

BALLANTYNE STRONG, INC.

Form 10-Q

November 12, 2013

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**UNITED STATES**

**SECURITIES AND EXCHANGE COMMISSION**

**Washington, DC 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 September 30, 2013**

**OR**

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15 (d) OF THE SECURITIES EXCHANGE  
ACT OF 1934**

**For the transition period from                      to**

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**Commission File Number: 1-13906**

**BALLANTYNE STRONG, INC.**

(Exact Name of Registrant as Specified in Its Charter)

**Delaware**

(State or Other Jurisdiction of  
Incorporation or Organization)

**47-0587703**

(IRS Employer  
Identification Number)

**13710 FNB Parkway, Suite 400, Omaha, Nebraska**

(Address of Principal Executive Offices)

**68154**

(Zip Code)

**(402) 453-4444**

(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 twelve months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

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

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

(Do not check if a smaller reporting company)

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

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Indicate the number of shares outstanding of each of the issuer's classes of common stock as of the latest practicable date:

| <b>Class</b>                   | <b>Outstanding as of November 1, 2013</b> |
|--------------------------------|-------------------------------------------|
| Common Stock, \$.01, par value | 14,139,462 shares                         |

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**PART I. Financial Information****Item 1. Condensed Consolidated Financial Statements****Ballantyne Strong, Inc. and Subsidiaries****Condensed Consolidated Balance Sheets****(In thousands)**

|                                                                                                      | <b>September<br/>30,<br/>2013<br/>(Unaudited)</b> | <b>December<br/>31,<br/>2012</b> |
|------------------------------------------------------------------------------------------------------|---------------------------------------------------|----------------------------------|
| <b>Assets</b>                                                                                        |                                                   |                                  |
| Current assets:                                                                                      |                                                   |                                  |
| Cash and cash equivalents                                                                            | \$ 26,333                                         | \$ 40,168                        |
| Accounts receivable (net of allowance for doubtful accounts of \$536 and \$487, respectively)        | 12,404                                            | 26,227                           |
| Inventories:                                                                                         |                                                   |                                  |
| Finished goods, net                                                                                  | 9,667                                             | 6,706                            |
| Work in process                                                                                      | 407                                               | 1,018                            |
| Raw materials and components, net                                                                    | 3,811                                             | 3,247                            |
| Total inventories, net                                                                               | 13,885                                            | 10,971                           |
| Deposit on Convergent acquisition                                                                    | 17,424                                            | —                                |
| Other current assets                                                                                 | 4,131                                             | 6,741                            |
| Total current assets                                                                                 | 74,177                                            | 84,107                           |
| Property, plant and equipment (net of accumulated depreciation of \$4,589 and \$3,750, respectively) | 10,149                                            | 11,105                           |
| Note receivable                                                                                      | 2,388                                             | 2,232                            |
| Intangible assets, net                                                                               | 635                                               | 105                              |
| Goodwill                                                                                             | 1,163                                             | —                                |
| Other assets                                                                                         | 2,172                                             | 1,997                            |
| Total assets                                                                                         | \$ 90,684                                         | \$ 99,546                        |
| <b>Liabilities and Stockholders' Equity</b>                                                          |                                                   |                                  |
| Current liabilities:                                                                                 |                                                   |                                  |
| Accounts payable                                                                                     | \$ 9,028                                          | \$ 16,646                        |
| Accrued expenses                                                                                     | 4,520                                             | 5,313                            |
| Income taxes payable                                                                                 | 57                                                | —                                |
| Customer deposits/deferred revenue                                                                   | 2,726                                             | 5,251                            |

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|                                                                                                                                                                                                                                                              |           |           |
|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------|-----------|
| Total current liabilities                                                                                                                                                                                                                                    | 16,331    | 27,210    |
| Deferred revenue                                                                                                                                                                                                                                             | 3,081     | 3,302     |
| Deferred income taxes                                                                                                                                                                                                                                        | 816       | 580       |
| Other accrued expenses, net of current portion                                                                                                                                                                                                               | 1,821     | 1,538     |
| Total liabilities                                                                                                                                                                                                                                            | 22,049    | 32,630    |
| Stockholders' equity:                                                                                                                                                                                                                                        |           |           |
| Preferred stock, par value \$.01 per share; Authorized 1,000 shares, none outstanding                                                                                                                                                                        | —         | —         |
| Common stock, par value \$.01 per share; Authorized 25,000 shares; issued 16,869 and 16,782 shares at September 30, 2013 and December 31, 2012, respectively; 14,138 and 14,051 shares outstanding at September 30, 2013 and December 31, 2012, respectively | 167       | 167       |
| Additional paid-in capital                                                                                                                                                                                                                                   | 38,116    | 37,770    |
| Accumulated other comprehensive income:                                                                                                                                                                                                                      |           |           |
| Foreign currency translation                                                                                                                                                                                                                                 | (287 )    | 269       |
| Postretirement benefit obligations                                                                                                                                                                                                                           | 46        | 46        |
| Retained earnings                                                                                                                                                                                                                                            | 48,832    | 46,903    |
|                                                                                                                                                                                                                                                              | 86,874    | 85,155    |
| Less 2,731 of common shares in treasury, at cost at September 30, 2013 and December 31, 2012                                                                                                                                                                 | (18,239 ) | (18,239 ) |
| Total stockholders' equity                                                                                                                                                                                                                                   | 68,635    | 66,916    |
| Total liabilities and stockholders' equity                                                                                                                                                                                                                   | \$ 90,684 | \$ 99,546 |

See accompanying notes to condensed consolidated financial statements.

**Ballantyne Strong, Inc. and Subsidiaries****Condensed Consolidated Statements of Operations****Three and Nine Months Ended September 30, 2013 and 2012****(In thousands, except per share data)****(Unaudited)**

|                                                     | <b>Three Months<br/>Ended<br/>September 30,</b> |             | <b>Nine Months<br/>Ended September<br/>30,</b> |             |
|-----------------------------------------------------|-------------------------------------------------|-------------|------------------------------------------------|-------------|
|                                                     | <b>2013</b>                                     | <b>2012</b> | <b>2013</b>                                    | <b>2012</b> |
| Net revenues                                        | \$18,855                                        | \$39,260    | \$70,865                                       | \$129,987   |
| Cost of revenues                                    | 15,517                                          | 35,539      | 58,934                                         | 113,569     |
| Gross profit                                        | 3,338                                           | 3,721       | 11,931                                         | 16,418      |
| Selling and administrative expenses:                |                                                 |             |                                                |             |
| Selling                                             | 850                                             | 1,349       | 2,586                                          | 3,405       |
| Administrative                                      | 2,524                                           | 2,345       | 7,478                                          | 8,547       |
| Total selling and administrative expenses           | 3,374                                           | 3,694       | 10,064                                         | 11,952      |
| Gain (loss) on the sale/disposal/transfer of assets | 3                                               | (17 )       | 7                                              | 1,361       |
| Income (loss) from operations                       | (33 )                                           | 10          | 1,874                                          | 5,827       |
| Net interest income (expense)                       | 152                                             | (8 )        | 169                                            | (30 )       |
| Equity income (loss) of joint venture               | 2                                               | (65 )       | (117 )                                         | 1           |
| Other income (expense), net                         | (33 )                                           | (205 )      | 463                                            | 208         |
| Income (loss) before income taxes                   | 88                                              | (268 )      | 2,389                                          | 6,006       |
| Income tax expense                                  | (42 )                                           | —           | (502 )                                         | (2,024 )    |
| Net earnings (loss)                                 | \$46                                            | \$(268 )    | \$1,887                                        | \$3,982     |
| Basic earnings (loss) per share                     | \$0.00                                          | \$(0.02 )   | \$0.13                                         | \$0.28      |
| Diluted earnings (loss) per share                   | \$0.00                                          | \$(0.02 )   | \$0.13                                         | \$0.28      |
| Weighted average shares outstanding:                |                                                 |             |                                                |             |
| Basic                                               | 14,009                                          | 13,959      | 13,995                                         | 14,055      |
| Diluted                                             | 14,039                                          | 13,959      | 14,025                                         | 14,136      |

See accompanying notes to condensed consolidated financial statements.

**Ballantyne Strong, Inc. and Subsidiaries**

**Condensed Consolidated Statements of Comprehensive Income**

**Three and Nine Months Ended September 30, 2013 and 2012**

**(In thousands)**

**(Unaudited)**

|                                             | <b>Three<br/>Months<br/>Ended<br/>September<br/>30,<br/>2013</b> |  | <b>2012</b> |  | <b>Nine Months<br/>Ended<br/>September 30,<br/>2013</b> |  | <b>2012</b> |  |
|---------------------------------------------|------------------------------------------------------------------|--|-------------|--|---------------------------------------------------------|--|-------------|--|
| Net earnings (loss)                         | \$46                                                             |  | \$(268)     |  | \$1,887                                                 |  | \$3,982     |  |
| Currency translation adjustment:            |                                                                  |  |             |  |                                                         |  |             |  |
| Unrealized net change arising during period | 535                                                              |  | 612         |  | (556)                                                   |  | 572         |  |
| Other comprehensive income (loss)           | 535                                                              |  | 612         |  | (556)                                                   |  | 572         |  |
| Comprehensive Income                        | \$581                                                            |  | \$344       |  | \$1,331                                                 |  | \$4,554     |  |

See accompanying notes to condensed consolidated financial statements.

**Ballantyne Strong, Inc. and Subsidiaries****Condensed Consolidated Statements of Cash Flows****Nine Months Ended September 30, 2013 and 2012****(In thousands)****(Unaudited)**

|                                                              | <b>Nine Months<br/>Ended September<br/>30,</b> |             |
|--------------------------------------------------------------|------------------------------------------------|-------------|
|                                                              | <b>2013</b>                                    | <b>2012</b> |
| Net cash provided by (used in) operating activities          | \$5,775                                        | \$(5,346 )  |
| Cash flows from investing activities:                        |                                                |             |
| Purchase of Peintures Elite, Inc.                            | (1,747 )                                       | —           |
| Deposit on Convergent acquisition                            | (17,424 )                                      | —           |
| Distribution from Joint Venture                              | —                                              | 2,508       |
| Capital expenditures                                         | (231 )                                         | (1,095 )    |
| Proceeds from sale of assets                                 | 6                                              | 3,332       |
| Net cash (used in) provided by investing activities          | (19,396 )                                      | 4,745       |
| Cash flows from financing activities:                        |                                                |             |
| Excess tax benefits from share-based arrangements            | (11 )                                          | —           |
| Purchase of treasury stock                                   | —                                              | (2,756 )    |
| Proceeds from employee stock purchase plan                   | 4                                              | —           |
| Net cash used in financing activities                        | (7 )                                           | (2,756 )    |
| Effect of exchange rate changes on cash and cash equivalents | (207 )                                         | 231         |
| Net decrease in cash and cash equivalents                    | (13,835 )                                      | (3,126 )    |
| Cash and cash equivalents at beginning of period             | 40,168                                         | 39,889      |
| Cash and cash equivalents at end of period                   | \$26,333                                       | \$36,763    |

See accompanying notes to condensed consolidated financial statements.

**Ballantyne Strong, Inc. and Subsidiaries**

**Notes to the Condensed Consolidated Financial Statements**

**(Unaudited)**

**1. Nature of Operations**

Ballantyne Strong, Inc. (“Ballantyne” or the “Company”), a Delaware corporation, and its wholly owned subsidiaries Strong Westrex, Inc., Strong Technical Services, Inc., Strong/MDI Screen Systems, Inc., Peintures Elite, Inc., and Strong Westrex (Beijing) Trading Inc., manufacture, distribute, integrate and service theatre and lighting systems on a worldwide basis.

The Company’s products are distributed to movie exhibition companies, sports arenas, auditoriums, amusement parks and special venues.

**2. Summary of Significant Accounting Policies**

***Basis of Presentation and Principles of Consolidation***

The condensed consolidated financial statements include the accounts of the Company and all majority owned and controlled domestic and foreign subsidiaries. All significant intercompany balances and transactions have been eliminated in consolidation.

The condensed consolidated financial statements included in this report are presented in accordance with the requirements of Form 10-Q and consequently do not include all of the disclosures normally required by accounting principles generally accepted in the United States of America for annual reporting purposes or those made in the Company’s Annual Report on Form 10-K. These condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company’s Annual Report on Form 10-K for the fiscal year-ended December 31, 2012.

The condensed consolidated balance sheet as of December 31, 2012 was derived from the Company's audited consolidated balance sheet as of that date. All other condensed consolidated financial statements contained herein are unaudited and, in the opinion of management, reflect all adjustments of a normal recurring nature necessary to present a fair statement of the financial position and the results of operations and cash flows for the respective interim periods. The results for interim periods are not necessarily indicative of trends or results expected for a full year.

### ***Use of Management Estimates***

The preparation of condensed consolidated financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the condensed consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results and changes in facts and circumstances may alter such estimates and affect results of operations and financial position in future periods.

### ***Fair Value of Financial and Derivative Instruments***

The categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement. Financial assets and liabilities carried at fair value will be classified and disclosed in one of the following three categories:

Level 1 - inputs to the valuation techniques are quoted prices in active markets for identical assets or liabilities

Level 2 - inputs to the valuation techniques are other than quoted prices but are observable for the assets or liabilities, either directly or indirectly

Level 3 - inputs to the valuation techniques are unobservable for the assets or liabilities

The following table presents the Company's financial assets and liabilities measured at fair value based upon the level within the fair value hierarchy in which the fair value measurements fall, as of September 30, 2013:

Fair Values Measured on a Recurring Basis:

|                                    | <b>Level 1</b>         | <b>Level 2</b> | <b>Level 3</b> | <b>Total</b> |
|------------------------------------|------------------------|----------------|----------------|--------------|
|                                    | <b>\$ in thousands</b> |                |                |              |
| Cash and cash equivalents          | \$26,333               | \$—            | \$—            | \$26,333     |
| Foreign currency forward contracts | \$—                    | \$9,985        | \$—            | \$9,985      |
| Notes Receivable                   | \$—                    | \$—            | \$2,388        | \$2,388      |

The notes receivable accrue interest at a rate of 15% per annum which is paid in accordance with an agreed-upon cash flow schedule.

Quantitative information about the Company's level 3 fair value measurements at September 30, 2013 is set forth below:

| <b>\$ in thousands</b> | <b>Fair Value at 9/30/2013</b> | <b>Valuation Technique</b> | <b>Unobservable input</b> | <b>Range</b> |
|------------------------|--------------------------------|----------------------------|---------------------------|--------------|
| Notes Receivable       | \$ 2,388                       | Discounted cash flow       | Probability of default    | 0 %          |
|                        |                                |                            | Prepayment rates          | 0 %          |
|                        |                                |                            | Loss severity             | 0 %          |

The significant unobservable inputs used in the fair value measurement of the Company's notes receivable are prepayment rates, probability of default and loss severity in the event of default. Significant increases (decreases) in any of these inputs in isolation would result in a significantly lower (higher) fair value measurement. Generally, a change in the assumption used for the probability of default is accompanied by a directionally similar change in the assumption used for the loss severity and directionally opposite change in the assumption used for prepayment rates.

The following table reconciles the beginning and ending balance of the Company's Notes Receivable fair value:

**Nine months  
ended****September 30  
2013 2012****\$ in thousands**

|                                               |         |         |
|-----------------------------------------------|---------|---------|
| Notes Receivable balance, beginning of period | \$2,232 | \$2,062 |
| Interest Income                               | 156     | —       |
| Issuances of new notes                        | —       | 155     |
| Notes Receivable balance, end of period       | \$2,388 | \$2,217 |

The following table presents the Company's financial assets and liabilities measured at fair value based upon the level within the fair value hierarchy in which the fair value measurements fall, as of December 31, 2012:

|                           | <b>Level 1</b>         | <b>Level 2</b> | <b>Level 3</b> | <b>Total</b> |
|---------------------------|------------------------|----------------|----------------|--------------|
|                           | <b>\$ in thousands</b> |                |                |              |
| Cash and cash equivalents | \$40,168               | \$ —           | —\$ —          | \$40,168     |
| Notes Receivable          | \$ —                   | \$ —           | —\$ 2,232      | \$2,232      |

The carrying values of all other financial assets and liabilities including accounts receivable, accounts payable and accrued expenses reported in the consolidated balance sheets equal or approximate their fair values due to the short-term nature of these instruments. All non-financial assets that are not recognized or disclosed at fair value in the financial statements on a recurring basis, which includes non-financial long-lived assets, are measured at fair value in certain circumstances (for example, when there is evidence of impairment). During the nine months ended September 30, 2013 we did not have any significant non-recurring measurements of non-financial assets or liabilities.

***Recently Issued Accounting Pronouncements***

There are no recently issued accounting pronouncements which the Company believes will materially impact its consolidated financial statements.

**3. Acquisitions**

On September 13, 2013, the Company acquired Peintures Elite, Inc. for \$1.7 million in cash. Elite is a manufacturer of paint and lacquer products and has been the primary provider of paint for our screen manufacturing business. Approximately \$1.2 million of the purchase price was allocated to goodwill and \$0.6 million was allocated to amortizable other intangibles. This business is included within the Theatre segment. The amounts allocated to

goodwill were primarily attributable to anticipated synergies and other intangibles that do not qualify for separate recognition. The fair value of the assets and liabilities related to the acquisition are subject to refinement as the Company completes our analyses of the fair values at the acquisition date. The pro forma effect of the acquisition was not material.

The Company paid a deposit of \$17.4 million for the acquisition of Convergent Media Systems, Inc. (“CMS”), which closed on October 1, 2013, subsequent to the end of our third quarter of fiscal 2013. CMS was acquired from Sony Corporation for approximately \$17.4 million in cash, which was the purchase price of \$16.0 million adjusted for cash on hand in Canada and working capital variance based upon CMS’s targeted working capital. CMS provides digital technologies for out-of-home messaging, advertising and communication (the Digital Out-of-Home or DOOH market) and Enterprise Video Solutions (EVS), which provides enterprises with the infrastructure necessary for communication, collaboration, training and education of employees. CMS operates from its offices in the United States and Canada and has customers in North America. Due to the timing of the acquisition, the Company has not yet completed its purchase allocation and analysis. Therefore, it is impracticable to provide proforma information or further information related to the assets and liabilities acquired at this time. In addition, the Company expects to incur costs attributable to integration and reorganization actions associated with this acquisition in the fourth quarter.

#### 4. Earnings (Loss) Per Common Share

Basic earnings (loss) per share have been computed on the basis of the weighted average number of shares of common stock outstanding. Diluted earnings (loss) per share has been computed on the basis of the weighted average number of shares of common stock outstanding after giving effect to potential common shares from dilutive stock options and certain non-vested shares of restricted stock. The following table provides the reconciliation between basic and diluted earnings (loss) per share:

|                                                              | Three Months<br>Ended<br>September 30,<br>2013 |           | Nine Months<br>Ended<br>September 30,<br>2013 |         |
|--------------------------------------------------------------|------------------------------------------------|-----------|-----------------------------------------------|---------|
|                                                              | 2012                                           |           | 2012                                          |         |
| (In thousands, except per share data)                        |                                                |           |                                               |         |
| Basic earnings (loss) per share:                             |                                                |           |                                               |         |
| Earnings (loss) applicable to common stock                   | \$46                                           | \$(268 )  | \$1,887                                       | \$3,982 |
| Basic weighted average common shares outstanding             | 14,009                                         | 13,959    | 13,995                                        | 14,055  |
| Basic earnings (loss) per share                              | \$0.00                                         | \$(0.02 ) | \$0.13                                        | \$0.28  |
| Diluted earnings (loss) per share:                           |                                                |           |                                               |         |
| Earnings (loss) applicable to common stock                   | \$46                                           | \$(268 )  | \$1,887                                       | \$3,982 |
| Basic weighted average common shares outstanding             | 14,009                                         | 13,959    | 13,995                                        | 14,055  |
| Dilutive effect of stock options and restricted stock awards | 30                                             | —         | 30                                            | 81      |
| Dilutive weighted average common shares outstanding          | 14,039                                         | 13,959    | 14,025                                        | 14,136  |
| Diluted earnings (loss) per share                            | \$0.00                                         | \$(0.02 ) | \$0.13                                        | \$0.28  |

For the three and nine month periods ended September 30, 2013, grants and options to purchase 291,000 and 293,200 shares of common stock were outstanding but were not included in the computation of diluted earnings per share as the option’s exercise price was greater than the average market price of the common shares for the respective periods.

For the three and nine month periods ended September 30, 2012, options to purchase 50,000 shares of common stock were outstanding but were not included in the computation of diluted earnings (loss) per share as the option’s exercise

price was greater than the average market price of the common shares for the respective periods. An additional 79,000 options were excluded from the three month period ended September 30, 2012 as their inclusion would be anti-dilutive, thereby decreasing the net loss per share.

## 5. Warranty Reserves

The Company has generally granted a warranty to its customers for a one-year period following the sale of manufactured and distributed products. In most instances, the distributed products are covered by the manufacturing firm's OEM warranty on parts and we cover warranty labor cost when required. However, there are certain customers where the Company may grant warranties in excess of the manufacturer's warranty for distributed products. The Company accrues for these costs at the time of sale or repair. The following table summarizes warranty activity for the three and nine months ended September 30 2013 and 2012:

|                                         | <b>Three<br/>Months<br/>Ended<br/>September<br/>30,</b> |             | <b>Nine Months<br/>Ended<br/>September 30,</b> |             |
|-----------------------------------------|---------------------------------------------------------|-------------|------------------------------------------------|-------------|
|                                         | <b>2013</b>                                             | <b>2012</b> | <b>2013</b>                                    | <b>2012</b> |
| <b>(In thousands)</b>                   |                                                         |             |                                                |             |
| Warranty accrual at beginning of period | \$851                                                   | \$846       | \$770                                          | \$1,028     |
| Charged to expense                      | 91                                                      | 98          | 280                                            | 321         |
| Amounts written off, net of recoveries  | (55 )                                                   | (89 )       | (171 )                                         | (495 )      |
| Foreign currency adjustment             | 4                                                       | 13          | 12                                             | 14          |
| Warranty accrual at end of period       | \$891                                                   | \$868       | \$891                                          | \$868       |

## 6. Digital Link II Joint Venture

On March 6, 2007, the Company entered into an agreement with RealD to form an operating entity Digital Link II, LLC (the "LLC"). Under the agreement, the LLC was formed with the Company and RealD as the only two members with membership interests of 44.4% and 55.6%, respectively. The LLC was formed for purposes of commercializing certain 3D technology and to fund the deployment of digital projector systems and servers to exhibitors.

The Company accounts for its investment by the equity method. Under this method, the Company recorded its proportionate share of LLC net income or loss based on the LLC's financial statements as of September 20, 2013 and September 21, 2012, respectively. The LLC uses four 13-week periods for a total of 52 weeks to align its fiscal year-end with that of its majority interest holder, RealD. The Company's portion of gain (loss) of the LLC was immaterial and (\$0.1) million for the three and nine months ended September 30, 2013. The Company's portion of income (loss) of the LLC was (\$0.1) million and immaterial gain for the three and nine months ended September 30, 2012, respectively.

In the past, the Company sold digital theatre projection equipment, in the normal course of business, to the LLC. The LLC in turn provides and sells the digital projection equipment to third party customers under system use agreements or through sales agreements. Revenue recognized by the Company on the sale transaction to the LLC is limited by its 44.4% ownership in the joint venture which will be recognized upon sale of the equipment to the third parties. There were no sales to the LLC during the three and nine months ended September 30, 2013. The Company recognized \$0 and \$0.2 million of gross margin during the three and nine months ended September 30, 2012, respectively, related to the LLC's sale of equipment to third parties. The total receivable balance due from the LLC was insignificant at September 30, 2013 and December 31, 2012.

During the first quarter of 2012 the Company received a \$1.5 million distribution from the LLC. During the third quarter of 2012 the Company received a \$1.0 million distribution from the LLC. The Company received no distributions from the LLC in the nine months ended September 30, 2013.

## 7. Corporate-wide strategic initiative

In the fourth quarter of 2011, the Board of Directors and management of the Company approved a corporate-wide strategic initiative to refocus its worldwide digital equipment distribution business, services platform and cinema screen manufacturing business and exit the analog projector manufacturing business. The strategic initiative consisted of selling the Company's Omaha, Nebraska-based analog projector facility and manufacturing equipment and relocating its corporate headquarters to a new, smaller location in Omaha, which also houses its Network Operations Center. Total life to date severance charges for the strategic initiative begun in 2011 are approximately \$1.4 million. The strategic initiative is expected to be completed by the end of 2013.

The following table reconciles the beginning and ending restructuring balance for the nine months ended September 30, 2013, which are included in accrued expenses:

|                                          | (in<br>thousands) |
|------------------------------------------|-------------------|
| Accrued severance at beginning of period | \$ 88             |

|                                    |       |
|------------------------------------|-------|
| Severance paid                     | (66 ) |
| Accrued severance at end of period | \$ 22 |

## 8. Income Taxes

The effective tax rate (calculated as a ratio of income tax expense to pretax earnings, inclusive of equity method investment losses) was approximately 47.8% and 21.0% for the three and nine months ended September 30, 2013, respectively as compared to 0.1% and 33.7% for the three and nine months ended September 30, 2012, respectively. The effective tax rate differs from the statutory rates primarily as a result of differing foreign and U.S. tax rates applied to respective pre-tax earnings by tax jurisdiction. The Company's estimated annual effective rate was higher in the three months ended September 30, 2013 compared to the comparable period of 2012 due to higher proportion of earnings before tax being within our US operations, which has a higher tax rate. The Company's estimated annual effective rate was lower in the nine months ended September 30, 2013 compared to the comparable period of 2012 due to higher proportion of earnings before tax being within our Canadian operations, Strong/MDI Screen Systems, Inc., which has a lower tax rate. In addition the effective tax rate for the three months and nine months ended September 30, 2013 were impacted as the Company also recorded \$0.03 million of additional tax expense due to return to provision adjustments related to filing the 2012 tax returns.

The Company's uncertain tax positions are related to tax years that remain subject to examination by the relevant taxable authorities. The Company has examinations not yet initiated for Federal purposes for fiscal years 2005 through 2012. In most cases, the Company has examinations open for State or local jurisdictions based on the particular jurisdiction's statute of limitations. The Company does not currently have any examinations in process. As of September 30, 2013, total unrecognized tax benefits amounted to approximately \$0.2 million.

## 9. Stock Compensation

The Company recognizes compensation expense for all share-based payment awards made to employees and directors based on their estimated fair values. Share-based compensation expense approximated the following for the three and nine months ended September 30, 2013 and 2012 (in thousands):

|                                  | <b>Three<br/>Months<br/>Ended<br/>September<br/>30,<br/>2013</b> |             | <b>Nine<br/>Months<br/>Ended<br/>September<br/>30,<br/>2013</b> |             |
|----------------------------------|------------------------------------------------------------------|-------------|-----------------------------------------------------------------|-------------|
|                                  | <b>2013</b>                                                      | <b>2012</b> | <b>2013</b>                                                     | <b>2012</b> |
| Share based compensation expense | \$ 125                                                           | \$ 10       | \$ 345                                                          | \$ 289      |

### *Long-Term Incentive Plan*

The Company's 2010 Long-Term Incentive Plan ("2010 Plan") provides the Compensation Committee of the Board of Directors with the discretion to grant stock options, stock appreciation rights, restricted shares, restricted stock units, performance shares, or performance units. Vesting terms vary with each grant and may be subject to vesting upon a "change in control" of the Company. The total number of shares reserved for issuance under the 2010 Plan was 600,000 shares. During the nine months ended September 30, 2013, the Company awarded 22,500 options and 9,000 restricted stock shares under the 2010 Plan.

### *Options*

As noted above, under the 2010 Plan, the Company granted options to purchase 22,500 shares of the Company's common stock during the nine months ended September 30, 2013. Options to purchase shares of common stock were granted with exercise prices equal to the fair value of the common stock on the date of grant and vest over a four-year period. The fair value of stock options granted was estimated using a Black-Scholes valuation model with the following assumptions:

|                                          |      |   |
|------------------------------------------|------|---|
| Expected dividend yield at date of grant | 0    | % |
| Expected stock price volatility          | 58.5 | % |
| Risk-free interest rate                  | 0.9  | % |
| Expected life of options (in years)      | 5.5  |   |

The risk-free interest rate assumptions were based on the U.S. Treasury yield curve in effect at the time of the grant. The expected volatility was based on historical monthly price changes of the Company's stock based on the expected life of the options at the date of grant. The expected life of options is the average number of years the Company estimates that options will be outstanding. The Company considers groups of associates that have similar historical exercise behavior separately for valuation purposes.

The following table summarizes the Company's activities with respect to its stock options for the nine months ended September 30, 2013 as follows:

|                                   | <b>Number of<br/>Options</b> | <b>Weighted<br/>Average<br/>Exercise<br/>Price<br/>Per Share</b> | <b>Weighted<br/>Average<br/>Remaining<br/>Contractual<br/>Term</b> | <b>Aggregate<br/>Intrinsic<br/>Value</b> |
|-----------------------------------|------------------------------|------------------------------------------------------------------|--------------------------------------------------------------------|------------------------------------------|
| Outstanding at December 31, 2012  | 191,200                      | \$ 5.64                                                          | 8.69                                                               | \$ —                                     |
| Granted                           | 22,500                       | 3.55                                                             |                                                                    |                                          |
| Exercised                         | —                            | —                                                                |                                                                    |                                          |
| Forfeited                         | —                            | —                                                                |                                                                    |                                          |
| Outstanding at September 30, 2013 | 213,700                      | \$ 5.42                                                          | 8.09                                                               | \$ 16,393                                |
| Exercisable at September 30, 2013 | 70,283                       | \$ 6.40                                                          | 7.68                                                               | \$ 418                                   |

The aggregate intrinsic value in the table above represents the total that would have been received by the option holders if all in-the-money options had been exercised on September 30, 2013.

The following table summarizes information about stock options outstanding and exercisable at September 30, 2013:

| <b>Range of<br/>option<br/>exercise<br/>price</b> | <b>Options Outstanding at<br/>September 30, 2013</b> |                                                                    |                                                                       | <b>Options Exercisable at<br/>September 30, 2013</b> |                                                                    |                                                                       |
|---------------------------------------------------|------------------------------------------------------|--------------------------------------------------------------------|-----------------------------------------------------------------------|------------------------------------------------------|--------------------------------------------------------------------|-----------------------------------------------------------------------|
|                                                   | <b>Number<br/>of<br/>options</b>                     | <b>Weighted<br/>average<br/>remaining<br/>contractual<br/>life</b> | <b>Weighted<br/>average<br/>exercise<br/>price<br/>per<br/>option</b> | <b>Number<br/>of<br/>options</b>                     | <b>Weighted<br/>average<br/>remaining<br/>contractual<br/>life</b> | <b>Weighted<br/>average<br/>exercise<br/>price<br/>per<br/>option</b> |
| \$3.55 to 8.32                                    | 213,700                                              | 8.09                                                               | \$ 5.42                                                               | 70,283                                               | 7.68                                                               | \$ 6.40                                                               |

#### ***Restricted Stock Plans***

The Company's 2005 Restricted Stock Plan (the "2005 Plan") provides for the grant of restricted stock awards. A total of 250,000 shares were reserved for issuance under the 2005 Plan. These shares are subject to such restrictions on transferability and other restrictions, if any, as the Compensation Committee may impose. During the nine months ended September 30, 2013, the Company awarded 41,000 restricted shares under the 2005 Plan, which vest annually over a three year period.

The Ballantyne Strong, Inc. Non-Employee Directors' Restricted Stock Plan (the "Non-Employee Plan") provides for the award of restricted shares to outside directors. A total of 250,000 shares are reserved for issuance under the Non-Employee Plan. During the nine months ended September 30, 2013, the Company granted 37,500 restricted shares under the Non-Employee Plan to the Board of Directors. These shares will vest the day preceding the Company's 2014 Annual Meeting of Stockholders.

In connection with the restricted stock granted to certain employees and non-employee directors, the Company accrues compensation expense based on the estimated number of shares expected to be issued utilizing the most current information available to the Company at the date of the financial statements. The Company estimates the fair value of restricted stock awards based upon the market price of the underlying common stock on the date of grant.

As of September 30, 2013, the total unrecognized compensation cost related to non-vested restricted stock awards was approximately \$0.7 million which is expected to be recognized over a weighted average period of 2.1 years.

The following table summarizes restricted stock activity for the nine months ended September 30, 2013:

|                                  | <b>Number of<br/>Restricted<br/>Stock<br/>Shares</b> | <b>Weighted<br/>Average<br/>Grant<br/>Price</b> | <b>Fair<br/>Value</b> |
|----------------------------------|------------------------------------------------------|-------------------------------------------------|-----------------------|
| Non-vested at December 31, 2012  | 84,200                                               |                                                 | \$ 5.24               |
| Granted                          | 87,500                                               |                                                 | 4.28                  |
| Shares vested                    | (42,200 )                                            |                                                 | 5.78                  |
| Shares forfeited                 | —                                                    |                                                 | —                     |
| Non-vested at September 30, 2013 | 129,500                                              |                                                 | \$ 4.42               |

#### ***Employee Stock Purchase Plan***

The estimated grant date fair value of purchase rights outstanding under the Employee Stock Purchase Plan at September 30, 2013 was \$1.57 per share using the Black-Scholes option-pricing model made with the following weighted average assumptions:

|                                          |         |
|------------------------------------------|---------|
| Expected dividend yield at date of grant | 0 %     |
| Expected stock price volatility          | 29.89 % |
| Risk-free interest rate                  | 0.14 %  |
| Expected term (in years)                 | 1       |

The Company recorded insignificant share-based compensation expense pertaining to the stock purchase plan with insignificant associated tax benefits for each of the three and nine months ended September 30, 2013 and 2012. At September 30, 2013, the total unrecognized estimated compensation cost was insignificant.

## 10. Foreign Exchange Contracts

The Company's primary exposure to foreign currency fluctuations pertains to its subsidiaries in Canada and China. In certain instances the Company may enter into foreign exchange forward contracts to manage a portion of this risk. The Company has not designated its foreign exchange forward contracts as hedges.

The following table presents the gross fair value of derivative instruments, all of which are not designated as hedging instruments:

| (in thousands)                     | Classification       | Asset Derivatives  |                   |
|------------------------------------|----------------------|--------------------|-------------------|
|                                    |                      | September 30, 2013 | December 31, 2012 |
| Foreign exchange forward contracts | Other current assets | \$ 9,985           | \$ —              |

The above fair value at September 30, 2013 is offset against \$10.0 million in other current assets, resulting in a net amount of \$0.02 million of net asset. All cash flows related to our foreign currency exchange contracts are classified as operating cash flows. We recognized in other income, the following realized and unrealized gains from foreign currency forward exchange contracts:

| (in thousands) | Classification | Three Months Ended September 30, |      | Nine Months Ended September 30, |      |
|----------------|----------------|----------------------------------|------|---------------------------------|------|
|                |                | 2013                             | 2012 | 2013                            | 2012 |

Foreign exchange forward contracts   Other Income (Loss)   \$197   \$(16)   \$9   \$145

## 11. Commitments, Contingencies and Concentrations

### *Concentrations*

The Company's top ten customers accounted for approximately 53.5% and 43.3% of total consolidated net revenues for the three and nine months ended September 30, 2013, respectively, and were from the theatre segment. Trade accounts receivable from these customers represented approximately 33.1% of net consolidated receivables at September 30, 2013. While the Company believes its relationships with such customers are stable, most arrangements are made by purchase order and are terminable at will by either party. A significant decrease or interruption in business from the Company's significant customers could have a material adverse effect on the Company's business, financial condition and results of operations. The Company could also be adversely affected by such factors as changes in foreign currency rates and weak economic and political conditions in each of the countries in which the Company sells its products.

Financial instruments that potentially expose the Company to a concentration of credit risk principally consist of accounts receivable. The Company sells product to a large number of customers in many different geographic regions. To minimize credit concentration risk, the Company performs ongoing credit evaluations of its customers' financial condition.

### *Leases*

The Company and its subsidiaries lease plant and office facilities, furniture, autos and equipment under operating leases expiring through 2023. These leases generally contain renewal options and the Company expects to renew or replace certain of these leases in the ordinary course of business.

The Company's future minimum lease payments for operating leases are as follows:

| <b>Payments due by period (\$ in thousands)</b> |              |                  |             |             |             |                   |
|-------------------------------------------------|--------------|------------------|-------------|-------------|-------------|-------------------|
|                                                 | <b>Total</b> | <b>2013</b>      | <b>2014</b> | <b>2015</b> | <b>2016</b> | <b>2017</b>       |
|                                                 |              | <b>Remainder</b> |             |             |             | <b>Thereafter</b> |
|                                                 |              | <b>2013</b>      |             |             |             |                   |
| Operating leases                                | \$3,767      | \$158            | \$579       | \$345       | \$355       | \$359             |
|                                                 |              |                  |             |             |             | \$ 1,971          |

**12. Business Segment Information**

As of September 30, 2013, the Company's operations were conducted principally through two business segments: Theatre and Lighting. Theatre operations include the sale and service of digital projection equipment, sound systems, xenon lamps, lenses and other accessories. The lighting segment operations include the design, assembly and sale of follow spotlights, stationary searchlights and computer operated lighting systems for the motion picture production, television, live entertainment, theme parks and architectural industries. The Company allocates resources to business segments and evaluates the performance of these segments based upon reported segment operating profit. All significant intercompany sales are eliminated in consolidation.

**Summary by Business Segments**

| (In thousands)                                  | <b>Three Months<br/>Ended<br/>September 30,<br/>2013      2012</b> |          | <b>Nine Months<br/>Ended<br/>September 30,<br/>2013      2012</b> |           |
|-------------------------------------------------|--------------------------------------------------------------------|----------|-------------------------------------------------------------------|-----------|
|                                                 |                                                                    |          |                                                                   |           |
| Net revenue                                     |                                                                    |          |                                                                   |           |
| Theatre                                         |                                                                    |          |                                                                   |           |
| Products                                        | \$15,601                                                           | \$34,145 | \$58,112                                                          | \$116,546 |
| Services                                        | 2,737                                                              | 4,276    | 8,381                                                             | 11,240    |
| Total theatre                                   | 18,338                                                             | 38,421   | 66,493                                                            | 127,786   |
| Lighting                                        | 517                                                                | 839      | 4,372                                                             | 2,201     |
| Total revenue                                   | \$18,855                                                           | \$39,260 | \$70,865                                                          | \$129,987 |
| Operating Income (Loss)                         |                                                                    |          |                                                                   |           |
| Theatre                                         |                                                                    |          |                                                                   |           |
| Products                                        | \$1,905                                                            | \$1,617  | \$6,071                                                           | \$9,096   |
| Services                                        | (38 )                                                              | 148      | 692                                                               | 1,236     |
| Total theatre                                   | 1,867                                                              | 1,765    | 6,763                                                             | 10,332    |
| Lighting                                        | (117 )                                                             | 44       | 309                                                               | (169 )    |
| Total segment operating income                  | 1,750                                                              | 1,809    | 7,072                                                             | 10,163    |
| Unallocated general and administrative expenses | (1,786 )                                                           | (1,782 ) | (5,205 )                                                          | (5,697 )  |
| Interest, net                                   | 152                                                                | (8 )     | 169                                                               | (30 )     |
| Gain on sale of assets                          | 3                                                                  | (17 )    | 7                                                                 | 1,361     |
| Equity income (loss) of joint venture           | 2                                                                  | (65 )    | (117 )                                                            | 1         |
| Other income                                    | (33 )                                                              | (205 )   | 463                                                               | 208       |
| Income (loss) before income taxes               | \$88                                                               | \$(268 ) | \$2,389                                                           | \$6,006   |

**(In thousands)**      **September 30, 2013**      **December 31, 2012**

Identifiable assets

Theatre

Products              \$ 85,334      \$ 92,525

Services              2,038      4,484

Total theatre      87,372      97,009

Lighting              3,312      2,537

Total              \$ 90,684      \$ 99,546

**Summary by Geographical Area**

| <b>(In thousands)</b>  | <b>Three Months Ended September 30, 2013</b> |             | <b>Nine Months Ended September 30, 2013</b> |             |
|------------------------|----------------------------------------------|-------------|---------------------------------------------|-------------|
|                        | <b>2013</b>                                  | <b>2012</b> | <b>2013</b>                                 | <b>2012</b> |
| Net revenue            |                                              |             |                                             |             |
| United States          | \$11,542                                     | \$30,050    | \$47,761                                    | \$107,579   |
| China                  | 4,374                                        | 4,263       | 10,821                                      | 12,261      |
| South America          | 1,055                                        | 3,271       | 7,505                                       | 3,873       |
| Canada                 | 530                                          | 537         | 2,036                                       | 2,950       |
| Asia (excluding China) | 120                                          | 841         | 486                                         | 1,847       |
| Mexico                 | 527                                          | 152         | 962                                         | 546         |
| Europe                 | 654                                          | 146         | 976                                         | 488         |
| Other                  | 53                                           | —           | 318                                         | 443         |
| Total                  | \$18,855                                     | \$39,260    | \$70,865                                    | \$129,987   |

**(In thousands)**      **September 30, 2013**      **December 31, 2012**

Identifiable assets

United States      \$50,900      \$65,868

Canada              24,218      21,092

Asia (excluding China)      5,961      7,337

China              9,605      5,249

Total              \$90,684      \$99,546

Net revenues by business segment are to unaffiliated customers. Identifiable assets by geographical area are based on location of facilities. Net sales by geographical area are based on destination of sales.

**13. Subsequent Event**

Subsequent to the end of the quarter, on October 1, 2013, we acquired Convergent Media Systems, Inc. (CMS) from Sony Corporation for approximately \$17.4 million in cash, which was the purchase price of \$16.0 million adjusted for cash on hand in Canada and working capital variance based upon CMS's targeted working capital.

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

The following discussion and analysis should be read in conjunction with the consolidated financial statements and notes thereto appearing elsewhere in this report. Management's discussion and analysis contains not only historical information, but also forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. Statements that are not historical are forward-looking and reflect expectations for future Company performance. For these statements, the Company claims the protection of the safe harbor for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995.

Forward-looking statements involve a number of risks and uncertainties, including but not limited to those discussed in the "Risk Factors" section contained in Item 1A in our Annual Report on Form 10-K for the fiscal year ended December 31, 2012. Given the risks and uncertainties, readers should not place undue reliance on any forward-looking statement and should recognize that the statements are predictions of future results which may not occur as anticipated. Actual results could differ materially from those anticipated in the forward-looking statements and from historical results, due to the risks and uncertainties described herein, as well as others not now anticipated. New risk factors emerge from time to time and it is not possible for management to predict all such risk factors, nor can it assess the impact of all such factors on our business or the extent to which any factor, or combination of factors, may cause actual results to differ materially from those contained in any forward-looking statements. Except where required by law, the Company assumes no obligation to update forward-looking statements to reflect actual results or changes in factors or assumptions affecting such forward-looking statements.

**Overview**

We are a manufacturer, distributor, integrator and service provider for the theatre exhibition industry on a worldwide basis. Through our Strong® branding, we can fully outfit and automate all aspects of a cinematic theatre including digital projection, cinema screens, library management systems, smart digital signage, flat panels and complete state of the art sound systems. We manufacture cinema screens in Joliette, Quebec, Canada, through our Strong/MDI Screens Systems, Inc. subsidiary.

Through our lighting division, we design, develop, manufacture, distribute, install and service lighting systems for premier architectural sites as well as for a full range of needs for the entertainment and various other industries worldwide. This includes followspots and other specialty lighting for event centers, arenas, exhibit halls, places of

worship, concert tours, staged theatrical performances, and music, dance and various other venues with theatric lighting needs.

We have two primary reportable core operating segments: theatre and lighting. Our segments were determined based on the manner in which management organizes segments for making operating decisions and assessing performance. Approximately 93.8% of the sales for the first nine months of the year were from theatre products and approximately 6.2% were lighting products. Additional information related to our reporting segments can be found in the notes to the consolidated financial statements.

## Results of Operations:

### Three Months Ended September 30, 2013 Compared to the Three Months Ended September 30, 2012

#### Revenues

Net revenues during the three months ended September 30, 2013 decreased 52.0% to \$18.9 million from \$39.3 million during the three months ended September 30, 2012.

|                        | <b>Three Months<br/>Ended<br/>September 30,<br/>2013      2012<br/>(In thousands)</b> |          |
|------------------------|---------------------------------------------------------------------------------------|----------|
| Theatre                |                                                                                       |          |
| Products               | \$15,601                                                                              | \$34,145 |
| Services               | 2,737                                                                                 | 4,276    |
| Total theatre revenues | 18,338                                                                                | 38,421   |
| Lighting               | 517                                                                                   | 839      |
| Total net revenues     | \$18,855                                                                              | \$39,260 |

#### Theatre Segment

Sales of theatre products and services decreased 52.3% to \$18.3 million in 2013 from \$38.4 million in 2012.

*Product Sales*

Sales of products in the third quarter of 2013 decreased 54.3% to \$15.6 million from \$34.1 million in 2012 as the industry change to digital projection equipment continues to wind down. Digital equipment and servers accounted for \$17.8 million of the \$20.0 million decrease in sales when compared to 2012, with sales of film equipment, parts and lamps accounting for the remaining decrease. This was partially offset by an increase in screen sales to \$3.7 million in 2013 from \$3.0 million a year-ago.

### *Service Revenues*

Service revenues decreased 36.0% in 2013 to \$2.7 million from \$4.3 million a year-ago due to non-recurring installation revenue related to the digital product sales. This reduction was partially offset by increasing revenue for recurring after-sale maintenance, repairs and NOC (Network Operation Center) services. As expected, revenues generated from servicing film equipment decreased to \$0.1 million in 2013 compared to \$0.2 million in the third quarter of 2012.

### **Lighting Segment**

Sales of lighting products decreased 38.3% to \$0.5 million from \$0.8 million a year-ago.

### **Export Revenues**

Sales outside the United States (mainly theatre sales) decreased to \$7.3 million in the second quarter of 2013 from \$9.2 million a year ago. This was primarily driven by decreased sales in South America and Asia. Export sales are sensitive to the timing of the digital cinema rollout in these countries in addition to being sensitive to worldwide economic and political conditions that lead to volatility. Certain areas of the world have significant pricing pressures from domestic manufacturers and suppliers. Additionally, foreign exchange rates and excise taxes occasionally make it difficult to market our products overseas at reasonable selling prices.

### **Gross Profit**

Consolidated gross profit decreased 10.3% to \$3.3 million in the third quarter of 2013 from \$3.7 million a year-ago and as a percent of total revenue increased to 17.7% from 9.5% in 2012. Gross profit in the theatre segment decreased to \$3.3 million in 2013 from \$3.4 million in 2012 and as a percentage of theatre sales increased to 18.1% from 8.9% a year-ago. The decrease in gross profit was driven by lower revenues in digital equipment sales. However, gross margin as a percentage of revenue increased as digital equipment sales, which carry lower margins, declined to make up a smaller percentage of total sales.

The gross profit in the lighting segment was \$0.03 million or 4.9% as a percentage of revenues in the third quarter of 2013 compared to \$0.3 million or 35.9% as a percentage of revenues in 2012. The decrease in gross margin was due

to decreased volumes.

### **Selling Expenses**

Selling expenses decreased 37.0% to \$0.9 million in the third quarter of 2013 compared to \$1.3 million a year-ago, but increased as a percentage of revenues to 4.5% in 2013 from 3.4% in 2012. The increase in selling expenses as a percentage of revenues is primarily due to decreased revenues. The decrease in selling expenses is due to lower consultant and tradeshow expenses.

### **Administrative Expenses**

Administrative expenses increased 7.6% to \$2.5 million in the third quarter of 2013 from \$2.3 million in 2012, and as a percent of total revenue to 13.4% in 2013 from 6.0% in 2012. The increase in expenses is primarily due to acquisition costs of \$0.2 million.

### **Other Financial Items**

Our results for the third quarter of 2013 reflect minimal gains pertaining to our 44.4% share of equity in the income from Digital Link II, LLC. This compares to a loss of approximately \$0.1 million during the third quarter of 2012.

The third quarter of 2013 includes a minimal loss in other income (expense) compared to \$0.2 million in 2012, primarily related to net gains (losses) on foreign currency transactions.

We recorded minimal income tax expense in the third quarter of 2013 and 2012. The effective tax rate (calculated as a ratio of income tax expense to pretax earnings, inclusive of equity method investment earnings) was approximately 47.8% and 0.1% in the quarters ending September 30, 2013 and 2012, respectively. The effective tax rate differs from the statutory rates primarily as a result of differing foreign and U.S. tax rates applied to respective pre-tax earnings by tax jurisdiction. The effective rate increased in 2013 from 2012 due to a higher proportion of earnings before tax being within our US operations which has a higher rate. In addition the effective tax rate for the three months ended September 30, 2013 were impacted as the Company also recorded \$0.03 million of additional tax expense due to return to provision adjustments related to filing the 2012 tax returns.

As a result of the items outlined above, we generated a minimal net gain and basic and diluted earnings per share in the three months ended September 30, 2013 compared to a loss of \$0.3 million in 2012 and basic and diluted loss per share of \$0.02 a year-ago.

**Nine Months Ended September 30, 2013 Compared to the Nine Months Ended September 30, 2012**

**Revenues**

Net revenues during the nine months ended September 30, 2013 decreased 45.5% to \$70.9 million from \$130.0 million during the nine months ended September 30, 2012.

|                        | <b>Nine Months<br/>Ended<br/>September 30,<br/>2013      2012<br/>(In thousands)</b> |           |
|------------------------|--------------------------------------------------------------------------------------|-----------|
| Theatre                |                                                                                      |           |
| Products               | \$58,112                                                                             | \$116,546 |
| Services               | 8,381                                                                                | 11,240    |
| Total theatre revenues | 66,493                                                                               | 127,786   |
| Lighting               | 4,372                                                                                | 2,201     |
| Total net revenues     | \$70,865                                                                             | \$129,987 |

**Theatre Segment**

Sales of theatre products and services decreased 48.0% to \$66.5 million in 2013 from \$127.8 million in 2012.

*Product Sales*

Sales of products decreased 50.1% to \$58.1 million in 2013 from \$116.5 million in 2012 as the industry change to digital projection equipment continues to wind down. Digital equipment and servers accounted for \$50.8 million of the \$58.4 million decrease in sales compared to 2012, with sales of film equipment and lamps accounting for the remaining decrease. This was partially offset by an increase in screen sales to \$10.8 million in 2013 from \$9.3 million a year-ago.

*Service Revenues*

Service revenues decreased 25.4% to \$8.4 million in 2013 from \$11.2 million a year-ago due to non-recurring installation revenue related to the digital product sales. This reduction was partially offset by increasing revenue for recurring after-sale maintenance, repairs and NOC (Network Operations Center) services. As expected, revenues generated from servicing film equipment decreased to \$0.2 million in 2013 compared to \$0.6 million in 2012.

### **Lighting Segment**

Sales of lighting products increased 98.6% to \$4.4 million from \$2.2 million a year-ago, primarily due to the completion of the beacon and uplights on the World Trade Center. This project shows our continuing focus on a growing market, architectural accent lighting.

### **Export Revenues**

Sales outside the United States (mainly theatre sales) increased to \$23.1 million in 2013 from \$22.4 million in 2012. This was driven by increased sales in South America. Export sales fluctuations in these markets are reflective of highly competitive environments combined with sensitivity to the timing of the digital cinema rollout in these countries as well as diminishing film equipment sales. Export sales are also sensitive to worldwide economic and political conditions that lead to volatility in the market.

### **Gross Profit**

Consolidated gross profit decreased 27.3% to \$11.9 million in 2013 from \$16.4 million a year-ago and as a percent of total revenue increased to 16.8% from 12.6% in 2012. Gross profit in the theatre segment decreased to \$11.1 million in 2013 from \$15.9 million in 2012 and as a percentage of theatre sales increased to 16.6% from 12.4% a year-ago. The decrease in gross profit was driven by lower revenues in digital equipment sales. However, gross margin as a percentage of revenue increased as digital equipment sales, which carry lower margins, declined to make up a smaller percentage of total sales.

The gross profit in the lighting segment amounted to \$0.9 million or 19.8% as a percentage of revenues in 2013 compared to \$0.5 million or 24.2% as a percentage of revenues in 2012. The increase in gross margin was due to the completion of the World Trade Center.



### **Selling Expenses**

Selling expenses decreased 24.1% to \$2.6 million during 2013 compared to \$3.4 million a year-ago and as a percentage of revenues increased to 3.6% from 2.6% a year-ago. The increase in selling expenses as a percentage of revenues is primarily due to decreased revenues. The decrease in selling expenses is due to lower travel, consultant and tradeshow expenses.

### **General and Administrative Expenses**

General and administrative expenses decreased 12.5% to \$7.5 million in 2013 from \$8.5 million in 2012 and amounted to 10.6% and 6.6% of revenues in 2013 and 2012, respectively. The decrease in expense is primarily due to salaries, travel expenses and lower professional fees.

### **Other Financial Items**

The gain on sale of assets in 2012 is the result of selling the analog projector manufacturing machinery and equipment previously identified as held for sale in connection with our corporate-wide restructuring initiative we began in 2011.

Our results for 2013 reflect losses of \$0.1 million pertaining to our 44.4% share of equity in the income from Digital Link II, LLC. This loss compares to minimal income during the nine months ended September 30, 2012.

Other income of \$0.5 million in 2013, compared to \$0.2 million in 2012, primarily related to net gains on foreign currency transactions.

We recorded income tax expense of approximately \$0.5 million in 2013 compared to \$2.0 million in 2012. The effective tax rate (calculated as a ratio of income tax expense to pretax earnings, inclusive of equity method investment earnings) was approximately 21.0% and 33.7% in the nine months ending September 30, 2013 and 2012, respectively. The effective tax rate differs from the statutory rates primarily as a result of differing foreign and U.S. tax rates applied to respective pre-tax earnings by tax jurisdiction. The effective rate decreased in 2013 from 2012 due to a higher proportion of earnings before tax being within our Canadian operations, Strong/MDI Screen Systems, Inc., which has a lower rate.

As a result of the items outlined above, we generated net earnings of approximately \$1.9 million and basic and diluted earnings per share of \$0.13 in 2013 compared to earnings of \$4.0 million during 2012 and basic and diluted earnings per share of \$0.28 a year-ago.

## **Liquidity and Capital Resources**

During the past several years, we have met our working capital and capital resource needs from either our operating or investing cash flows or a combination of both. We ended the third quarter with total cash and cash equivalents of \$26.3 million compared to \$40.2 million at December 31, 2012.

We are party to a \$20 million Revolving Credit Agreement and Note (collectively, the “Revolving Credit Agreement”) with Wells Fargo Bank, N.A. (“Wells Fargo”). The borrowings from the Revolving Credit Agreement will primarily be used for working capital purposes and for other general corporate purposes. The Company’s accounts receivable, general intangibles and inventory secure the Revolving Credit Agreement. Since inception of the agreement, no amounts have been borrowed on the Revolving Credit Agreement. At September 30, 2013, the Company had availability of \$20 million.

### *Cash Flows from Operating Activities*

Cash flows from operating activities consist of net income adjusted for non-cash items including depreciation and amortization, deferred taxes, and the effect of working capital changes.

Net cash provided by operating activities was \$5.8 million in the first nine months of 2013, which included net income of \$1.9 million, plus non-cash charges (benefits) for gain on assets, deferred tax expense, depreciation and amortization, reserve provisions and non-cash stock compensation totaling \$2.4 million. Changes in working capital provided cash from operating activities of \$1.5 million. Additional changes in working capital was driven by a decrease in accounts receivable, partially offset by increases in inventories and decreases in accounts payable and customer deposits. Accounts receivable balances decreased \$13.6 million due to collections of the higher sales volume of the prior quarter 2012 as compared to the third quarter of 2013. Accounts payable decreased \$7.7 million as the Company paid for fourth quarter 2012 inventory purchases.

Net cash used in operating activities was \$5.3 million in the first nine months of 2012, which included net income of \$4.0 million, plus non-cash charges (benefits) for gain on assets, deferred tax expense, depreciation and amortization, reserve provisions and non-cash stock compensation totaling \$2.0 million. Changes in working capital used cash from operating activities of \$11.3 million. This is primarily due to a decrease in accounts payable, as well as accruals and

timing of tax deposits, partially offset by a decrease in the balance of accounts receivables and other current assets. Accounts payable decreased \$12.7 million as the Company paid for fourth quarter 2011 inventory purchases. Accounts receivable balances decreased \$6.5 million due to collections of the higher sales volume of the prior fourth quarter 2011 as compared to the third quarter of 2012.

### *Cash Flows from Investing Activities*

Net cash used in investing activities amounted to \$19.4 million in 2013 compared to net cash provided by investing activities of \$4.7 million in 2012. This is primarily due to the deposit of \$17.4 million for the acquisition of Convergent prior to quarter end. The acquisition's effective date was October 1, 2013. The remaining cash used in investing activities in 2013 was for capital expenditures of \$0.2 million and the acquisition of Elite of \$1.7 million. Cash was provided by a \$1.5 million distribution from our joint venture investment in Digital Link II and \$3.0 million from the sale of the analog facility and equipment in 2012, which was partially offset by \$0.2 million of capital expenditures.

### *Cash Flows from Financing Activities*

Net cash used in financing was minimal in 2013. Cash of \$2.7 million was used in 2012 to purchase treasury stock.

### **Hedging and Trading Activities**

Our primary exposure to foreign currency fluctuations pertain to our subsidiaries in Canada and China. In certain instances, we may enter into a foreign exchange contract to manage a portion of this risk. For the nine months ended September 30, 2013 we recorded minimal realized and unrealized gains associated with these contracts in our condensed consolidated statement of income. This compares to gains \$0.2 million in the comparative period of 2012.

We do not have any trading activities that include non-exchange traded contracts.

### **Off Balance Sheet Arrangements and Contractual Obligations**

The future estimated payments under these arrangements are summarized below along with our other contractual obligations:

| <b>Contractual Obligations</b> | <b>Total</b> | <b>Remaining<br/>in 2013</b> | <b>One<br/>to</b> | <b>Three<br/>to</b> | <b>Thereafter</b> |
|--------------------------------|--------------|------------------------------|-------------------|---------------------|-------------------|
|--------------------------------|--------------|------------------------------|-------------------|---------------------|-------------------|

|                              |         |        | <b>Three<br/>Years</b> | <b>Five<br/>Years</b> |          |
|------------------------------|---------|--------|------------------------|-----------------------|----------|
| Postretirement benefits      | 178     | 5      | 42                     | 46                    | 85       |
| Operating leases             | 3,767   | 158    | 924                    | 714                   | 1,971    |
| Contractual cash obligations | \$3,945 | \$ 163 | \$ 966                 | \$ 760                | \$ 2,056 |

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(1) The schedule above excludes the following items:

We have accrued approximately \$0.2 million of unrecognized tax benefits in the financial statements as tax liability, including interest and penalties, in accordance with FIN 48 as of September 30, 2013. Amounts for which the year of settlement occurs cannot be reasonably estimated.

There were no other material contractual obligations other than inventory and property, plant and equipment purchases in the ordinary course of business.

### **Seasonality**

Generally, our quarterly revenue and earnings fluctuate moderately from quarter to quarter. As we increase our sales in our current markets, and as we expand into new markets in different geographies, it is possible we may experience different seasonality patterns in our business. As a result, the results of operations for the period ended September 30, 2013 are not necessarily indicative of the results that may be expected for an entire fiscal year.

### **Litigation**

From time to time we may be involved in various claims and legal actions which are routine litigation matters incidental to the business. In the opinion of management, the ultimate disposition of these matters will not have a material adverse effect on our financial condition, results of operations or liquidity.

### ***Recently Issued Accounting Pronouncements***

There are no recently issued accounting pronouncements which we believe will materially impact its consolidated financial statements.



## **Critical Accounting Policies and Estimates**

In preparing our consolidated financial statements in conformity with U.S. generally accepted accounting principles; management must make a variety of decisions which impact the reported amounts and the related disclosures. These decisions include the selection of the appropriate accounting principles to be applied and the assumptions on which to base accounting estimates. In making these decisions, management applies its judgment based on its understanding and analysis of the relevant circumstances and our historical experience.

Our accounting policies and estimates that are most critical to the presentation of our results of operations and financial condition, and which require the greatest use of judgments and estimates by management, are designated as our critical accounting policies. See further discussion of our critical accounting policies under Item 7, “Management’s Discussion and Analysis of Financial Condition and Results of Operations” in our Annual Report on Form 10-K for our year ended December 31, 2012. We periodically re-evaluate and adjust our critical accounting policies as circumstances change. There were no significant changes in our critical accounting policies during the nine months ended September 30, 2013.

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

The principal market risks affecting us are exposure to interest rates and foreign currency exchange rates. We market our products throughout the United States and the world. As a result, we could be adversely affected by such factors as changes in foreign currency rates and weak economic conditions. As a majority of our sales are currently denominated in U.S. dollars, a strengthening of the dollar can and sometimes has made our products less competitive in foreign markets.

**Interest Rates** — We have a variable interest rate credit facility, however, we have no outstanding balances as of September 30, 2013. If we would borrow up to the maximum amount available under these facilities, a one percent increase in the interest rate would increase interest expense by \$0.2 million per annum. Interest rate risks from our other interest related accounts such as our postretirement obligations are not deemed significant. We currently have long-term notes receivables bearing interest rates of 15% and are recorded at fair market value. A change in long-term interest rates for comparable types of instruments would have the effect of us recording changes in fair value through our statement of operations.

**Foreign Exchange** — Exposures to transactions denominated in a currency other than the entity’s functional currency are primarily related to our China and Canadian subsidiaries. From time to time, as market conditions indicate, we will enter into foreign currency contracts to manage the risks associated with forecasted transactions. At September 30, 2013, we had outstanding Canadian foreign currency forward contracts to sell \$10.3 million Canadian at fixed prices

which will settle during the fourth quarter of 2013.

A portion of our cash in the China and Canadian subsidiaries is denominated in foreign currencies, where fluctuations in exchange rates will impact our cash balances in U.S. dollar terms. A hypothetical 10% change in the value of the U.S. dollar would impact our reported cash balances by approximately \$0.4 million.

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

The Company carried out an evaluation under the supervision and with the participation of the Company's management, including the Company's Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures pursuant to Securities Exchange Act Rule 13a-15. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that as of the end of the period covered by this report, the Company's disclosure controls and procedures are effective at ensuring that information required to be disclosed in the reports that the Company files or submits under the Securities Exchange Act of 1934 (as amended) is (1) accumulated and communicated to management, including the Company's Chief Executive Officer and Chief Financial Officer, to allow timely decisions regarding required disclosures and (2) recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms. There have been no changes in the Company's internal control over financial reporting during the fiscal quarter for the period covered by this report that have materially affected, or are reasonably likely to materially affect, such internal control over financial reporting.

## **PART II. Other Information**

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

In the ordinary course of business operations, we are involved, from time to time, in certain legal disputes. No such disputes, individually or in the aggregate, are expected to have a material effect on our business or financial condition.

### ***Item 1A. Risk Factors***

Item 1A “Risk Factors” in our Annual Report on Form 10-K for the year ended December 31, 2012 includes a detailed discussion of the Company’s risk factors. There have been no material changes to the risk factors previously disclosed.

### ***Item 6. Exhibits***

See the Exhibit Index.

## **SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) 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.

BALLANTYNE STRONG, INC.

By: /s/ GARY L. CAVEY  
Gary L. Cavey, President,  
Chief Executive Officer and Director

By: /s/ MARY A. CARSTENS  
Mary A. Carstens,  
Chief Financial Officer

Date: November 12, 2013

Date: November 12, 2013



**EXHIBIT INDEX**

| <b>Exhibit<br/>Number</b> | <b>Document Description</b>                                                                                                                                                                                                                                                                                                                                                                                                        | <b>Incorporated by Reference</b> |                |                        |                           |
|---------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|----------------------------------|----------------|------------------------|---------------------------|
|                           |                                                                                                                                                                                                                                                                                                                                                                                                                                    | <b>Form</b>                      | <b>Exhibit</b> | <b>Filing<br/>Date</b> | <b>Filed<br/>Herewith</b> |
| 2.1                       | Stock Purchase Agreement, dated as of October 1, 2013, by and between Ballantyne Strong, Inc. and Sony Electronics Inc.                                                                                                                                                                                                                                                                                                            | 8-K                              | 2.1            | October 3, 2013        |                           |
| 31.1                      | Rule 13a-14(a) Certification of Chief Executive Officer                                                                                                                                                                                                                                                                                                                                                                            |                                  |                |                        | X                         |
| 31.2                      | Rule 13a-14(a) Certification of Chief Financial Officer                                                                                                                                                                                                                                                                                                                                                                            |                                  |                |                        | X                         |
| 32.1                      | 18 U.S.C. Section 1350 Certification of Chief Executive Officer                                                                                                                                                                                                                                                                                                                                                                    |                                  |                |                        | X                         |
| 32.2                      | 18 U.S.C. Section 1350 Certification of Chief Financial Officer                                                                                                                                                                                                                                                                                                                                                                    |                                  |                |                        | X                         |
| 101                       | The following materials from Ballantyne Strong's, Inc.'s Quarterly Report on Form 10-Q for the quarter ended September 30, 2013, formatted in XBRL (Extensible Business Reporting Language): (i) the Condensed Consolidated Balance Sheets, (ii) the Condensed Consolidated Statements of Operations, (iii) the Condensed Consolidated Statements of Cash Flows and (iv) the Notes to Condensed Consolidated Financial Statements. |                                  |                |                        | X                         |