a third party, goods or services that are immaterial in the context of the contract and licensing arrangements. ASC 606 may be adopted on either a full retrospective or modified retrospective basis. The Company plans to adopt the ASU effective the first quarter of fiscal year ending April 30, 2019. As the new standard will supersede all existing revenue guidance affecting the Company, it could impact the timing and amounts of revenue and costs recognized from customer contracts. The Company, along with its third-party advisor, is currently performing an analysis to determine the impact the new standard will have on its consolidated financial statements. This includes reviewing the terms and conditions included in its contracts with customers and evaluating which, if any, practical expedients the Company will elect upon adoption. The Company expects that the disclosures in the notes to its

SigmaTron International, Inc.

October 31, 2017

Notes to Condensed Consolidated Financial Statements

(Unaudited)

Note G - Critical Accounting Policies - Continued

consolidated financial statements related to revenue recognition will be expanded under the new standards. Companies have the option of using either a full or modified retrospective approach in applying this standard. The Company has not yet concluded upon its selection of the transition method but plans to select a transition method by the end of the third quarter of the current fiscal year.

In July 2015, the FASB issued ASU No. 2015-11, "Inventory (Topic 330): Simplifying the Measurement of Inventory". ASU No. 2015-11 requires an entity that determines the cost of inventory by methods other than last-in, first-out (LIFO) and the retail inventory method (RIM) to measure inventory at the lower of cost and net realizable value. Net realizable value is the estimated selling price in the ordinary course of business, less reasonably predictable costs of completion, disposal and transportation. This amendment applies to all inventory that is measured using the average cost or first-in first-out (FIFO) methods. This supersedes prior guidance which allowed entities to measure inventory at the lower of cost or market, where market could be replacement cost, net realizable value or net realizable value less an approximately normal profit margin. ASU No. 2015-11 is effective for annual reporting periods, and interim periods therein, beginning after December 15, 2016 and prospective application is required. The Company adopted the ASU on May 1, 2017 and the adoption did not have an impact on its consolidated financial position or results of operations.

In February 2016, the FASB issued ASU No. 2016-02, "Leases". The new standard establishes a right-of-use (ROU) model that requires a lessee to record a ROU asset and a lease liability on the balance sheet for all leases with terms longer than 12 months. Leases will be classified as either finance or operating, with classification affecting the pattern of expense recognition in the income statement. The new standard is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. A modified retrospective transition approach is required for capital leases and operating leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements, with certain practical expedients available. While the Company is still evaluating the impact of its pending adoption of the new standard on its consolidated financial statements, the Company expects that upon adoption in the fiscal year ending April 30, 2020, it will recognize ROU assets and lease liabilities and that the amounts could be material.

In March 2016, the FASB issued ASU No. 2016-09, “Compensation—Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting”, a new accounting standard update intended to simplify several aspects of the accounting for share-based payment transactions including: income tax consequences, classification of awards as either equity or liabilities and classification on the statement of cash flows. Specifically, the update requires that excess tax benefits and tax deficiencies (the difference between the deduction for tax purposes and the compensation cost recognized for financial reporting purposes) be recognized as income tax expense or benefit in the Consolidated Statements of Income, introducing a new element of volatility to the provision for income taxes. This update is effective for fiscal years beginning after December 15, 2016. Early adoption is permitted. The Company adopted the ASU on May 1, 2017. Effective with the adoption of the ASU all share-based awards continue to be accounted for as equity awards, excess tax benefits recognized on stock-based compensation expense are reflected in the consolidated statements of income as a component of the provision for income taxes on a prospective basis, excess tax benefits recognized on stock-based compensation expense are classified as an operating activity in the consolidated statements of cash flows on a prospective basis and the Company has elected to continue

20

SigmaTron International, Inc.

October 31, 2017

Notes to Condensed Consolidated Financial Statements

(Unaudited)

Note G - Critical Accounting Policies - Continued

to estimate expected forfeitures over the course of a vesting period. The adoption of the ASU had no impact on the retained earnings, other components of equity or net assets as of the beginning of the period of adoption.

In June 2016, the FASB issued ASU No. 2016-13, “Financial Instruments—Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments.” ASU 2016-13 introduces a new forward-looking approach, based on expected losses, to estimate credit losses on certain types of financial instruments, including trade receivables. The estimate of expected credit losses will require entities to incorporate considerations of historical information, current information and reasonable and supportable forecasts. This ASU also expands the disclosure requirements to enable users of financial statements to understand the entity’s assumptions, models and methods for estimating expected credit losses. For public business entities, ASU 2016-13 is effective for annual and interim reporting periods beginning after December 15, 2019, and the guidance is to be applied using the modified-retrospective approach. Earlier adoption is permitted for annual and interim reporting periods beginning after December 15, 2018. The Company is currently evaluating the new guidance and has not determined the impact this ASU may have on its consolidated financial statements.

In August 2016, the FASB issued ASU Update No. 2016-15, “Statement of Cash Flows- Classification of Certain Cash Receipts and Cash Payments,” which is intended to reduce diversity in practice in how certain transactions are classified in the statements of cash flows. This update will be effective for fiscal years beginning after December 15, 2017 (the Company’s fiscal year ending April 30, 2019), and interim periods within those fiscal years. Early adoption is permitted, provided that all of the amendments are adopted in the same period. The guidance requires application using a retrospective transition method. The Company plans to adopt the ASU in its fiscal year ending April 30, 2019 using the retrospective transition method. The Company does not expect the impact of the adoption of this ASU to have a material impact on the Company’s Consolidated Statements of Cash Flows.

In January 2017, the FASB issued ASU No. 2017-04, “Intangibles-Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment,” which removes the step 2 requirement to perform a hypothetical purchase price allocation to measure goodwill impairment. Goodwill impairment will now be the amount by which a reporting unit’s carrying value exceeds its fair value, not to exceed the recorded amount of goodwill. This guidance is effective for public companies for annual or any interim goodwill impairment tests in fiscal years beginning after December 15,

2019, and early adoption is permitted. The Company does not expect this guidance to have a significant impact on its financial statements and plans to adopt ASU No. 2017-04 in its fiscal year ending April 30, 2018.

In January 2017, the FASB issued ASU No. 2017-01, “Business Combinations (Topic 805): Clarifying the Definition of a Business,” which clarifies the definition of a business when evaluating whether transactions should be accounted for as acquisitions (or disposals) of assets or businesses. For public companies, this ASU is effective for annual periods beginning after December 15, 2017, including interim periods within those periods. The Company plans to adopt this ASU in the first quarter of its fiscal year ending April 30, 2019. The Company will apply the clarified definition of a business, as applicable, from the period of adoption.

SigmaTron International, Inc.

October 31, 2017

Notes to Condensed Consolidated Financial Statements

(Unaudited)

Note H - Related Parties

In March, 2015, two of the Company's executive officers invested in a start-up customer. The executive officers' investments constitute less than 2% (individually and in aggregate) of the outstanding beneficial ownership of the customer, according to information provided by the customer to the executive officers. As of October 31, 2017, the Company had an outstanding note receivable and account receivable from that customer of approximately \$1,200,000 and \$1,356,000, respectively, compared to an outstanding note receivable and account receivable of approximately \$888,000 and \$1,271,000, respectively, at April 30, 2017. As of October 31, 2017, inventory on hand related to this customer approximated \$208,000 compared to \$310,000 at April 30, 2017. Sales to this customer have not been material for the three and six months ended October 31, 2017 or during fiscal year 2017.

On January 29, 2016, the Company entered into a memorandum of understanding with this customer. Under the subsequent agreement, effective January 29, 2016, the then outstanding account receivable of approximately \$888,000 was converted into a short-term promissory note. The promissory note bears interest at the rate of 8% per annum, payable at the maturity of the promissory note. The promissory note was scheduled to mature at the earlier of October 31, 2016, or within 10 days after the customer obtains certain equity financing, or at the closing of a sale of substantially all of the customer's stock or assets. As additional consideration, the Company received warrants under the agreement. The warrants are ten years in duration and may be exercised at an exercise price of \$0.01 per share and for a number of shares determined pursuant to the warrant, expected to be, at a minimum, approximately 1% of the customer's then – outstanding equity securities. The Company believes the warrants have nil value. Further, the Company was granted a security interest in the customer's accounts receivable and authority to access and be a signatory on the customer's deposit accounts.

On December 6, 2016, the Company extended the maturity of the promissory note to July 31, 2017. The promissory note continues to bear interest at the rate of 8% per annum, payable monthly. As consideration, the Company received additional warrants under the agreement, which the Company currently believes have nil value.

On August 25, 2017, effective as of July 31, 2017, the Company and the customer entered into a new forbearance agreement. The Company agreed to extend the maturity of the promissory note and forbear exercising its remedies until the earliest of a capital raise, the sale of the customer, or October 31, 2017, and to fund the customer's operations while the customer explores its options by advancing a maximum of \$315,000 through October 31, 2017, pursuant to

a new promissory note that bears interest at 8% per annum. Additionally, should the customer's business be sold at a price exceeding \$5,000,000 and the amount necessary to pay its creditors, the Company would receive a fee in addition to the debt owed to the Company. The forbearance period and maturity date of the notes expired on the earliest of a capital raise, the sale of the customer or October 31, 2017, but the Company has a unilateral right to extend the forbearance period and maturity of the notes and to make additional advances.

On October 27, 2017, while the preparation of a private placement memorandum for the sale of the customer was underway, the Company extended the forbearance period and maturity of the notes until November 30, 2017. The Company advanced the customer \$315,000 in the second fiscal quarter and

SigmaTron International, Inc.

October 31, 2017

Notes to Condensed Consolidated Financial Statements

(Unaudited)

Note H - Related Parties - Continued

\$105,000 to fund working capital through the month of November, 2017. On December 1, 2017 the Company extended the forbearance period and maturity of the notes to December 31, 2017 and advanced the customer \$105,000 to fund working capital through the month of December, 2017.

Management continues to assess whether the recorded accounts receivable, notes receivable and inventory are recoverable and whether reserves are necessary. The Company is primarily relying on an assessment of the value of the customer by an investment banker with significant experience in the customer's industry. The Company retains its priority position as a secured creditor in a potential sale, liquidation or bankruptcy filing by or against the customer. Based on these factors, the Company believes the accounts receivable, notes receivable and inventory are recoverable. However, in the event that the customer fails to sell its business or raise additional capital in the short term, the Company may not receive payment in full of the obligations owed by the customer or payments by the customer to the Company may be further delayed. The Company will continue to monitor and assess any need to record a reserve against this obligation.

SigmaTron International, Inc.

October 31, 2017

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

In addition to historical financial information, this discussion of the business of SigmaTron International, Inc. ("SigmaTron"), its wholly-owned subsidiaries Standard Components de Mexico S.A., AbleMex, S.A. de C.V., Digital Appliance Controls de Mexico, S.A. de C.V., Spitfire Controls (Vietnam) Co. Ltd., Spitfire Controls (Cayman) Co. Ltd., wholly-owned foreign enterprises Wujiang SigmaTron Electronics Co., Ltd. and SigmaTron Electronic Technology Co., Ltd. (collectively, "SigmaTron China") and international procurement office SigmaTron Taiwan branch (collectively, the "Company") and other Items in this Quarterly Report on Form 10-Q contain forward-looking statements concerning the Company's business or results of operations. Words such as "continue," "anticipate," "will," "expect," "believe," "plan," and similar expressions identify forward-looking statements. These forward-looking statements are based on the current expectations of the Company. Because these forward-looking statements involve risks and uncertainties, the Company's plans, actions and actual results could differ materially. Such statements should be evaluated in the context of the risks and uncertainties inherent in the Company's business including, but not necessarily limited to, the Company's continued dependence on certain significant customers; the continued market acceptance of products and services offered by the Company and its customers; pricing pressures from the Company's customers, suppliers and the market; the activities of competitors, some of which may have greater financial or other resources than the Company; the variability of the Company's operating results; the results of long-lived assets and goodwill impairment testing; the collection of aged account receivables; the variability of the Company's customers' requirements; the availability and cost of necessary components and materials; the ability of the Company and its customers to keep current with technological changes within its industries; regulatory compliance, including conflict minerals; the continued availability and sufficiency of the Company's credit arrangements; changes in U.S., Mexican, Chinese, Vietnamese or Taiwanese regulations affecting the Company's business; the turmoil in the global economy and financial markets; the stability of the U.S., Mexican, Chinese, Vietnamese and Taiwanese economic, labor and political systems and conditions; currency exchange fluctuations; and the ability of the Company to manage its growth. These and other factors which may affect the Company's future business and results of operations are identified throughout the Company's Annual Report on Form 10-K, and as risk factors, may be detailed from time to time in the Company's filings with the Securities and Exchange Commission. These statements speak as of the date of such filings, and the Company undertakes no obligation to update such statements in light of future events or otherwise unless otherwise required by law.

SigmaTron International, Inc.

October 31, 2017

Overview:

The Company operates in one business segment as an independent provider of EMS, which includes printed circuit board assemblies and completely assembled (box-build) electronic products. In connection with the production of assembled products, the Company also provides services to its customers, including (1) automatic and manual assembly and testing of products; (2) material sourcing and procurement; (3) manufacturing and test engineering support; (4) design services; (5) warehousing and distribution services; and (6) assistance in obtaining product approval from governmental and other regulatory bodies. The Company provides these manufacturing services through an international network of facilities located in the United States, Mexico, China, Vietnam and Taiwan.

The Company relies on numerous third-party suppliers for components used in the Company's production process. Certain of these components are available only from single-sources or a limited number of suppliers. In addition, a customer's specifications may require the Company to obtain components from a single-source or a small number of suppliers. The loss of any such suppliers could have a material impact on the Company's results of operations. Further, the Company could operate at a cost disadvantage compared to competitors who have greater direct buying power from suppliers. The Company does not enter into long-term purchase agreements with major or single-source suppliers. The Company believes that short-term purchase orders with its suppliers provides flexibility, given that the Company's orders are based on the changing needs of its customers.

Sales can be a misleading indicator of the Company's financial performance. Sales levels can vary considerably among customers and products depending on the type of services (turnkey versus consignment) rendered by the Company and the demand by customers. Consignment orders require the Company to perform manufacturing services on components and other materials supplied by a customer, and the Company charges only for its labor, overhead and manufacturing costs, plus a profit. In the case of turnkey orders, the Company provides, in addition to manufacturing services, the components and other materials used in assembly. Turnkey contracts, in general, have a higher dollar volume of sales for each given assembly, owing to inclusion of the cost of components and other materials in net sales and cost of goods sold. Variations in the number of turnkey orders compared to consignment orders can lead to significant fluctuations in the Company's revenue and gross margin levels. Consignment orders accounted for less than 1% of the Company's revenues for the three and six months ended October 31, 2017 and 2016, respectively.

The Company's international footprint provides our customers with flexibility within the Company to manufacture in China, Mexico, Vietnam or the U.S. We believe this strategy will continue to serve the Company well as its customers continuously evaluate their supply chain strategies.

The Company had a good quarter in terms of both revenue growth and bottom line growth. Revenues increased modestly and net income increased significantly from the first quarter of 2018. However, the Company continues to encounter shortages in the component marketplace, primarily with semiconductor products. These shortages negatively affected the Company's revenue in the second fiscal quarter and the Company anticipates these shortages will continue during the third fiscal quarter. The shortages have not only negatively impacted the Company's ability to assemble and ship finished goods, but in some cases there were price increases which required customer approval and slowed down production. The Company is heading into what has historically been a slower quarter, driven by the calendar year end, holidays and customers adjusting inventory for their year-end. While the third fiscal quarter may reflect some slowing in the short-term, the Company has landed several new significant customers and their business is projected to start during the Company's fourth fiscal

25

SigmaTron International, Inc.

October 31, 2017

quarter. The Company continues to see positive trends going forward and is optimistic for the balance of this fiscal year.

Results of Operations:

The following table sets forth selective financial data as a percentage of net sales for the periods indicated.

	Three Months Ended October 31, 2017 (Unaudited)	Three Months Ended October 31, 2016 (Unaudited)	Six Months Ended October 31, 2017 (Unaudited)	Six Months Ended October 31, 2016 (Unaudited)
Net sales	100.0%	100.0%	100.0%	100.0%
Operating expenses:				
Cost of products sold	90.3	91.2	90.4	90.8
Selling and administrative expenses	7.7	8.4	8.0	8.7
Total operating expenses	98.0	99.6	98.4	99.5
Operating income	2.0%	0.4%	1.6%	0.5%

Net Sales

Net sales increased for the three month period ended October 31, 2017 to \$72,959,074 from \$66,159,586 for the three month period ended October 31, 2016. Net sales increased for the six month period ended October 31, 2017 to \$144,183,367 from \$125,344,917 for the same period in the prior year. Sales volume increased for the three and six month periods ended October 31, 2017 as compared to the prior year in the industrial electronics, fitness, gaming, auto and medical/life science marketplaces. During the three and six month periods ended October 31, 2017, sales in the appliance and telecommunications marketplaces decreased compared to the same period in the prior year. Sales in the first six months increased due to increasing demand from existing and new customers.

Gross Profit

Gross profit increased during the three month period ended October 31, 2017 to \$7,103,568 or 9.7% of net sales compared to \$5,818,669 or 8.8% of net sales for the same period in the prior fiscal year. Gross profit increased for the six month period ended October 31, 2017 to \$13,860,622 or 9.6% of net sales compared to \$11,589,259 or 9.2% of net sales for the same period in the prior fiscal year. The increase in gross profit for the six month period ended October 31, 2017 was primarily the result of increased sales in the majority of marketplaces the Company serves compared to the same period in the prior year and product mix.

Selling and Administrative Expenses

Selling and administrative expenses increased to \$5,642,273 or 7.7% of net sales for the three month period ended October 31, 2017 compared to \$5,555,385 or 8.4% of net sales for the same period in the prior fiscal year. The net increase in selling and administrative expenses for the three month period

SigmaTron International, Inc.

October 31, 2017

ended October 31, 2017 was driven by increases in general office salaries and bonus expenses. The increase in the foregoing selling and administrative expenses was partially offset by a decrease in accounting professional fees and other general administrative expenses. Selling and administrative expenses increased to \$11,554,419 or 8.0% of net sales for the six month period ended October 31, 2017 compared to \$10,915,276 or 8.7% of net sales for the same period in the prior fiscal year. This increase was primarily due to an increase in general office salaries.

Interest Expense

Interest expense increased to \$345,656 for the three month period ended October 31, 2017 compared to \$276,538 for the same period in the prior fiscal year. Interest expense for the six month period ended October 31, 2017 was \$654,070 compared to \$519,781 for the same period in the prior fiscal year. The increase in interest expense for the three and six month periods ended October 31, 2017 was due to increased loan obligations and higher interest rates compared to the same period in the prior year. Interest expense for future quarters may fluctuate depending on interest rates and borrowings levels.

Income Tax Expense

The income tax expense was \$415,339 for the three month period ended October 31, 2017 compared to an income tax benefit of \$6,679 for the same period in the prior fiscal year. The increase in income tax expense for the three month period ended October 31, 2017 compared to the same period in the previous year is the result of significantly higher pretax income recognized in the U.S. The Company's effective tax rate was 36.07% and negative 25.1% for the quarters ended October 31, 2017 and 2016, respectively. The effective tax rate is higher for the quarter ended October 31, 2017 than the quarter ended October 31, 2016 due to more income recognized in high tax rate jurisdictions for the period ended October 31, 2017. The income tax expense was \$613,302 for the six month period ended October 31, 2017 compared to income tax expense of \$73,582 for the same period in the prior year. The Company's effective tax rate was 35.4% and 29.0% for the six months ended October 31, 2017 and 2016, respectively. The effective tax rate is higher for the six month period ended October 31, 2017 compared to the same period in the previous year due to more income recognized in high tax rate jurisdictions for the period ended October 31, 2017.

The Company has not recorded U.S. income taxes on the undistributed earnings of the Company's foreign subsidiaries. The earnings of the foreign subsidiaries have been, and under fiscal year 2018 plans will continue to be, indefinitely reinvested, and as a result, no deferred tax liability was recorded at October 31, 2017. The cumulative amount of unremitted earnings for which U.S. income taxes have not been recorded is \$10,273,000 as of October 31,

2017. The amount of U.S. income taxes on these earnings is impractical to compute due to the complexities of the hypothetical calculation.

Net Income

Net income increased to \$736,115 for the three month period ended October 31, 2017 compared to net income of \$33,295 for the same period in the prior fiscal year. Net income increased to \$1,118,997 for the six month period ended October 31, 2017 compared to net income of \$179,892 for the same period in the prior fiscal year. Basic and diluted earnings per share for the second quarter of 2018 were \$0.18 and \$0.17 each, respectively, compared to basic and diluted earnings per share of \$0.01 each for the same period in the prior fiscal year. Basic and diluted earnings per share for the six month period ended October 31, 2017 were \$0.27 and \$0.26, respectively, compared to basic and diluted earnings

27

SigmaTron International, Inc.

October 31, 2017

per share of \$0.04 each for the same period in the prior fiscal year. The increases in net income and earnings per share are due to the results of operations described above, mainly from an increase in net sales.

Liquidity and Capital Resources:

Operating Activities.

Cash flow used in operating activities was \$2,810,061 for the six months ended October 31, 2017. During the first six months of fiscal year 2018, cash flow used in operating activities was primarily the result of an increase in inventory in the amount of \$7,384,393 and a decrease in accrued expenses and wages of \$1,089,676. The increase in inventory is the result of an increase in customer orders and in some cases orders being pushed out. Further, capacity issues in the component industry are making it difficult to obtain some components to complete assemblies for shipping. Cash flow used in operating activities was partially offset by the result of an increase in accounts payable, decrease in prepaid expenses and other, net income and the non-cash effects of depreciation and amortization.

Cash flow used in operating activities was \$1,313,777 for the six months ended October 31, 2016. During the first six months of fiscal year 2017, cash flow used in operating activities was primarily the result of an increase in inventory of \$2,305,356 and accounts receivable of \$3,396,989. Cash flow used in operating activities was partially offset by net income, an increase in accounts payable of \$1,308,064 and the non-cash effects of depreciation and amortization. The increase in inventory was the result of slower than expected demand for customer orders based on forecast. The increase in accounts receivable was due to the timing of customer payments in the ordinary course of business.

Investing Activities.

During the first six months of fiscal year 2018, the Company purchased \$3,232,111 in machinery and equipment to be used in the ordinary course of business. The Company has received forecasts from current customers for increased business that would require additional investment in capital equipment and facilities. To the extent that these forecasts come to fruition, the Company anticipates that it will make additional machinery and equipment purchases in fiscal year 2018. The Company anticipates purchases will be funded by lease transactions and its senior secured credit facility.

During the six months of fiscal year 2017, the Company purchased \$1,901,654 in machinery and equipment used in the ordinary course of business. The Company made additional machinery and equipment purchases of \$1,603,832 during the balance of fiscal year 2017.

Financing Activities.

Cash provided by financing activities was \$4,992,700 for the six months ended October 31, 2017. Cash provided by financing activities was primarily the result of net borrowings under the line of credit and proceeds under equipment notes.

Cash provided by financing activities was \$2,211,156 for the six months ended October 31, 2016. Cash provided by financing activities was primarily the result of net borrowings under the line of credit.

SigmaTron International, Inc.

October 31, 2017

Financing Summary.

Notes Payable – Banks

On March 31, 2017, the Company entered into a \$35,000,000 senior secured credit facility with U.S. Bank, N.A., which expires on March 31, 2022. The credit facility is collateralized by substantially all of the Company's domestically located assets. The facility allows the Company to choose among interest rates at which it may borrow funds: the fixed rate of four percent or LIBOR plus one and one half percent (effectively 2.775% at October 31, 2017). Interest is due monthly. Under the senior secured credit facility, the Company may borrow up to the lesser of (i) \$35,000,000 or (ii) an amount equal to a percentage of the eligible receivable borrowing base plus a percentage of the inventory borrowing base. Deferred financing costs of \$14,632 and \$207,647 were capitalized in the first quarter of fiscal 2018 and the fourth quarter of fiscal 2017, respectively, which are amortized over the term of the agreement. There were no deferred financing costs capitalized in the second quarter of fiscal 2018. As of October 31, 2017 and April 30, 2017 the unamortized amount included in other assets was \$196,346 and \$204,186, respectively. As of October 31, 2017, there was \$28,801,000 outstanding and \$6,199,000 of unused availability under the credit facility agreement compared to an outstanding balance of \$23,178,429 and \$11,821,571 of unused availability at April 30, 2017. At October 31, 2017, the Company was in compliance with its financial covenant and other restricted covenants under the credit facility.

On August 4, 2015, the Company's wholly-owned subsidiary, Wujiang SigmaTron Electronics Co., Ltd., entered into a credit facility with China Construction Bank. Under the agreement Wujiang SigmaTron Electronics Co., Ltd. could borrow up to 5,000,000 Renminbi and the facility was collateralized by Wujiang SigmaTron Electronics Co., Ltd.'s manufacturing building. Interest was payable monthly and the facility had a fixed interest rate of 6.67%. The facility was due to expire on August 3, 2017. The credit facility was closed as of March 1, 2017. There was no outstanding balance under the facility at October 31, 2017 or April 30, 2017.

On March 24, 2017, the Company's wholly-owned subsidiary, SigmaTron Electronic Technology Co., Ltd., entered into a credit facility with China Construction Bank. Under the agreement SigmaTron Electronic Technology Co., Ltd. can borrow up to 9,000,000 Renminbi and the facility is collateralized by Wujiang SigmaTron Electronics Co., Ltd.'s manufacturing building. Interest is payable monthly and the facility bears a fixed interest rate of 6.09%. The term of the facility extends to February 7, 2018. There was no outstanding balance under the facility at October 31, 2017 or April 30, 2017.

Notes Payable – Buildings

The Company entered into a mortgage agreement on January 8, 2010, in the amount of \$2,500,000, with Wells Fargo, N.A. to refinance the property that serves as the Company's corporate headquarters and its Illinois manufacturing facility. On November 24, 2014, the Company refinanced the mortgage agreement with Wells Fargo, N.A. The note requires the Company to pay monthly principal payments in the amount of \$9,500, bears an interest rate of LIBOR plus two and one-quarter percent (effectively 3.625% at October 31, 2017) and is payable over a sixty month period. A final payment of approximately \$2,289,500 is due on or before November 8, 2019. The outstanding balance was \$2,517,500 and \$2,574,500 at October 31, 2017 and April 30, 2017, respectively.

The Company entered into a mortgage agreement on October 24, 2013, in the amount of \$1,275,000, with Wells Fargo, N.A. to finance the property that serves as the Company's engineering and design

SigmaTron International, Inc.

October 31, 2017

center in Elgin, Illinois. The Wells Fargo, N.A. note requires the Company to pay monthly principal payments in the amount of \$4,250, bears interest at a fixed rate of 4.5% per year and is payable over a sixty month period. A final payment of approximately \$1,030,000 is due on or before October 2018. The outstanding balance was \$1,071,000 and \$1,096,500 at October 31, 2017 and April 30, 2017, respectively.

Note Payable – Equipment

On November 1, 2016, the Company entered into a secured note agreement with Engencap Fin S.A. DE C.V. to finance the purchase of equipment in the amount of \$596,987. The term of the agreement extends to November 1, 2021 with average quarterly payments of \$35,060 beginning on February 1, 2017 and a fixed interest rate of 6.65%. The balance outstanding under this note agreement was \$507,439 and \$567,138 at October 31, 2017 and April 30, 2017, respectively.

On February 1, 2017, the Company entered into a secured note agreement with Engencap Fin S.A. DE C.V. to finance the purchase of equipment in the amount of \$335,825. The term of the agreement extends to February 1, 2022 with average quarterly payments of \$20,031 beginning on May 1, 2017 and a fixed interest rate of 7.35%. The balance outstanding under this note agreement was \$302,243 and \$335,825 at October 31, 2017 and April 30, 2017, respectively.

On June 1, 2017, the Company entered into a secured note agreement with Engencap Fin S.A. DE C.V. to finance the purchase of equipment in the amount of \$636,100. The term of the agreement extends to June 1, 2022 with average quarterly payments of \$37,941 beginning on September 1, 2017 and a fixed interest rate of 7.35%. The balance outstanding under this note agreement was \$604,295 at October 31, 2017.

On October 1, 2017, the Company entered into a secured note agreement with Engencap Fin S.A. DE C.V. to finance the purchase of equipment in the amount of \$307,036. The term of the agreement extends to November 1, 2022 with average quarterly payments of \$18,314 beginning on February 1, 2018 and a fixed interest rate of 7.35%. The balance outstanding under this note agreement was \$307,036 at October 31, 2017.

Capital Lease and Sales Leaseback Obligations

From October 2013 through June 2017, the Company entered into various capital lease and sales leaseback agreements with Associated Bank, National Association to purchase equipment totaling \$6,893,596. The terms of the lease agreements extend to September 2018 through May 2022 with monthly installment payments ranging from \$1,455 to \$40,173 and a fixed interest rate ranging from 3.75% to 4.90%. The balance outstanding under these capital lease agreements was \$3,612,558 and \$3,627,760 at October 31, 2017 and April 30, 2017, respectively. The net book value of the equipment under these leases was \$5,083,596 and \$4,713,044 at October 31, 2017 and April 30, 2017, respectively.

From April 2014 through July 2015, the Company entered into various capital lease agreements with CIT Finance LLC to purchase equipment totaling \$2,512,051. The terms of the lease agreements extend to March 2019 through July 2020 with monthly installment payments ranging from \$1,931 to \$12,764 and a fixed interest rate ranging from 5.65% through 6.50%. The balance outstanding under these capital lease agreements was \$1,219,552 and \$1,448,269 at October 31, 2017 and April 30, 2017, respectively. The net book value of the equipment under these leases was \$1,841,357 and \$1,946,026 at October 31, 2017 and April 30, 2017, respectively.

30

SigmaTron International, Inc.

October 31, 2017

From September 2017 through October 2017, the Company entered into various capital sales leaseback agreements with First American Equipment Finance to purchase equipment totaling \$1,432,114. The terms of the lease agreements extend to August 2021 through September 2021 with monthly installment payments ranging from \$12,912 to \$20,093 and a fixed interest rate ranging from 5.82% through 6.37%. The balance outstanding under these capital lease agreements was \$1,362,487 at October 31, 2017. The net book value of the equipment under these leases was \$1,374,731 at October 31, 2017.

Operating Leases

In September 2010, the Company entered into a real estate lease agreement in Union City, CA, to rent approximately 117,000 square feet of manufacturing and office space. Under the terms of the lease agreement, the Company receives incentives over the life of the lease, which extends through March 2021. The amount of the deferred rent income recorded for the three and six month periods ended October 31, 2017 was \$25,383 and \$50,765, respectively. The amount of the deferred rent income recorded for the three and six month periods ended October 31, 2016 was \$19,395 and \$38,790, respectively. In addition, the landlord provided the Company tenant incentives of \$418,000, which are being amortized over the life of the lease. The balance of deferred rent at October 31, 2017 was \$499,907 compared to \$550,672 at April 30, 2017.

On May 31, 2012, the Company entered into a lease agreement in Tijuana, MX, to rent approximately 112,000 square feet of manufacturing and office space. Under the terms of the lease agreement, the Company receives incentives over the life of the lease, which extends through November 2018. The amount of the deferred rent income for the three and six month periods ended October 31, 2017 was \$33,577 and \$67,154, respectively. The amount of the deferred rent income for the three and six month periods ended October 31, 2016 was \$30,860 and \$61,719, respectively. The balance of deferred rent at October 31, 2017 was \$157,809 compared to \$224,964 at April 30, 2017.

Other

The Company provides funds for salaries, wages, overhead and capital expenditure items as necessary to operate its wholly-owned Mexican, Vietnam and Chinese subsidiaries and the Taiwan international procurement office. The Company provides funding, as needed, in U.S. dollars, which are exchanged for Pesos, Dong, Renminbi, and New Taiwan dollars. The fluctuation of currencies from time to time, without an equal or greater increase in inflation, could have a material impact on the financial results of the Company. The impact of currency fluctuation for the six month period ended October 31, 2017 resulted in a foreign currency transaction gain of \$78,503 compared to a

foreign currency transaction loss of approximately \$197,614 for the same period in the prior year. Foreign currency gains or losses are recorded in the cost of products sold. During the first six months of fiscal year 2018, the Company's U.S. operations paid approximately \$25,770,000 to its foreign subsidiaries for services provided.

The Company has not recorded U.S. income taxes on the undistributed earnings of the Company's foreign subsidiaries. The earnings of the foreign subsidiaries have been, and under fiscal April 30, 2018 plans, will continue to be indefinitely reinvested, and as a result, no deferred tax liability was recorded at October 31, 2017. The cumulative amount of unremitted earnings for which U.S. income taxes have not been recorded is \$10,273,000 as of October 31, 2017. The amount of U.S. income taxes on these earnings is impractical to compute due to the complexities of the hypothetical calculation.

SigmaTron International, Inc.

October 31, 2017

The Company anticipates that its credit facilities, cash flow from operations and leasing resources are adequate to meet its working capital requirements and capital expenditures for fiscal year 2018. In addition, in the event the Company desires to expand its operations, its business grows more rapidly than expected, the current economic climate deteriorates, customers delay payments, or the Company desires to consummate an acquisition, additional financing resources may be necessary in the current or future fiscal years. There is no assurance that the Company will be able to obtain equity or debt financing at acceptable terms, or at all, in the future. There is no assurance that the Company will be able to retain or renew its credit agreements in the future, or that any retention or renewal will be on the same terms as currently exist.

The impact of inflation on the Company's net sales, revenues and income from operations for the past two fiscal years has been minimal.

Off-balance Sheet Transactions:

The Company has no off-balance sheet transactions.

Tabular Disclosure of Contractual Obligations:

As a smaller reporting company, as defined in Item 10(f)(1) of Regulation S-K under the Exchange Act, the Company is not required to provide the information required by this item.

Item 3. Quantitative and Qualitative Disclosures About Market Risks.

As a smaller reporting company, as defined in Item 10(f)(1) of Regulation S-K under the Exchange Act, the Company is not required to provide the information required by this item.

Item 4. Controls and Procedures.

Disclosure Controls:

The Company's management, including its President and Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of the design and operation of its disclosure controls and procedures (as defined under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), Rules 13a-15(e) and 15(d)-15(e)) as of October 31, 2017. The Company's disclosure controls and procedures are designed to provide reasonable assurance of achieving their objectives and its President and Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures were effective at the reasonable assurance level as of October 31, 2017.

Internal Controls:

There has been no change in the Company's internal control over financial reporting during the three months ended October 31, 2017, that has materially affected or is reasonably likely to materially affect, its internal control over financial reporting. The Company's internal controls over financial reporting are designed to provide reasonable assurance regarding the reliability of financial reporting and preparation of financial statements for external purposes in accordance with U.S. GAAP.

On May 14, 2013, the Committee of Sponsoring Organizations of the Treasury Commission ("COSO") issued an updated version of its Internal Control - Integrated Framework (the "2013 Framework") which officially superseded COSO's earlier Internal Control-Integrated Framework

SigmaTron International, Inc.

October 31, 2017

(1992) (the “1992 Framework”) on December 15, 2014. Originally issued in 1992, the framework helps organizations design, implement and evaluate the effectiveness of internal control concepts and simplify their use and application. None of COSO, the Securities and Exchange Commission or any other regulatory body has mandated adoption of the 2013 Framework by a specified date. We are currently performing an analysis to evaluate what changes to our control environment, if any, would be needed to successfully implement the 2013 Framework. Until such time as such analysis and any related transition to the 2013 Framework is complete, we will continue to use the 1992 Framework in connection with our assessment of internal control. The Company anticipates the transition will be completed in fiscal year 2018.

PART II – OTHER INFORMATION

Item 1. Legal Proceedings.

From time to time the Company is involved in legal proceedings, claims, or investigations that are incidental to the Company’s business. In future periods, the Company could be subjected to cash cost or non-cash charges to earnings if any of these matters are resolved on unfavorable terms. However, although the ultimate outcome of any legal matter cannot be predicted with certainty, based on present information, including management’s assessment of the merits of any particular claim, the Company does not expect these legal proceedings or claims will have any material adverse impact on its future consolidated financial position or results of operations.

Item 1A. Risk Factors.

As a smaller reporting company, as defined in Item 10(f)(1) of Regulation S-K under the Exchange Act, the Company is not required to provide the information required by this item.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.

None.

Item 3. Defaults Upon Senior Securities.

None.

Item 4. Mine Safety Disclosures.

Not applicable.

Item 5. Other Information.

None.

33

SigmaTron International, Inc.

October 31, 2017

Item 6.Exhibits.

- 10.1 Lease No. 1, entered into September 13, 2017, is an attachment to Master Lease No. 2017389 dated August 15, 2017 by and between First American Commercial Bancorp, Inc. and SigmaTron International, Inc.
- 10.2 Lease No. 2, entered into October 9, 2017, is an attachment to Master Lease No. 2017389 dated August 15, 2017 by and between First American Commercial Bancorp, Inc. and SigmaTron International, Inc.
- 10.3 Promissory Note, entered into October 12, 2017, by and between ENGENCAP FIN, S.A. DE C.V., SOFOM, E.N.R. "HOLDER") and SigmaTron International, Inc. ("The Maker").
- 31.1 Certification of Principal Executive Officer of the Company Pursuant to Rule 13a-14(a) under the Exchange Act, as adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. 1350).
- 31.2 Certification of Principal Financial Officer of the Company Pursuant to Rule 13a-14(a) under the Exchange Act, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. 1350).
- 32.1 Certification by the Principal Executive Officer of SigmaTron International, Inc. Pursuant to Rule 13a-14(b) under the Exchange Act and Section 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. 1350).
- 32.2 Certification by the Principal Financial Officer of SigmaTron International, Inc. Pursuant to Rule 13a-14(b) under the Exchange Act and Section 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. 1350).

101.INS XBRL Instance Document

101.SCH XBRL Taxonomy Extension Scheme Document

101.CAL XBRL Taxonomy Extension Calculation Linkbase Document

101.DEF XBRL Taxonomy Extension Definition Linkbase Document

101.LAB XBRL Taxonomy Extension Label Linkbase Document

101.PRE XBRL Taxonomy Extension Presentation Linkbase Document

SigmaTron International, Inc.

October 31, 2017

SIGNATURES:

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

SIGMATRON INTERNATIONAL, INC.

/s/ Gary R. Fairhead

December 12, 2017

Gary R. Fairhead
President and CEO (Principal Executive Officer)

Date

/s/ Linda K. Frauendorfer

December 12, 2017

Linda K. Frauendorfer
Chief Financial Officer, Secretary and Treasurer
(Principal Financial Officer and Principal
Accounting Officer)

Date